

TRANSCRIPT OF PROCEEDINGS

FEDERAL HOUSING FINANCE BOARD
BOARD MEETING

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FEDERAL HOUSING FINANCE BOARD
BOARD MEETING

Board Room
Federal Housing Finance Board
1777 F Street, N.W.
Washington, D.C.

Tuesday,
September 19, 2000

2:06 p.m. The parties met, pursuant to notice, at

APPEARANCES:

Director William C. Apgar
Director Franz S. Leichter
Director J. Timothy O'Neill
Mr. Scott L. Smith
Mr. Neil Crowley
Mr. James L. Bothwell
Ms. Deborah F. Silberman
Ms. Christina Maradian
Mr. Thomas E. Joseph
Mr. Alex J. Pollock
Mr. James D. Roy
Mr. Raymond R. Christman
Mr. William E. Lewis
Mr. Horacio Sobol

P R O C E E D I N G S

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(2:06 p.m.)

MR. APGAR: Come to order. I just want to start the meeting by saying hello to the folks in the outer benches. I can't see you but I'm glad that this meeting has generated significant interest. Before I begin I'd like to move that the Board of Directors determine that the Finance Board business, which requires the addition of, "an extension of the comment period for the proposed capital regulations agenda item for the open portion of the Board of Directors meeting. This change is made on less than seven days notice to the public." I further move that the Board determine that no earlier notice of this change in the subject matter of the meeting was possible. So ordered.

Let me just begin by saying a few opening remarks.

First of all, for folks who are here in the room or on the videocam, they can notice that one of our distinguished Board members has come to do battle, and his arm had to be restrained in order to keep it even, but most of you know, Tim had an accident last week, broke some bones, which he described, which my recollection of biology didn't recognize but apparently it's in the shoulder and apparently it's very painful, and so we really appreciate the tremendous effort he made in order for us to continue to have this meeting on schedule, literally right from the hospital and the doctor's

1 office. So I think the pain shoots through his body from
2 time to time, but we really appreciate this effort, Tim.

3 MR. O'NEILL: It's great to be here.

4 MR. APGAR: There you go. And I want to also just
5 acknowledge the presence of Franz Leichter, our newest Board
6 member. Again, we're pleased to have a trio here and able
7 to move forward with the Finance Board business. And I also
8 just want to point out that Jim Bothwell is here of course,
9 an old hand at the Board but in a new position as the new
10 managing director, so we'll be in able hands when we turn
11 the portion of the agenda over to Jim and his team.

12 I just wanted to say a few things about my view on
13 this meeting. Obviously, I'm a newcomer to this role, but a
14 longtime student and fan of the Federal Housing Finance
15 Board, and very excited about this. I've learned a lot of
16 the lingo now, having met with various constituent groups
17 about the rule. Everyone wants to make sure that the rule
18 we're talking about today is workable, and I suppose that
19 that comes from the urge that some regulators produce
20 unworkable rules, but I think it's a reasonable press
21 because at the end of the day, the rule has to create a
22 workable capital structure that ensures safety and
23 soundness, preserves the cooperative nature of the System
24 and provides the capital necessary for the Banks to fulfil
25 their housing mission, so "workable" is clearly an important

1 watchword that we're aiming to.

2 We're also, heard a lot about the word,
3 "flexibility," and we are working on a rule that gives the
4 goal as providing sufficient flexibility for each Bank to
5 produce a capital plan that supports their own business
6 strategy. And I'm going to be interested today to see how
7 we're doing as we see these business strategies being
8 formulated, whether or not we provided sufficient
9 flexibility. Certainly, that has to be flexible enough for
10 each Bank to design a capital plan that will not trigger
11 adverse tax accounting or other consequences for the members
12 and to take note of those potentially adverse consequences.

13 We've been meeting with our staff and talking to
14 Banks and their members as they develop their specific
15 plans, and the more specific plan, of course, the more we're
16 able to assess whether or not these potentially adverse
17 consequences are present and what we can do about the rule
18 itself to modify the way in which the rule may trigger these
19 adverse consequences, but within the range of the
20 flexibility we provide, that's certainly a watchword.

21 And there's another word that we coined, I think,
22 at the ACB Conference last week, it was, "commonality," and
23 recognizing the fact that each Bank is unique and each set
24 of plans will vary in certain ways, there was a sense that
25 maybe we ought to think about how the various plans that

1 came out under the end of the fourth rule had some common
2 features. Certainly it was a concern that we didn't want to
3 have a particular plan produce the adverse consequences of
4 encouraging the sort of roaming around of members to try to
5 find the best deal in town. That could have a destabilizing
6 effect on the entire System, something we certainly would
7 want to be mindful of.

8 And so we'll talk about what do we mean by
9 "commonality."? Obviously, commonality and flexibility
10 appear to be opposites, but I think we can find what those
11 two words and find that balance that makes the System strong
12 while giving each individual member, each individual Bank,
13 an opportunity to do what makes sense in their area. And
14 ultimately, of course, this Board must decide on how we
15 produce a final rule, procedures followed by the Finance
16 Board in approving each Bank's plan, and we're going to try
17 to address those possibilities as we move forward.

18 So I'm excited about the opportunity to continue
19 what was a very productive dialogue we've had with many of
20 the people in the room earlier in some of the previous
21 meetings, and now we get a chance to do it in a little bit
22 different manner as part of this Board meeting. Franz, do
23 you have any opening comments you'd like to make?

24 MR. LEICHTER: Well, this is my first Board
25 meeting, and I'm really very delighted to be a member of the

1 Board and to be part of this System, which I think is so
2 important to the American homeowners and which supports and
3 plays such a significant role in the vitality of our Banking
4 System and our capital markets. I'm still in the early
5 stages of trying to learn the details of the System, but I
6 want to state how much I've been helped by the staff and how
7 impressed I am with the staff and the willingness of people
8 here to work with the Banks and with the members to assure
9 that the changes that are occurring are made in a manner
10 that will maintain the strength and the soundness and safety
11 of the System and will allow also the System to continue its
12 role of achieving its core mission.

13 It's a particular delight for me to work with Bill
14 Apgar and Tim O'Neill, and Tim assured me that his shoulder
15 was not broken by Bill Apgar twisting his arm. I come from
16 the legislative arena where I served many years in the New
17 York state legislature and we had a lot of people walked
18 around like Tim, but I must say, nobody ever showed, to me
19 at least, the grit that Tim O'Neill has to be here after
20 suffering this accident, but he's shown throughout his life
21 that he's got a lot of grit, so it's a pleasure for me also
22 to get to know the Bank presidents. I hope to get to know
23 everybody better and to visit the Banks, and that all of you
24 help me as I'm in my learning curve mode. Thank you.

25 MR. APGAR: Tim? Any opening remarks?

1 MR. O'NEILL: I just want you to know, Franz, that
2 I will not always dress down like this for Board meetings,
3 but this is a great group that we have pulled together. I
4 want to thank Bill Apgar for thinking of this kind of
5 format. I think that it will be great to hear both from our
6 staff but from some of the Bank presidents, in addition to
7 PricewaterhouseCoopers. And because I have a lot of
8 questions, we probably ought to get started.

9 MR. APGAR: That's very good. Get to work. We're
10 going to start with an introduction of the prototype capital
11 plans. Jim Bothwell and his team.

12 Jim?

13 MR. BOTHWELL: Thank you very much, Director
14 Apgar, and good afternoon Director O'Neill and Director
15 Leichter. And might I add, speaking for the entire staff of
16 the Finance Board, that we also extend a very warm welcome
17 to you Director Leichter on the occasion of your first Board
18 meeting since your appointment by the President last month,
19 and also to you, Director Apgar in chairing your first
20 meeting of the Board since the departure of Chairman
21 Morrison in July. I can assure you that we on the staff are
22 all ready, willing and able to support and work closely with
23 each of you in your new positions.

24 As you are all very well aware, one of the most
25 important requirements of Title 6 of the Gramm-Leach-Bliley

1 Act is the requirement that the Finance Board issue
2 regulations describing uniform capital standards applicable
3 to each Federal Home Loan Bank. These capital standards are
4 to include both the leverage requirement, that is a minimum
5 ratio of total capital to total assets of 5 percent as
6 specified in the legislation, and a set of risk-based
7 capital requirements as established by Finance Board
8 regulations. The Gramm-Leach-Bliley Act also stipulated
9 that the Finance Board issue its capital regulations not
10 later than one year after the date of enactment, which would
11 be by November 12th of this year, a date which is less than
12 two months away from today.

13 After the rule is published, the Act allows the
14 Banks up to 270 days to develop and submit their capital
15 plans for Finance Board approval. The legislation also
16 contains a transition provision. This provision allows up
17 to three years for the Bank to come into compliance with the
18 Finance Board's capital regulations and for members to come
19 into compliance with the stock investment requirements of
20 their respective Federal Home Loan Banks' capital plans. So
21 there is quite a bit of time built into this process.

22 As you all know, the Board issued its proposed
23 capital rule on July 13th of this year for a 90-day public
24 comment period. Because of the extreme importance of this
25 rule to the Federal Home Loan Bank System and its over 7,500

1 owner-members, the staff of the Finance Board has been
2 actively soliciting comments and feedback from members of
3 the System, as well as from the Federal Home Loan Banks
4 themselves. Our goal, from the staff perspective, is to
5 take what we believe is a very good proposed rule and make
6 it even better.

7 The Finance Board has also received several
8 requests from the major banking trade associations, the
9 Council of Federal Home Loan Banks and individual members
10 for some delay in this rulemaking schedule in order to allow
11 more time for consideration of what is, at its very core, a
12 vital safety and soundness rule. To further this process of
13 open discussion and dialogue, today's agenda contains one
14 very important item, a discussion of several different
15 capital structure prototypes that are composites of those
16 currently under development at several of the Federal Home
17 Loan Banks.

18 I will ask Scott Smith, acting director of the
19 Policy Office, and Neil Crowley, deputy general counsel to
20 begin this discussion. We are also very happy to have three
21 distinguished Federal Home Loan Bank presidents here with us
22 today, Alex Pollock of the Chicago Bank, J. Roy of the
23 Pittsburgh Bank, and Ray Christman of the Atlanta Bank. I
24 also note that several other presidents are in attendance
25 today, which is a very good sign indeed. They will provide

1 the Board with their Banks' current thinking about capital
2 structures and their capital plans.

3 And finally, we are very pleased to have Bill
4 Lewis and Horacio Sobol, both of PricewaterhouseCoopers,
5 here today to discuss issues that we know are of extremely
6 great importance and interest to the members of the Federal
7 Home Loan Bank System, that is the tax and accounting
8 implications of this \$30 billion recapitalization process.
9 So without further ado, I'd like to turn it over to Scott to
10 summarize several of the capital structure prototypes.

11 MR. SMITH: Thank you, Jim, and good afternoon
12 Directors Apgar, O'Neill and Leichter. To the prototypes.
13 The discussions nearly two months ago, Director Apgar
14 suggested to the committee and the Bank presidents that the
15 Banks might rapidly advance their thinking on the proposed
16 capital rule by going through the exercise of developing
17 prototype capital structures. A number of the Banks
18 responded to this suggestion and used the experience to
19 quickly develop draft comments on the proposed rule, in
20 addition to the prototypes.

21 So far, the Finance Board's staff has obtained six
22 prototype structures from five different Banks. We then
23 constructed three composite prototypes, which are presented
24 in the handout. These composites display the range of
25 differences among the six structures. As composites, the

1 three prototypes in the handout do not represent any single
2 Bank's submission. This was done on purpose in recognition
3 of the fact that the submissions of the Banks were first
4 drafts, were incomplete in some areas, and may no longer
5 represent the current thinking of those Banks.

6 In particular, I would point out that several
7 Banks, after submitting structures that included both A and
8 B stock have since expressed leanings toward an all B
9 structure. I will now go through some highlights of each
10 composite prototype. Please note that some provisions of
11 the prototypes do not comply with the proposed rule and,
12 therefore, represent desired changes in the proposed rule,
13 and they are identified in the handout by an asterisk. And
14 some areas were simply not addressed and are labeled "N/A."

15 Please turn your page to the first prototype. The
16 first prototype is a stock structure that includes both
17 Class A and Class B stock. Looking at the stock price
18 characteristics, we see the par value set at \$100 and the
19 price at which the Bank would purchase the stock back from
20 the member set at par. In other words, both A and B stock
21 would have the price fixed at par for all trades.

22 Note, however, that the proposed rule would have
23 to be changed to allow a Bank to purchase stock from members
24 at other than a negotiated price, as required by the
25 proposed rule. Also note that at least one prototype would

1 not permit stock transfers among members. Again, however,
2 this provision is not in compliance with the proposed rule.
3 For issuance, this prototype suggests a fixed-dollar amount
4 as a floor membership investment.

5 But more likely, that requirement would be set
6 according to a percentage of member assets above the floor.
7 There would also be activity-based stock purchase
8 requirements for both advances and acquired member assets
9 or AMA, in recognition of the fact that the risk associated
10 with advances will be less than that for AMA so that the
11 stock purchase requirements could be set separately and in
12 different percentage amounts. Also, there are similar
13 issuance requirements for Class B, but always in lesser
14 proportion to the A requirements in recognition of the 1.5
15 weight assigned to the B stock in measuring total capital.

16 The proposed rule allows the Banks the option of
17 allowing members to pay a membership fee in lieu of a
18 mandatory membership investment. Only one prototype that we
19 received addressed this issue, indicating that a fee would
20 not be allowed. For voting rights, the term "trigger"
21 indicates the prototype would only assign voting rights to
22 class A stock in the event that A shares did not receive
23 sufficient dividends over a period of time. Also, for
24 dividends, note that some prototypes favored having Class A
25 dividends determined by the Board of Directors each period,

1 whereas the proposed rule requires that Class A dividends be
2 stated or predetermined, in order that Class B shareholders
3 not be positioned to inflate B's dividend at the expense of
4 A's dividend.

5 Turning now to the second prototype, again, it is
6 an A/B class structure, but there are three big areas of
7 difference from the first prototype. One, the Class B stock
8 is to trade at book value, a value that incorporates B's
9 ownership interest in retained earnings and paid-in surplus.
10 Compared to the par pricing approach, this structure might
11 make it easier for the Banks to accumulate retained earnings
12 rather than pay all retained earnings out as dividends.

13 Second, there is no activity-based stock purchase
14 requirement for AMA, leaving the Bank to issue stock to
15 willing members as needed to capitalize that activity. And
16 finally, this prototype includes more restrictive voting and
17 ownership caps for Class B than are contained in the
18 proposed rule.

19 Turning now to the third prototype, this is a
20 version of the all Class B structure currently being
21 considered by a number of Banks. The combination of a
22 single class of stock, stock price fixed at par, and an
23 activity-based requirement adds up to a structure very
24 similar to what now exists. Turning the page again are the
25 comments received to date on changes requested in the

1 proposed capital rule.

2 In compiling this list of suggested changes we
3 drew from comments received from various sources, including
4 individual members and member organizations, such as the
5 ICBA, the ABA and the ACB and the Federal Home Loan Banks,
6 specifically through the Federal Home Loan Bank Council, the
7 Federal Home Loan Bank Directors, the Bank Presidents
8 Conference, and Bank CFOs as a group, as well as from
9 individual Banks.

10 Going now quickly through the comments, I won't
11 read each comment through, but I'll just comment on them.
12 Comment number one. This is a concern that has been
13 expressed rather intensely by members to us, the idea that
14 there should be some commonality among the Federal Home Loan
15 Banks' plans. As things currently stand, the authority of
16 the Finance Board to approve the capital structure plans is
17 at least one place in the process where commonality can be
18 considered.

19 Turning now to number two, this issue has to do
20 with the requirement of the proposed rule that class B
21 activity-based stock purchase requirement must not be
22 enforced if to do so would result in capital ratios in
23 excess of the operating capital ratios, which are preset.
24 The intent of this provision in the proposed rule was to
25 minimize any unnecessary increase in the Bank's capital.

1 Turning now to number three, this is the requested
2 change would be necessary, again, in order to try to
3 replicate the capital structure as it now exists, to have a
4 hold attached to any activity-based stock purchase
5 requirement.

6 Number four, again, this would be necessary to try
7 to replicate the current structure.

8 Number five, I would simply note that on this
9 issue, we're almost certainly going to have to make some
10 modification in the final rule to address the Class B-only
11 structure. As this was written, it did not contemplate
12 that, so it focuses on A and allows for B, but we didn't
13 address the case of a Class B-only structure.

14 On comment number six, again, this suggested
15 change goes to allowing a replication of the current
16 structure, but perhaps more importantly, allowing
17 flexibility to achieve favorable tax and accounting
18 treatment.

19 On number seven, with the continued consolidation
20 taking place in the industry, and we've seen a lot of that
21 recently. This is becoming a very important issue that
22 deserves some attention as to what's the appropriate
23 percentage cap to propose.

24 Number eight, I would just note that under the
25 current rules, some institutions in a few states do have

1 voting rights exceeding the 20-percent limit suggested in
2 the proposed rule, but for most states and institutions, the
3 voting rights now tend to be no greater than 5 percent.

4 On number nine, this issue may affect the ability
5 of the Banks to share or participate in AMA investments,
6 particularly if a Bank would otherwise rely on an
7 activity-based stock purchase requirement to meet the vast
8 majority of their capital needs.

9 And then number 10, this has to do with the
10 risk-based capital provisions. I would simply note that
11 staff is, the Finance Board staff is working on these issues
12 and is looking for input and comments to try to make sure
13 that they're workable and practical as we go forward.

14 If we turn the page one more time, there are two
15 other comments here. First, on the accounting, FASB 133
16 issue, these are issues that the Finance Board, working with
17 accounting experts and now working on, and they will apply
18 next year, with or without the capital rule, so in this
19 regard we consider these issues to be largely outside of the
20 consideration for the current capital rule. I mean these
21 are going to happen anyway, the concerns, so we're working
22 on those.

23 And then, second, on the risk weighting of the
24 Federal Home Loan Bank stock, I would only say here that the
25 representative from FFIEC have said that they cannot begin

1 to address this issue until a capital rule is final. So our
2 only concern at this point would be to allow the capital
3 rule to be flexible enough to accommodate structures with
4 reasonable risk weights as they might suggest. That
5 concludes my presentation.

6 MR. APGAR: Very good.

7 MR. SMITH: Thank you.

8 MR. APGAR: It was nice that your list came out to
9 10, because now we can run this on Letterman and get wide
10 exposure, but were there other issues that maybe didn't rise
11 to the level of being a top concern that you've heard as
12 you've heard, especially from the members who may be very
13 interested and concerned about the changes that are going
14 forward?

15 MR. SMITH: Well, I would just emphasize two
16 points. One, it's a theme that's throughout the prototype
17 plans, that generally, members that we've heard from
18 directly have expressed a strong desire to allow a capital
19 structure very similar to what exists now. That's one
20 recurrent theme. I would also like to point to another
21 concern that was expressed by members that they felt that
22 finalizing the capital rule would trigger tax and accounting
23 consequences immediately.

24 So if, for example, the rule were finalized this
25 November, that this November there would be tax and

1 accounting consequences. And this obviously is not correct,
2 not a correct interpretation of how things will unfold.
3 Those tax and accounting implications, whatever they are,
4 will not happen until the Banks actually issue the new stock
5 and replace the old stock. So we have to go through the
6 process of finalizing the rule, and then the Banks have to
7 develop their capital structure plans, for which they have
8 270 days after the rule is finalized, and then they actually
9 have to have the plans approved and the stock issued before
10 there would be any tax and accounting consequences.

11 MR. APGAR: Right. This has been a kind of
12 constant dilemma, because we're in this, you know, sort of
13 classic chicken and egg debate where it's hard to get the
14 exact tax rule until the plans are put forward. On the
15 other hand, we can't have the exact plans until the rule's
16 been promulgated.

17 And again, that led us to the notion of trying to
18 run these prototype plans through a check to see if there's
19 anything that was hanging out there that looked like
20 show-stoppers, knowing at the end of the day, every detail
21 in the final plans will affect it, but to see whether or
22 not, and this is the broad sweep of things. There was an
23 option for plenty of flexibility to manage whatever tax
24 implications might be forthcoming or to manage whatever
25 accounting issues more than forthcoming, to know that there

1 were some scenarios that clearly had the capacity to
2 minimize, for example, on the tax issues, by making the new
3 System very similar to what it replaces. So that's of
4 interest.

5 I'll just, I'd like to ask some more questions,
6 and then I'll turn to my colleagues but, you know, I'm
7 getting to sit here in the middle, so I'm going to be first.

8 This commonality has been, at first I didn't quite
9 understand it, because in some senses it seemed so
10 diametrically opposed to this whole issue of flexibility. I
11 mean more than just opposed, the statute clearly gives the
12 individual Banks certain statutory rights as to what they're
13 allowed to do under the rule.

14 On the other hand, I'm beginning to understand
15 that there may be a safety and soundness reason to have some
16 concern about how every individual plan may make sense but,
17 collectively the group of plans may pose issues that lead to
18 safety and soundness implications. Could you elaborate a
19 little bit more about what are some of those possible
20 scenarios that we might want to watch going down the road in
21 the area of activities that could happen that would lead to
22 concern?

23 MR. APGAR: Mr. Bothwell

24 MR. BOTHWELL: Well, if I could just try to make
25 an attempt to answer that. The statute itself, as I

1 remarked in my opening comment, requires a uniform capital
2 charge, and so our risk-based capital charges that the
3 Finance Board will establish through its rule will be the
4 same for all Banks. And above and beyond that, as Scott has
5 talked about in his composite prototypes, many of the Banks
6 are thinking about activity-based capital charges.

7 So one possible thing that we may need to look at
8 when we get the individual capital plans in here is to make
9 sure that those activity-based charges are not dramatically
10 different, so that the cost of taking down an advance in
11 terms of how much capital you have to put into the Bank
12 dramatically differs from district-to-district so you,
13 because if it does, then you might get wide swings and large
14 members going from one district to another, or activity
15 going from one district to another that could be
16 destabilizing to an individual Bank.

17 So one area that we are going to have to look
18 carefully at when we look at the individual plans is to what
19 extent are these activity-based stock requirements
20 different?

21 MR. SMITH: In addition to that, I think we don't
22 really know the answer to it yet, but there is the concern,
23 or there might be a concern in terms of the risk-weighting
24 of the stock or the tax or accounting implications if the
25 plans are very different, a question about whether there

1 would be one rule to apply to all the Banks or whether the
2 rule on the risk-weighting of a stock, for example, would be
3 set individually. And that might have an implication.

4 MR. APGAR: For a form of competition that may not
5 be as, may have these destabilizing effects down the road.

6 MR. SMITH: Or for pressure to achieve a certain
7 degree of commonality in order to achieve the risk-weighting
8 bargain.

9 MR. APGAR: Right. Very good. Well, I have other
10 questions, but maybe Franz would like to join in now.

11 MR. LEICHTER: Insofar as capital plans are
12 developed which really mirror the present System, would that
13 be in conflict with the intent of Gramm-Leach-Bliley?

14 MR. BOTHWELL: Director Leichter, I don't believe
15 it would be in conflict with the intent of
16 Gramm-Leach-Bliley. Nor do I think there's necessarily
17 anything wrong with a Bank proposing a capital plan that
18 very much like the status quo. I think there are probably a
19 lot of positives to that to the members of particular
20 Federal Home Loan Banks. But what I think we need to keep
21 alert to is to make sure that we have enough flexibility to
22 allow innovation among the Banks, perhaps going to a
23 different, more efficient type of capital structure.

24 So I think we need to be alert to the possibly of
25 destabilizing destructive competition, but at the same time,

1 I think we have to allow enough flexibility so that we can
2 permit innovation to occur at the same time. It's a
3 delicate balance that I think we have to achieve in our
4 capital rule.

5 MR. APGAR: Mr. O'Neill?

6 MR. O'NEILL: I have questions for each of the 10
7 questions, but some for the staff and some for the Bank
8 presidents.

9 MR. APGAR: I thought we'd just, whatever was, you
10 know, appropriate to the staff, and then we won't keep our
11 friends, the Bank presidents, waiting long and bring them in
12 and then, you know, just continuing on. If we have any that
13 were particularly relative to Jim and Scott's presentation
14 or other issues that Neil may join in, we can take them now
15 or what's your preference?

16 MR. O'NEILL: I'll just wait. I'll wait until we
17 get the Bank presidents involved, then I'll ask questions of
18 everybody.

19 MR. APGAR: Okay. So since I'm dying to hear
20 Tim's questions, why don't we invite the Bank presidents to
21 move along and we can continue to just ask questions. At
22 some level, this meeting's a little bit of a replication of
23 a meeting we had rather early in August where the Capital
24 Committee of the Bank presidents group came and talked about
25 it and, again, at that stage they were still in the very

1 earliest stages of pulling together their own thoughts.
2 But again, we learned very quickly that the more tangible
3 the discussion in terms of what they're likely to do, there
4 are a lot of what ifs here, a lot of possible models that
5 people put forward.

6 And once we started talking about things which are
7 actually beginning to show up on the drawing Board, we had a
8 lot more productive discussion, so that's why we thought it
9 was and we're very pleased that three of the Bank presidents
10 volunteered to come and be our representatives, although, as
11 you'll note, many others are putting their plans together
12 and, again, that gives us a possibility for a very
13 productive dialogue as to seeing whether we see any issues
14 that ought to be on the top 10 list that are emerging from
15 whatever the Banks are starting to put together. So why
16 don't we just move to the, some observations. Jay, do you
17 want to start us off?

18 MR. ROY: Sure, I'll be glad to.

19 MR. APGAR: Okay.

20 MR. ROY: Thanks for the opportunity to visit with
21 you and to discuss this critically important issue. I
22 thought rather than review in detail our plan, which we
23 submitted and I think which Scott summarized in general
24 terms very well, it might be helpful if I tried to review
25 some of the principles that we used to guide our plan

1 development, which I should say is, well, on the one hand,
2 well along, but on the other hand, still awaits some
3 meetings with members and a lot of further thought and
4 discussion.

5 But obviously, to start, we're intending to comply
6 with the law that provides for strength in capital structure
7 and a greater permanence to our capital. But beyond that,
8 we want to preserve the cooperative nature of the System, we
9 want to reduce the complexity, where possible, and I think
10 this speaks to Director Apgar's earlier comment about the
11 desire to build a regulation that provides sufficient
12 flexibility without such complexity that it becomes just
13 extremely difficult to administer and implement.

14 So we were concerned about reducing complexity,
15 keep it relatively simple, do the minimum necessary to
16 implement Gramm-Leach-Bliley, it seems should be a direction
17 that might be appropriate for us. To change as little as
18 possible, echoing a point that Scott made earlier. This is
19 a System that has functioned very effectively. The
20 objective is to increase permanence in capital. It's not
21 intended necessarily to turn the capital structure upside
22 down. So we think changing as little as possible has
23 virtues.

24 Allow for expansion and contraction of the balance
25 sheet. But we've found that without activity-based

1 requirements, it was becoming very difficult for us to
2 develop a plan that allowed us to experience the kind of
3 significant fluctuation of asset levels that we can have
4 that are beyond our control. Since the beginning of the
5 year our advances have contracted by \$7 billion or about 20
6 percent. We would have a tough time adjusting for that kind
7 of activity without some flexible capital structure, so that
8 became an important principle for us to pursue.

9 And to minimize the accounting and tax disruption,
10 which I guess is a way of saying that our members, like all
11 of us, would prefer not to have to deal with uncertainty.
12 And to the extent that we can develop structures that are
13 accounting- and tax-friendly, at least with respect to
14 predictably, we're going to be better off. Now, as we
15 attempted to incorporate these principles into our plan,
16 frankly, we bumped up against some of the regulatory
17 features that just didn't give us quite the flexibility that
18 we needed. We've submitted those in the form of our own
19 version of a top 10, which is pretty close to that which
20 Scott used here just a little while ago.

21 Scott incorporated some members comments as well
22 as other from the Bank presidents. I'll not go through
23 those now, but I would simply say that those that Scott
24 highlighted for us are, in our view, very important. And
25 one other we didn't touch, I guess, on the risk-based

1 dimension. And while we've commented on the need to make
2 sure we get this risk-based capital structure right, as
3 right as we possibly can. There's still some work being
4 done on that, particularly with respect to market risk and
5 operations risk-based capital. We want to also emphasize
6 that getting the credit risk as right as we possibly can is
7 critically important, as well.

8 This speaks to the risk-based requirements for
9 advances, as well as for required member assets. We think
10 there's some work to do on that count, as well. So with
11 that, I'll pass on to my friends here for their comments.

12 MR. APGAR: Well, I was going by the order in
13 which you were listed on our program, so that gives Ray next
14 up. What is this? I don't know, it's not alphabetic, it's
15 not whatever, but Ray's next on my list.

16 MR. CHRISTMAN: It's by seniority.

17 MR. APGAR: Is it seniority.

18 MR. POLLOCK: I think it's geographic.

19 MR. APGAR: I see.

20 MR. CHRISTMAN: I think there was the South and
21 then West.

22 MR. APGAR: Okay. There must be some order, who
23 put this list together that I have in front of me.

24 MR. CHRISTMAN: Thank you, Mr. Chairman, and thank
25 you and I appreciate the opportunity to make some comments

1 on this obviously very important matter. And I guess I'll
2 start by complementing the Finance Board for the process
3 that has existed over the last couple of months, which has
4 really been a very open process with a lot of opportunities
5 for dialogue on what is clearly the most important issue
6 that's come before the System in many, many years.

7 MR. APGAR: Very cooperative system, we share the
8 microphones.

9 MR. CHRISTMAN: And I think the process of open
10 dialogue and communication, which there have been many
11 manifestations, including this one, has been very healthy
12 and I'm looking forward to that continuing. I want to make
13 a couple of comments that share some of our thoughts from
14 Atlanta on capital and relate to and reinforce some of the
15 comments that have been made earlier, and perhaps a few
16 additional points as well.

17 First, on the matter of principles, as we've been
18 working on our capital plan, there are really four
19 principles that we have tried to follow, and they overlap
20 with some of the things that Jay and others have said, but I
21 still want to put them on the record in any event.

22 First, that the plan be simple, easy for the
23 members and their Boards to understand and administer. And
24 let's not overlook the Board's other members, because when
25 all things, when the dust settles, this, this is going to

1 come before the Board of each of our 7,500 member
2 institutions. It's not just something that the management
3 of these Banks need to understand, it's something that they
4 can sell to their Boards, which obviously, with a lot of lay
5 people, should be something that's not forgotten.

6 Second, that it's predictable, that it allows
7 members to project their stock ownership requirements and
8 predict some kind of an income stream looking ahead. That
9 it be flexible. We've talked about that. And that it
10 reinforce the cooperative nature of the System, so as we've
11 developed our plan, we've tried to keep coming back to those
12 four principles in what we develop.

13 Now, I will say on the record that as people here
14 at the table, we have suggested the best course of action is
15 an all Class B structure in our earlier conversations with
16 the Finance Board. I'm not here to sell that concept today.
17 It's what we think we think is the best approach. And
18 obviously, until we see a final regulation, until we can
19 test this out with a degree of specificity with our members,
20 we won't know.

21 And other information may come available that will
22 persuade us to go in a different course of action, but it's
23 what we think we think would be the best approach at this
24 time. We think it meets at least three of the key
25 principles that I enumerated earlier. It would maximize

1 commonality of stockholder priorities and, therefore, the
2 cooperative relationship would be simple and it would
3 provide predictably.

4 Now, of the issues that Scott enumerated, his top
5 10 list, there are at least four that we think are
6 particularly important. And they're all important, but four
7 that are particularly important in terms of moving to an all
8 Class B structure or, frankly, I think, any other kind of
9 structure as well. First of all, I think the Finance Board
10 should review the entire regulation and make sure that the
11 existing regulation does explicitly permit an all Class B
12 structure. There's nothing in there that prevents it, but
13 I'm not sure that it, the language as currently constructed
14 explicitly permits it in the way that you would want to to
15 create that kind of flexibility.

16 Secondly, with respect to the activity-based stock
17 requirement, we urge the Finance Board to modify the
18 regulation to permit Federal Home Loan Banks to require
19 their members to maintain ownership of their activity-based
20 stock, because that's essential for allowing this to work.

21 Third, we think that it is important that the
22 capital ratio framework provision be eliminated. This has
23 been discussed at great length, already mentioned by Scott,
24 and I won't go into further detail on that at this time.

25 And fourth, we need to have a regulation that

1 specifies that all transactions should occur at par value,
2 not at a negotiated price. And again, this has been
3 discussed at great length and mentioned already and perhaps
4 in the questions and answer period we can talk about that
5 further if people wish to.

6 There are two issues that I want to briefly touch
7 upon where we may have a slightly different viewpoint than
8 that expressed in the top 10 issues summary. One is on
9 voting rights limitations. I know there's a lot of
10 discussion going on regarding how that provision should be
11 written in the first place, and there's some legal questions
12 that I'm sure you're going to be getting some comments on
13 once the comment period expires, but our basic concern from
14 an economic perspective, not from a legal perspective, in
15 Atlanta, is that we have a rich mix of large and small
16 Banks.

17 Every district in the System is somewhat different
18 in this regard, but I don't think we're alone in this. And
19 we believe that to get members, large members, to buy Class
20 B stock, they're going to have the assurance that they can
21 vote their shares. We think that the current regulation
22 does provide a methodology and flexibility whereby that can
23 be achieved, and we just want to make sure that in the final
24 regulation, however written, there's the continued
25 opportunity for large members, as well as small members, to

1 be able to vote their shares. And we can achieve, hopefully
2 down the road, a representation in both voting rights and
3 eventually on the Boards of directors that mirrors the
4 shares and membership of the System.

5 The other issue I just wanted to briefly touch on
6 was the joint pooled stock item on the top 10 list. That's
7 an issue that's a little bit new, to us anyway, in terms of
8 having seen it in previous discussion. We're not sure
9 exactly what the, all the implications or details or
10 background part of that, but we do have some concerns about
11 that from a complexity standpoint and perhaps from an
12 implementation standpoint, and I just wanted to go on the
13 record with that.

14 A final comment. Risk-based capital. This is
15 obviously the most complex and challenging part of the
16 regulation, that is in its entirety the complex and
17 challenging and although we believe that if an all Class B
18 structure were followed, the risk-based capital issues would
19 be minimized and mitigated, they still, even in that
20 situation, would be of concern.

21 As the directors and the staff knows, the System
22 has engaged and commissioned two consulting studies already.

23 There's a third consulting study on this issue underway,
24 and I would simply encourage in the spirit of the dialogue
25 that has been occurring in the last couple of months, that

1 in the next period of weeks there be a special effort to
2 have a three-way dialogue on this issue of risk-based
3 capital between the Bank presidents, CFOs and others, the
4 Finance Board staff and directors and the consultants who
5 have been engaged in this work, because I think this is an
6 issue of such importance and such complexity that we really
7 need to think this through together. And with that, I'll
8 stop and thank you for the opportunity.

9 MR. APGAR: Great. Alex?

10 MR. POLLOCK: Thank you, Mr. Chairman, members of
11 Board, colleagues and friends on the staff. It's a pleasure
12 to be here. Maybe I should take the microphone.

13 MR. APGAR: Yes, absolutely.

14 MR. POLLOCK: Thank you. A pleasure to be here
15 with you all in the issue of Federal Home Loan Bank capital.
16 As in everything in life, we cannot escape history. I know
17 we of course have the history of what is a very strange
18 financial instrument. We're used to it but, in fact, it's
19 highly odd, namely the existing current Federal Home Loan
20 Bank stock. And one of the odd things about it is and we
21 just discussed this this morning with
22 PricewaterhouseCoopers, and I expect Bill Lewis in his
23 comments will touch on it. One of the interesting aspects
24 of it is you can't tell whether it's debt or equity.

25 Now, if you think it's debt, that obviously poses

1 highly interesting questions. The Financial Accounting
2 Standards Board, if I understand this document right, has a
3 draft out now suggesting that a liability would include
4 mandatorily redeemable equity shares. So we have an equity
5 share that has a mandatory redemption. According to the
6 FASB's latest thinking, that would be classified as a
7 liability, not equity.

8 Moreover, the FASB says, "a component should not
9 be classified as equity unless it conveys to the holder the
10 risks and rewards of ownership." One of the things about
11 historical Federal Home Loan Bank stock is at least there's
12 an argument that it doesn't convey the risks and rewards of
13 ownership, and so there's an interesting argument about the
14 nature of this instrument. But of course as we've had it,
15 since we got very big and reasonably complex balance sheets
16 that build upon it, we're somewhat stuck with going to the
17 future out of the existing past.

18 Now, Ray mentioned the all Class B, and there is
19 something of high elegance about the all Class B suggestion,
20 which is it changes only one thing, which is to say
21 basically, it leaves the Federal Home Loan Bank stock
22 exactly as it is except it changes a six-month notice period
23 to a five-year notice period, and that's the only change
24 you're making. You're calling it different things, but
25 that's all that's really happening.

1 It doesn't seem, however, to change this debate
2 about what is the nature of this instrument and is it really
3 the quality of capital Federal Home Loan Banks ought to
4 have? And as I have thought about this over the last few
5 years, I have come to favor, and I think that just to keep
6 on the subject here, there are a number of problems in a
7 two-class structure.

8 On this thought: that while there are a lot of
9 members, there are within those members at least two
10 different sets of member stockholders. I'm not sure how big
11 the respective sizes are, but the two sets are those who
12 would rather own an instrument that looks something more
13 like debt or at least has debt-like characteristics, that
14 has minimum down side and limited up side. That is to say,
15 doesn't really represent the risks and rewards of ownership.

16 And there may be other members who would rather have an
17 instrument that has more of the characteristics of an
18 equity, of a true equity instrument, conveying the risks and
19 rewards of ownership.

20 It might be useful to recall in this instance
21 within Federal Home Loan Bank context the famous case, Fahey
22 v. O'Melveny & Myers in which Judge Bone held that
23 stockholders in a Federal Home Loan Bank do not own the Bank
24 and in fact, they do not own the retained earnings, he
25 opined, they own only the par value of their shares. So

1 there's this history we're coming out of.

2 So on the notion that there may be at least two
3 groups of potential shareholders, it seems to me we might
4 design a capital structure that gives them a choice of where
5 they'd rather be in a capital structure, in something that
6 looks more like a preferred stock that has certain debt-like
7 characteristics or something that looks more like an equity
8 instrument, and let them decide.

9 One of the biggest obstacles to getting to this
10 sort of two-Class structure is the definition of the
11 risk-based capital System. I have been working on
12 risk-based capital sorts of ideas, systems, calculations in
13 my own career for the last 20 years, and I think I have a
14 fair idea of the problems involved. In my judgment, there
15 are major problems, let me repeat, major problems in the
16 current risk-based capital proposal, very big ones in the
17 credit sections, very big ones in the market-risk sections,
18 which I find it very hard to believe can be settled in the
19 amount of time that we're talking about.

20 Let me just mention one, Fannie Mae and Freddie
21 Mac's credit requirement for mortgages, and I'm speaking of
22 unenhanced whole loan mortgages. It is, by statute, 45
23 basis points of capital, but OFHEO, after exhaustive years
24 of testing, concluded that 40 to 45 basis points is the
25 right level for the total credit risk of an unenhanced

1 mortgage. Now, an unenhanced mortgage, when you run it on
2 an S&P or another rating agency scale the way we do with
3 NPF, comes out unrated, in other words, triple C.

4 So if you take the Finance Board's proposed
5 risk-based scale and apply it to an unenhanced mortgage, you
6 get a giant capital charge. And another way of saying this
7 is, we have created a complete inconsistency between the
8 proposal in the proposed regulation and the OFHEO model.
9 Now, I'd like to suggest that nothing should be done in the
10 way of adopting a risk-based capital proposal until two
11 thorough pieces of analysis are completed. One piece would
12 take the proposed Federal Home Loan Bank risk-based capital
13 standards and apply them in a rigorous way to Fannie Mae and
14 Freddie Mac and see how much capital would be required.

15 And a second is to take the OFHEO risk-based
16 capital standards, which are essentially complete, and apply
17 them to the Federal Home Loan Banks and see if the two
18 answers are reasonably consistent. And if they aren't,
19 obviously one or the other or both are wrong. But I'd like
20 us to complete that piece of homework before proceeding on
21 any finalization of a risk-based capital rule, because
22 obviously there are gigantic competitive advantages or
23 disadvantages conveyed through any risk-based capital system
24 that treats one set of competitors in a very different way
25 from another set of competitors, as we already know with

1 among depositories and Fannie and Freddie.

2 Let me touch just a moment on the notion of a
3 two-Class System where the A Class is very much like the
4 current stock and, on my notion, plays the flexibility role.

5 This notion that the members have to come in and out and
6 expand and contract capital of the System seems to me an A
7 stock, which looks essentially if not identical, at least
8 extremely similar to the current stock, serves that role
9 very well. But the B stock conveys something much more
10 substantially, the risks and rewards of ownership.

11 Now, we know in trying to do this that, because
12 the Act as has defined exceptionally small ownership classes
13 for Federal Home Loan Bank shares, in some Banks as little
14 as 300 members would constitute the entire universe of
15 possible owners of the shares. You certainly cannot have an
16 efficient trading market. I think almost everyone would
17 agree it's simply impossible with such a small potential
18 buying and selling universe to have a meaningful trading
19 activity, especially when there are huge concentrations of
20 share ownership with many of the Banks.

21 So in thinking about this, we are pursuing and I
22 think there's some promise too, although a lot of problems
23 to work out, a notion of a book value per share principle,
24 where the Class B would be issued to newly buying members or
25 at the discretion of the Bank, repurchased if the Bank so

1 chooses and the member so chooses, at book value per share.

2 Not par. This gives a way of conveying to those members
3 who want a more equity-like instrument, the value of the
4 retained earnings, which the Banks are accumulating.

5 And I'll just say in passing, I think there are
6 some very important forces in the world which suggest the
7 Federal Home Loan Banks need to increase their retained
8 earnings. And if we're increasing our retained earnings, we
9 need to have a way of conveying the value of that increase
10 to our members. And in a par value System you can't do it,
11 by definition. The retained earnings bill is by definition
12 not a dividend. And it's by definition, capital in excess
13 of par value, so the notion that I'd like to get at is a way
14 of getting to those members that want a more ownership-like
15 share, the value of the retained earnings billed, which I
16 believe we need to do for other reasons. I have two final
17 points to make, but I'd like to give each of the directors
18 something if I may and ask you to go ahead and pass these
19 down. In looking at any capital structure, this is simply a
20 grid which I suggest you might usefully think about. There
21 are at least these many questions and maybe a good many
22 others about any instrument which we would define.

23 And my notion is in any scheme you'd have to fill
24 in all these boxes and answer each of these questions, and
25 the schemes which Scott very insightfully, I thought,

1 discussed would be a quarter or so of the key points, but
2 there are a lot of other points you have to address
3 including, of course, voting, Class A and Class B, and I
4 think we have all of the problems we know about of Section
5 seven of the Act in figuring out how to do that.

6 I have two final points to make, and I thank you
7 for the chance to comment altogether. One is, in thinking
8 about the capital stock, we really, especially for the
9 members who really want something which is putable and has a
10 meaningful par value at redemption and looks more like a
11 subordinated debt or a preferred stock, you have to somehow
12 come to grips with the line of the Act which says that "No
13 Federal Home Loan Bank may redeem any share if it's below
14 its capital ratio." That's to say, not, the stock isn't
15 impaired, you may not have had losses, but if you're below
16 your capital ratio there is no redemption.

17 And you have to, I really haven't been able to
18 settle in my own mind how that fits with description of a
19 putable share when you have a general prohibition in the Act
20 against, against redeeming what would be 95 percent or so of
21 the outstanding, theoretically but not really, redeemable
22 stock.

23 The second issue is another line in the Act as
24 revised, which in effect makes Federal Home Loan Bank stock
25 infinitely assessable stock, as some of us have discussed in

1 other ways before, it gives the Boards of directors an
2 ongoing responsibility to assess all the members additional
3 capital if the Bank needs it. Well, what that really means
4 is this is not a limited liability company as defined by the
5 current Gramm-Leach-Bliley Act. It's sort of a partnership
6 with an infinite liability for the member-partners to be
7 assessed additional capital, and I don't think, I know I
8 haven't in my own mind, and I haven't seen anybody really
9 come to grips with how that affects, although I'm sure it
10 does affect in important ways, how we think about, account
11 for, describes, and deal with the capital structure as
12 required by the revised Act.

13 Thank you very much, Mr. Chairman and members of
14 the Board for the chance to make a few, I hope, helpful
15 comments.

16 MR. APGAR: Great. Maybe we'll just have a few
17 comments and questions now then, before we bring our
18 PricewaterhouseCoopers people on Board, but just with
19 respect to this member outreach, I know that been important.
20 You mentioned it, Jay, as something you're into. Could you
21 describe a little bit of what you've been doing and talk
22 about any ways in which we here at the Board could be
23 helpful in this necessary outreach and education that needs
24 to take place among the members?

25 MR. ROY: Our members meetings are scheduled for

1 Monday and Tuesday of next week. At that meeting, we'll
2 have Winthrop Watson come down from J.P. Morgan to talk
3 about the work that he's done in reviewing the proposed
4 regulation. We'll have our chief financial officer make a
5 presentation as to the general outline of the plan that we
6 anticipate at this point, making it clear to our members
7 that this is what we think at the moment subject to their
8 input in part, and then we will have the general counsel
9 review the legal aspects.

10 I really appreciate your willingness to help in
11 that regard. I'm not so sure at this point that we'd see an
12 opportunity for that or whether it would add value at this
13 moment. Depending on the upshot of those meetings, however,
14 it well might, and I appreciate your willingness to help us
15 in any way.

16 MR. APGAR: Obviously, the members that are on the
17 Board have a higher degree of knowledge on all this and at
18 some level are representative of the broad class of your
19 membership, but what do you think is the awareness and
20 degree of understanding of what's going on here relative to
21 the complexities of the Gramm-Leach-Bliley legislation.

22 MR. ROY: With respect to the Federal Home Loan
23 Banks.

24 MR. APGAR: Members.

25 MR. ROY: My suspicion is it's not very high at

1 this point, and part of what we're engaged in is trying to
2 educate through outreach. I don't think it's where it ought
3 to be by a longshot.

4 MR. APGAR: Ray, I know when you came to visit us
5 in August, one of your Board members came and he was the
6 first person that articulated to me this importance of the
7 KISS principle of keep it simple, stupid, because there are
8 a lot of members. And as you say, it's not just them, it's
9 moving beyond the management of the members to their Boards,
10 and you're now twice removed from a group that may be
11 following this closely. And that does, I think, suggest the
12 value of the simplicity. Do you have any comments on that?

13

14 MR. CHRISTMAN: Just a few additional thoughts
15 building on what Jay has said. I suspect all the Banks have
16 engaged in some kind of a communication process along the
17 lines of what Jay has suggested. We've had, as we have
18 various regular meetings with our members, we have added
19 capital to the discussion. We created a special committee
20 of our Board, so they're deeply engaged in it.

21 We've sent out some written communications, but
22 it's a little bit of a tricky issue because the level of
23 communication that we really want to engage in really has to
24 await the point in time when we know definitively what we're
25 dealing with in terms of a final regulation, and also, based

1 on that, what our final point of view in terms of a plan
2 that we want to put out there. Not necessarily a final plan
3 cast in stone, but at least a direction clearly that we
4 think we want to move in.

5 So from Atlanta's standpoint, while we've been not
6 hesitant to have general conversation and sort of
7 awareness-building kinds of conversations, communication
8 with our members, the kind of more engaged meetings with
9 members we've deliberately stayed away from until we felt
10 more confident about where we were going with this.

11 MR. APGAR: All right. Alex, any comments on
12 that? You articulated the fact that there are different
13 types of members in terms of their interests, of course,
14 that they would all line up and have similar interests but
15 different in terms of their orientation, in terms of what
16 they're looking for out of membership, so that makes it
17 additionally complex.

18 MR. POLLOCK: It does indeed. I would say we
19 have, of course, talked with a lot of members about this at
20 meetings. We had a questionnaire soliciting their comments
21 and suggestions. If I had to guess, I would say for most of
22 the members, the current state is confusion. This is a
23 complex issue. The structure of the Federal Home Loan Bank
24 System is unique, and I think obviously there are a few
25 strongly held beliefs by some people, but if you went across

1 7,500 members and interviewed them, my guess is the primary
2 reaction would be a reasonable amount of being overwhelmed
3 by the difficulty of the questions and confused by the
4 discussion.

5 MR. APGAR: Very well. Well, we can add to that
6 confusion by continuing our dialogue here, but one of the
7 things that keeps coming up is this issue of the cap and the
8 operating capital ratio. I know that has made it into your
9 top 10 list. Scott, could you articulate a little bit more
10 about what was the intent, you know, behind what we're doing
11 and how you understand the concerns.

12 MR. SMITH: Well, under the current rules there's
13 an activity-based requirement with respect to advances, and
14 it was felt that, oh, about a year or two back when we were
15 working on early versions of the capital rule, that the
16 System was overcapitalized and overcapitalized largely
17 because of a subscription-based stock purchase requirement
18 on advances, which resulted in more capital coming in than
19 was necessary to really support the risks associated with
20 the advances. So the limit on the operating level of
21 capital ratios was intended to try to cap any activity-based
22 stock purchase requirement from pushing in the direction of
23 requiring too much capital.

24 MR. APGAR: We've had this conversation with
25 various folks. It's always important to remember what we

1 intended to do and then, if there's comments that there's
2 unintended consequences of that, figure out other ways to
3 achieve our intent without the unintended consequences. And
4 so I think that through our top 10 list we'll also be
5 articulating what it was that we felt we meant to do and
6 then figure out whether there's another way to do it that
7 gives the flexibility and still achieves our goal.

8 But I know that it was not willy-nilly that this
9 came forward, although it is, I think, something that
10 clearly is going to require another look, because we've been
11 getting lots of comments about that operating capital ratio
12 issue.

13 MR. SMITH: Well, if I could, I would also like to
14 add that our thinking on that also was tied into the way
15 it's not in the proposed rule where the Banks cannot
16 purchase stock back from members at their discretion. So it
17 was felt that this capital would be out there and the Banks
18 wouldn't have an adequate way to pull it back.

19 MR. APGAR: Any other thoughts on this?

20 MR. ROY: We're able to redeem at capital
21 discretion.

22 MR. POLLOCK: That's an easy fix.

23 MR. APGAR: It's an easy fix.

24 MR. ROY: We had that listed as number one on our
25 top 10 list.

1 MR. APGAR: Okay.

2 MR. ROY: We kept bumping into that again and
3 again.

4 MR. APGAR: Right. Well, we're looking for fixes
5 that work, so, just to go back, I mean you all were polite,
6 but if you were going to have a top 14 list what would be
7 the next four? Well, certainly the intent here is if our
8 list doesn't capture the concerns, make sure you communicate
9 that. Because again, what we're trying to do here is not
10 wait until the last minute at midnight when the Federal
11 Express truck rolls in and we get 4,000 pages of comments,
12 and we are working on every one of these 10 issues now and
13 we'll work on other issues that we become aware of, so if
14 you have any particular ones that you'd like to highlight
15 that were the four or five that weren't quite on our list,
16 now would be a good time.

17 MR. CHRISTMAN: I'm not going to add any specific
18 issues at this point in time. I do think that because of
19 the dialogue that has existed, the issues that Scott
20 outlined earlier are a pretty good reflection of the
21 priority issues that the Bank presidents and CFOs have
22 identified in their own collaborative meetings which have
23 been occurring. In addition as you know from some of the
24 informal communications we've had that there's sort of the
25 larger policy type issues than the type that we've been

1 talking about today, and then inevitably, a long list of the
2 more technical issues.

3 MR. APGAR: Right.

4 MR. CHRISTMAN: And we've tried, and I'm sure
5 other Banks have, as well, to differentiate between the two,
6 so I'm not saying there won't be other substantive policy
7 issues uncovered in the next several weeks, and if there
8 are, we should get them into you, but I think that we've
9 done a pretty good job of identifying the big ones so far.

10 MR. APGAR: Good. Alex?

11 MR. POLLOCK: My top two, to reiterate, are all
12 elements of the risk-based capital.

13 MR. APGAR: Right.

14 MR. POLLOCK: Including the credit, which is not
15 on your list.

16 MR. APGAR: Okay.

17 MR. POLLOCK: I think there are huge issues of the
18 market risk, interest rate risk part of the rule that also
19 the credit part as well as everybody knows about the issue
20 on the operating risk, which is somewhat hard to do anything
21 that isn't arbitrary. The second one is an issue which maybe
22 doesn't come quite through here all the way, but it's the
23 issue which has been debated and discussed of the voting
24 rights and the conflict between the parts of the revised act
25 the voting rights left in place versus the capital

1 structure, and I guess as an observer of legal debates, my
2 subjective appreciation is that the argument that Section 7
3 or Chapter 7 or whatever it's called is still there and is
4 pretty convincing, at least to me, and that we need to find
5 a way to make consistent the different elements, which has
6 led me in my own two-class ideas to think that maybe my
7 first impulse was to say the A's don't vote unless they
8 don't get their dividend.

9 Certainly, the typical preferred stock protection,
10 if you don't get your deferred dividend you get to elect two
11 or three or four directors to come represent your interests.

12 I've just been brooding on this Chapter 7 issue and I've
13 come to think maybe you do have to have some votes there and
14 a way to do it would be to split the Board, you know, the
15 A's get maybe two directors and the B's get eight, or
16 something, or certainly other GSC analogues with split
17 voting Boards, Sallie Mae. That and Farmer Mac has
18 different classes getting certain seats on the Boards.
19 They've talked about that, but that's one of the ways to
20 approach the voting right issue is to be able to elect a
21 certain number of directors for the classes.

22 MR. APGAR: Maybe, Neil, as the keeper of our
23 effort to balance the complexities of the legislation and
24 the various traditions on voting rights that are out there
25 might comment on the kind of dilemmas that Alex was talking

1 about.

2 MR. CROWLEY: Sure. And there are really two
3 distinct issues. One is the designation of directorships,
4 which is something that the Finance Board is required to do,
5 and the second is the voting rights. And there are
6 conflicts between Section 6 and 7 of varying magnitude on
7 both of those issues. With respect to voting rights, I
8 think it's a much more straightforward issue.

9 Section seven says each member shall be entitled
10 to one vote for each share of stock that it has, subject to
11 the average cap. Section six as amended say that the Banks
12 and their capital clients can establish voting rights,
13 voting preferences. There's no limit on that. So a Bank
14 could, under Section six, say only Class A votes, only Class
15 B votes, or some combination in different weights. I think
16 that there's, they can reach that result on the voting
17 rights.

18 The question of designation of directorships is
19 somewhat more open. The purpose of the proposed rule was to
20 lay that issue on the table. At that time, based in large
21 part on the concerns expressed by J.P. Morgan that the Class
22 B shareholders would require or would demand the right to
23 control the election of the directors, we were willing to
24 open that issue up and to request comment on that. The
25 thing that we wanted to avoid was a failed IPO where the

1 economic substance of Gramm-Leach was subordinated to the
2 provisions in Section seven about directorship structure.

3 To the extent that somebody could make a case that
4 the Banks will not be able to sell the Class B stock unless
5 they are able to assure the Class B members of the right to
6 control the Board, then I think you would have a compelling
7 case to show that Section seven is indeed repealed by
8 implication to some degree or another. That is still very
9 much an open question, and we're waiting for comments on
10 that.

11 MR. APGAR: Yes, Jim.

12 MR. BOTHWELL: If I could just address the issue
13 of the risk-based capital.

14 MR. APGAR: Okay.

15 MR. BOTHWELL: Requirements as they are proposed
16 in our rule, I think it should be important for Director
17 Leichter to understand how we came up with what we came up
18 with in the proposed rule. The risk-based capital
19 requirements are really nothing new. They've been around
20 since the mid-80s, standards. Our goal as a staff was to
21 come forth with a state of the art risk-based capital
22 requirement structure. What we did is we went around to
23 existing regulators and asked them two questions. One, what
24 do you do now that you like and why do you like it? Two,
25 what do you do now that you would change and why would you

1 change it?

2 And based upon those responses of the primary
3 regulators, OFHEO doesn't have its risk-based capital yet,
4 five or six years and everyone's still waiting, but based on
5 those comments we formulated our approach. And our approach
6 is quite simple actually. For the credit risk component,
7 it's based upon the extent we have data on actual losses,
8 credit losses for assets of different rated categories.
9 That's where those charges are coming from. To the extent
10 we don't have data on actual losses for rated assets, we
11 looked to what other regulators are charging.

12 So what you see in the proposed rule, that's the
13 basis for those charges. We have actually tried to do
14 exactly what Alex Pollock has suggested, work with OFHEO to
15 try and get some of the data from Fannie and Freddie. And
16 Scott can tell you why that wasn't successful. But the
17 other point to make, as is explained in the proposed rule,
18 is we know that these aren't perhaps the perfect capital
19 charges, nor will they ever be.

20 We need a rule that's flexible so that when more
21 data becomes available with regards to actual credit losses
22 on particular assets of rated classes, we'll modify the
23 charges. It says so right in the proposed rule. Now, the
24 other part of it is the market risk charge. There, we've
25 gone, I think, to again, a state of the art approach.

1 That's the approach that OFHEO is directed to use, which is
2 a stress test approach. We give quite a bit of flexibility
3 to the Federal Home Loan Banks.

4 We are actually proposing an approach that Fannie
5 Mae and Freddie Mac would actually die to have. We are
6 letting the Federal Home Loan Banks use their internal
7 models to set the market risk capital charge. The one
8 requirement is that these models are to be approved by the
9 Finance Board.

10 They can either use a value at risk model or they
11 can use a cash flow model. I think Congress did something
12 very good in Gramm-Leach-Bliley in the sense that they did
13 not specify what the parameters of the stress test would be,
14 as they did for OFHEO. that's part of the problem that
15 OFHEO is facing, but they left it up to the Finance Board to
16 determine how the market risk capital charge is allocated
17 and set, taking into consideration the OFHEO model, and that
18 is exactly what we have done as proposed in this rule.

19 MR. APGAR: All right. But it's also safe to say
20 that there are a lot of people who have concerns, and we've
21 heard them, about the risk charges. At some level, they're
22 the heart of the matter. We appreciate that. And so we
23 welcome the opportunity, and I know this is something that
24 we've planned to do anyway, but we'll give you all credit
25 for urging us to do it, sitting down with a consultant and

1 with the representatives and our staff to go through in more
2 detail the kind of issues that were raised by the report
3 from the, what's it, Cox. What's the guy's name?

4 MR. BOTHWELL: NetRisk.

5 MR. APGAR: NetRisk, and others who would be able
6 to articulate exactly what the issues that the people
7 perceive are remaining. Again, this is under the idea that
8 he is, that consultant is working, generate information, we
9 might as well engage a conversation with him as soon as
10 possible so that we are able to quickly get to the heart of
11 the matter of whether or not there are any remaining
12 disagreements between what we're attempting to do and what
13 in fact there is a perception that we're doing. So we'll
14 take you up on that suggestion.

15 But this is an important issue, and again, it is
16 one that at some level we're finding our way along and may
17 not be completely settled by the time we promulgate the
18 rule, and in some instances, the issues may not even be
19 known to us until you get deeper into your business plans
20 and things become more apparent as we move forward, but
21 that's, I thought it was a good suggestion that we take
22 advantage of the expertise of the consultants and the others
23 who are working on this. Franz, do you have any comments?

24 MR. LEICHTER: I'm going to yield to Tim.

25 MR. APGAR: Oh, Tim?

1 MR. O'NEILL: I guess I would like to hear from
2 PricewaterhouseCoopers, then we have everybody there
3 together and I can ask questions of different people.

4 MR. APGAR: Okay. Good.

5 MR. LEICHTER: Can I?

6 MR. APGAR: Sure.

7 MR. LEICHTER: Just address some questions to the
8 Presidents. I first want to say how helpful I felt this
9 discussion is and also how useful it was to have some of the
10 prototypes and I think it certainly moves the process along
11 and, I think, enables us to engage in this sort of a
12 discussion in a meaningful way, and I know these discussions
13 will continue and I'm sure that great flexibility and
14 responsiveness is going to be shown by the staff and by the
15 Board, because your concerns are obviously very real. I
16 just have a number of questions but I'm going to limit
17 myself to a few.

18 One, in the proposal to have really just one class
19 of stock, and call it a Class B stock, then of course have
20 the five-year notice period. Is that going to be a
21 disincentive to your members from purchasing the Class B
22 stock? In other words, now, as I understand it, they can
23 redeem on six months notice now. If they can only redeem on
24 five months, and maybe that's going to get us into the
25 comments of Mr. Lewis and his colleague, I also wonder

1 whether that's going to impact on the, how this is going to
2 be treated, as Alex says, doesn't that bear on the question
3 are we dealing with debt or are we dealing with equity and
4 what the tax consequences might be.

5 MR. CHRISTMAN: I guess, Franz, the best way I can
6 answer that is by giving you the theory that we have at this
7 time. And yes, the tax and accounting issues hinge very
8 much on this as they do on a broader set of issues and
9 options, but our thinking is that if we could achieve a
10 conversion of the current stock to an all Class B structure,
11 which, as Alex said earlier, does have the attractive
12 feature of simplicity, and if a Bank can demonstrate
13 convincingly a projected future level of earnings and
14 dividend payments that, as well as the other benefits that
15 our services provide, primarily at the advance window, that
16 that could be a very compelling case and could certainly
17 persuade, we would hope all, but certainly a very high
18 majority of our members to accept the five-year redemption
19 feature without that being an undue burden for them.

20 So, lots of unanswered questions around that, but
21 we think that kind of conversion is possible and sellable to
22 our members so long as we can meet the, put the plan
23 together with the kinds of characteristics, including the
24 very important return features that we need to be able to
25 demonstrate that I indicated earlier.

1 MR. ROY: I would just add to that that virtually
2 all of our voluntary members have been members for five
3 years or more now in any event, and secondly, to the extent
4 we have excess capital in the new world of capital plans and
5 new regulation, we'd be able to redeem it, we wouldn't have
6 to wait five years if we have excess capital.

7 MR. LEICHTER: So it's redeemable at the Bank's
8 option, not at the member's option.

9 MR. ROY: That's correct. They present it to us,
10 if we have excess capital it would be our intent as we think
11 about it now, frankly, to redeem it. It's no different than
12 what we do with a six-month capital today. So if we
13 maintain our safe and sound position, our triple A ratings,
14 good financial returns, if they continue to have need for
15 our liquidity, we can't see any reason why the Class B would
16 be a disincentive for them. At first we did, but we've
17 grown in our thinking, I guess.

18 MR. POLLOCK: If you want, one more comment,
19 Director Leichter?

20 MR. LEICHTER: Sure.

21 MR. POLLOCK: If you think about the nature of the
22 instrument and how you react to the five-year notice
23 requirement for a withdrawal, it depends on who you are. If
24 you are a former mandatory member who represent, I think,
25 about 40 percent of the shares. Is that right? The former

1 mandatory members today? Let's say, I think it's about
2 right, 40 percent of the shares. You would say, well,
3 before, I had a stock which I couldn't redeem at all, so now
4 I can redeem it on five-year notice. Moreover, before, I
5 had a stock which was effectively junior to the stock of the
6 voluntary members, since the voluntary members could redeem.
7 The de facto, were a preferred Class to me. So you might
8 feel like, well, maybe I'm a little better off.

9 On the other hand, if you were a former voluntary
10 member who thought I had a stock redeemable on six months
11 notice, and by the way, I have a stock which was de facto
12 preferred to the mandatory member stock. I used to be a
13 senior class, and now I'm not anymore, and I think about
14 everything that could happen in five years from the time I
15 give notice, it's a rolling five-year notice to when I might
16 get redemption in the way of economic events, in the way of
17 management mistakes or one could even imagine Congress
18 acting to do something or other in a span of five years.

19 MR. APGAR: As unlikely as that could be.

20 MR. POLLOCK: You would conclude I now have a much
21 riskier instrument than I used to have.

22 MR. CHRISTMAN: If I could, just one other, one
23 comment. And obviously, as I said earlier, this is pure
24 speculation on all our parts, but I guess I have a little
25 bit more of an optimistic view about the attitudes of the 60

1 percent. You know, I think the greater, the great majority
2 of them view themselves as being in the System for the long
3 haul. You know, they, now, we don't have, arguably, in
4 economic terms, a long, long history with them. We've got
5 really a decade or so of experience.

6 But I think most of them view themselves as being
7 in the System for the long haul and do not really focus
8 greatly on the fact that they now have that six-month
9 redeemable option. And I think that also when you look at
10 the performance of the System in terms of dividends, return
11 on equity and the benefits of our advance window, as well as
12 other services that we offer, most of them sit around and
13 say, if you really get them to be honest with you, this is a
14 pretty good deal, this is a pretty good deal. It may vary
15 some from Bank to Bank and so forth but it's a pretty good
16 deal.

17 So I think to the degree that we can achieve this
18 conversion in this kind of manner that replicates as much as
19 possible what they have been used to seeing, we will have a
20 very, very good chance of being able to persuade them to
21 move to the five-year feature.

22 MR. LEICHTER: I'm sure you're going to test that
23 issue when you're at your meetings with members and so on.
24 Let me ask you, to what extent are your core mission
25 objectives enhanced or maybe hindered by the new capital

1 plan? And also if you could address whether it makes any
2 difference whether you have just Class B or whether you go
3 Alex's way and have both A and B. Which one helps you in
4 achieving your core mission?

5 MR. POLLOCK: I guess my view is it doesn't make a
6 lot of difference.

7 MR. ROY: As to A or B.

8 MR. POLLOCK: As to capital structure versus
9 mission. I have to say I haven't thought about it in quite
10 those terms. I'll have to reflect on it and let you know if
11 I think it's something else.

12 MR. ROY: The tension in this regulation is to, it
13 seems to me, and I've heard you all express this, that we
14 not allow the mission regulation to interfere with the
15 safety and soundness emphasis in the System. And it occurs
16 to me that one of the issues that we have already talked
17 about, number one on our list, this operating capital ratio,
18 is a ratio that is intended in part to ensure that we pursue
19 the mission and not bulk up on, "nonmission assets" as a
20 result of excess capitalization.

21 To the extent that prevents us from managing a
22 capital structure that's appropriate for the asset size of
23 the mission-related asset size of the Bank, it can be a
24 problem. And that's one of the tensions that, of course,
25 we're all trying to work out, and why that issue bubbles up

1 to the top of the list for us.

2 MR. POLLOCK: I agree with Alex. I don't think
3 the A or B structure, the mix of stock, has a whole lot to
4 do with the mission.

5 MR. LEICHTER: Let the indulgent Chairman just ask
6 maybe one more question. I was, the, the voting rights
7 issue, and I realize it's a very difficult issue for you in
8 dealing with members of different size, but Ray, as I heard
9 you describe it, you thought it was important that the
10 larger members with a larger amount of shares be able to
11 vote those shares and, therefore, would really, or could
12 possibly control the Board. How is this going to affect
13 your smaller members, and I guess the majority of your
14 members are probably smaller members. And do you see some
15 way in which you can satisfy the legitimate interests of the
16 large members without, I may not say without, but at the
17 same time, giving a role and some protection to the smaller
18 members.

19 MR. CHRISTMAN: Well, one of the challenges in
20 talking about any issue, as you'll soon appreciate, is it's
21 impossible to generalize across the System on almost
22 anything. Every Bank is unique in some ways in its
23 characteristics. In Atlanta, we have almost 1,200 members
24 now. The great percentage of them are small Banks. Our
25 Board is comprised entirely of community Banks, community

1 Banking representatives.

2 We, however, have in our district an unusually
3 large number of major regional and national institutions,
4 First Union, Wachovia, SunTrust, Banks who are among the top
5 50 in the country in size, who account for a large
6 percentage of the member assets in our district and the
7 advances in our district. And that mix may be particularly
8 profound in the Atlanta district but I think it exists to
9 some degree in at least certain other districts, as well.
10 Because of a variety of factors, not just the rules by which
11 people, by which voting rights are handled now, but also
12 because of the culture of the Banking System and the level
13 of interest that larger Bank executives have in running for
14 office as a Federal Home Loan Bank director, you do not see
15 in our district and in many other districts, large financial
16 institution representation on the Boards.

17 I was merely expressing the point of view that not
18 only as a matter of fairness should Banks be able to vote
19 their shares, but also that in an ideal world, over a period
20 of years you would see a mix of community and larger Bank
21 representatives on the Boards of Federal Home Loan Banks to
22 the degree that larger Banks are represented in those
23 districts and members of the System. You don't want to
24 create a situation where community Banks don't have a voice,
25 obviously. On the other hand, you don't want to have a

1 situation where the rules somehow prevent or foreclose
2 opportunities for larger Banks to have their opportunity, as
3 well.

4 MR. LEICHTER: So you would agree that there ought
5 to be some protection for the smaller Banks, the community
6 Banks to ensure that they have some say on the Board of
7 directors.

8 MR. CHRISTMAN: I think it would be, I think it
9 would be equally unfortunate if you had a situation occur
10 where community Banks represented a very significant
11 majority of the total institutions but perhaps a minority of
12 shares, and did not achieve representation on the Board.

13 MR. LEICHTER: So it's something that really, both
14 the Banks, but maybe also the regs that give you the
15 flexibility so that you can achieve that balance and that
16 fairness.

17 MR. CHRISTMAN: And I want to stress I think the
18 existing, the proposed regulation on this matter does by and
19 large provide that flexibility. However, it's now
20 complicated by this Chapter six versus seven legal
21 discussion, which I have not, do not pretend to be an expert
22 on, but I just, depending on how that whole matter gets
23 sorted out, I just want to make sure that the flexibility
24 remains.

25 MR. POLLOCK: As a general comment on the issue of

1 voting rights, I think you could say the more like a
2 preferred stock or a subordinated debt the instrument is,
3 the less important voting rights are. The more like an
4 equity with the risks and rewards of ownership the
5 instrument is, the more important voting rights are.

6 MR. ROY: And I guess the only thing I would add
7 to this is that we have to be careful that we keep in
8 perspective this voting rights issue, because at least
9 historically, the voting rights have been limited to voting
10 for directors, period. Somehow, we sweep into this all
11 other kinds of financial management decisions. It's voting
12 for directors. And it's pretty limited. It may be that the
13 Banks need to identify other things that ought to be subject
14 to vote by members.

15 MR. LEICHTER: And conceivably have different
16 requirements, depending on what the issues are.

17 MR. ROY: Exactly.

18 MR. LEICHTER: Thank you.

19 MR. APGAR: Okay, our two guest from
20 PricewaterhouseCoopers have been patient and now it's your
21 turn, William Lewis and Horacio Sobol. Start us off.

22 MR. LEWIS: Thank you for inviting us today to
23 share in the discussion. We appreciate the opportunity and
24 also applaud and commend you for the effort to try and get
25 people talking on these difficult issues. You talked about

1 complexity and confusion were words we heard a few times
2 today, and I think it would be more confusing and more
3 complex if we weren't having these dialogues, so we're glad
4 to be a part of them.

5 Today, I'm accompanied by my colleague Horacio
6 Sobol from our national tax practice. We've been working
7 with the System on their tax questions, and really to try
8 and summarize where we're going to come from today, we'd
9 like to really accomplish two things. One is I'll talk
10 about what I consider to be the pervasive accounting issue
11 involved here and the effects as considered in these
12 prototypes, as well as some of the top 10 items, and then
13 ask my colleague, Horacio, to comment on the more pervasive,
14 most pervasive tax issue, and limit it to that, because
15 there are underlying tax and accounting tax issues, which, I
16 think, given the processes that you've afforded this group
17 earlier, have been largely considered, at least as best they
18 can at this point in the way the reg was drafted and the way
19 people are currently commenting on the regulation.

20 To reiterate, we had given comments to the staff
21 of the Finance Board earlier on some accounting and tax
22 issues to allow them to consider that as they drafted the
23 regulation and then, as a result of the second meeting that
24 this Board had, we issued talking points to the Banks so
25 that as they dealt with their members they could try to

1 articulate those accounting and tax issues in a way that
2 made them as clear as possible as could be achieved at this
3 point.

4 To put this in perspective, I'd like to remind the
5 group that probably, where we're at is trying to deal with
6 two outside forces right now that have been sort of dealt to
7 us. And by us, I mean everyone here collectively. One is
8 the fact that the law stipulates that the shares that we're
9 talking about would be redeemable. And the fact that
10 they're redeemable and that the redemption begins an action
11 of the holder, is a very important consideration from an
12 accounting standpoint and also a tax standpoint.

13 So the two large pervasive issues I was talking
14 about are largely driven off that. From the accounting
15 standpoint, there's another external factor at work here,
16 and that is the fact that, as Alex mentioned earlier, the
17 Financial Accounting Standards Board has decided to rewrite
18 the rules, or to really maybe for the first time, stake out
19 good rules on what differentiates a debt security from an
20 equity security. And it's in trying to deal with those two
21 issues that we find ourselves discussing this important
22 matter.

23 As Alex mentioned, just last week, the FASB staff
24 summarized the Board's, the FASB Board's deliberations
25 through the meetings that were held in August and then

1 subsequent internal discussions with the staff and issued a
2 paper, which is available on their website. And among other
3 things, that paper, I think, for one of the first times,
4 very clearly states, as Alex said, that mandatorily
5 redeemable equity shares are liabilities. However, that
6 statement is in the context of a very, a much longer
7 discussion of the attributes of liability and equity shares,
8 which would not make it as clear in the end analysis as to
9 exactly how that debate will come out.

10 There are words like "acquired" and "mandatory,"
11 which has to be considered in the context of the attributes
12 of both the law and the regulation and the powers that are
13 vested in the Finance Board with respect to redemptions that
14 would have to be considered in deciding whether or not these
15 shares would fall on the side of, ultimately fall on the
16 side of debt versus equity. But I think there's enough a
17 signal there in what FASB has done issuing these views to
18 indicate that this is a topic worth discussing further
19 internally and then perhaps discussing with the FASB as to
20 their intent as to how their developing rule would be
21 applied to member institutions.

22 One of the observations we've been making as we go
23 through this process collectively is that many of the rules
24 of late that have been written have not necessarily been
25 focusing on member institutions and such attributes. We

1 hear that particularly that a hallmark of the whole System
2 is the fact that, and any other member institution, is that
3 shares can be redeemed when a member decides that the
4 activity that the share entitles him to is no longer
5 desirable for one reason or another. And that's not an
6 attribute of a corporate equity security, and so the
7 question is whether the model that FASB has started to
8 develop is contemplating that, many institutions, not just
9 the Federal Home Loan Bank System, that have similar
10 membership structures, and if so, how? And if not, perhaps
11 should it be altered or somehow a separate project at all to
12 deal with the unique equity and debt issues of member
13 institutions.

14 Our view is that's a discussion worth having and
15 we'd be happy to participate with the System as they think
16 about how they want to have that discussion and with the
17 FASB staff. In terms of the prototypes that we've gone
18 through, as I mentioned earlier, the rule laid out many of
19 the issues that we thought were important to try to best
20 define some of these accounting rules. In the A/B
21 prototype, those attributes are laid out for the most part
22 in a way that I think there aren't many new accounting
23 issues that evolve from prototype one.

24 The B contains attributes such as the
25 subordination features to Class A that would add weight to

1 the argument that it is more an equity-like instrument.
2 Many of the points that Alex was alluding to. The second
3 structure, the one where B has the value-based redemption
4 features, I agree with Alex that, from, just purely from an
5 accounting rules perspective and perhaps ignoring for the
6 moment operational issues surrounding that type of
7 structure, that it would add weight to the notion that it is
8 more of an equity-type security in that it does provide more
9 evidence of the members participating in the risks and
10 rewards of ownership.

11 Not knowing exactly where any debate with FASB or
12 others might come out, I think you would be far better armed
13 with an argument that because of the value-based approach, a
14 member has more skin in the game, let's say, at any point in
15 time, and realizes at any point in time that if the
16 institution were showing signs of diminishing value that
17 they would, if they stayed, they might retain less of a
18 right to the retained earnings. And, therefore, I think
19 that's a good attribute to have in trying to argue for an
20 equity-based approach for those B shares. I'm not saying
21 it's critical to winning the argument, but I'd have to say
22 that that has a more attractive accounting slant to it in
23 trying to make the argument.

24 And the third, the third structure, the pure B
25 structure, as everyone has mentioned is very similar to

1 today's structure. The irony here is that, as a few people
2 have mentioned, just at a time when the law, which was
3 structured to add more permanence to the stock does that by
4 creating an interest in retained earnings and more
5 participation in other risk activities and a longer
6 redemption period, we're talking about taking something
7 that's currently classified as equity and perhaps calling it
8 debt. And that, again, is just due to the fact that FASB is
9 in the process or reevaluating this whole issue.

10 I would agree with your comments earlier, Mr.
11 Chairman, as I stated before, that managing this accounting
12 issue is important right now and would suggest that the
13 interplay of FASB's words right now with the words that Alex
14 and some others have highlighted from the regulation about
15 the fact that there is a prohibition on the redemption of
16 shares in certain cases, and also the fact that there is
17 also this requirement for a sort of perpetual put. I'm not
18 saying those are the right words, but that there is at least
19 that possibility that there could be an expectation for
20 members to put more shares in the future, ought to be
21 considered in the context of the FASB's words and decide
22 whether or not more definitively this standard would likely
23 apply to the System in a negative way.

24 The second thing I thought I'd talk about were the
25 top 10 items. A few of those, I think, have some accounting

1 angles that I'd like to mention. One, the joint or pooled
2 stock, I would agree that's the first time I think we've
3 really considered that. On a small subclass basis it might
4 be something that's manageable from an accounting
5 standpoint, but obviously if it became a larger scale
6 initiative, it's something that would have to be seriously
7 considered in light of the current structure of the combined
8 financial statements, you know, the fact that they are
9 combined and that if you had more common ownership within
10 entities, then you would get, raise questions about whether
11 there should be a consolidated approach taken to those
12 financial statements. That's something to consider but,
13 again, by no means a showstopper. It's just a question of
14 how pervasive something like that would be.

15 Second, with respect to the dividends, I would
16 agree, and actually as part of our FASB 133 project we've
17 been talking to the Banks about seeking clarification from
18 the Finance Board about how certain attributes of the
19 standard affecting stockholders' equity will affect some of
20 the ratios and regulatory requirements. When it comes to
21 dividends, I think that the GAP is fairly lenient in this
22 regard. In other words, the issues that are going to be
23 largely on the table are going to be regulatory safety and
24 soundness issues.

25 The two things I'd note is that where there are

1 any kind of dividend rules right now they're typically both
2 in a current earnings test and a retained earnings test.
3 I'd say from a current earnings perspective, the fact that a
4 dividend might be paid despite the fact that there weren't
5 any current period earnings due to simply a timing effect of
6 a FASB 133 adjustment, would not particularly trouble me
7 from an accounting standpoint, but the notion that retained
8 earnings might be fully exhausted or sent negative through a
9 dividend action would be a very unusual thing.

10 And so, you know, it's not unusual for any of
11 these from time to time to have accumulated deficits but
12 they're typically created from profit issues, and has been
13 pointed out to people. There's a timing issue of what comes
14 first, the profit or the dividend, or the loss of a dividend
15 in this case. But I would just simply caution that that's
16 something that, from an accounting standpoint, we'd want to
17 make sure we were comfortable that there would not be
18 adverse external reaction from a dividend in creating an
19 accumulated deficit, even though there might be a temporary,
20 a tiny difference in the accounting recognition.

21 The voting right caps issue, there's a comment in
22 here about perhaps allowing the voting right caps to be an
23 adequate privacy for the ownership caps. I think that's a
24 reasonable point. As we discussed in the past, this whole
25 issue is here from the standpoint of ensuring that an entity

1 that owned a fair amount of the stock of an individual
2 Federal Home Loan Bank would not be forced to take equity
3 method accounting, which would mean that they would actually
4 record an investment in the Federal Home Loan Bank on their
5 books that would include undivided earnings reduced,
6 undistributed earnings, rather.

7 The most important measure of control of these
8 situations is not ownership percentage but rather voting
9 percentage, so if the voting cap was in place, absent a
10 situation where somebody just had such a large ownership
11 interest that, de facto, they have other ways to control,
12 normally should solve the accounting concern there, and, so
13 that the idea of just moving towards a voting right cap as
14 opposed to a membership percentage cap is not a troubling
15 issue for us at the moment.

16 And the last point, and this one may be a fairly
17 subtle point, it was in one of the 10 lists, was a concern
18 about ownership transfer and the fact that ownership as a
19 clear proportion of activity might not be maintained. I
20 think in the write-up it noted that there was a concern that
21 collateral protection might also flee in those kinds of
22 situations, and while there might be other ways to attach
23 collateral, one thing I did want to point out from an
24 accounting standpoint is that the longstanding acceptable
25 position that the System has taken that it doesn't need

1 reserves for loan losses on its advances has been based on
2 the fact that there is always a very high amount of
3 collateral for those advances. The MPF program is now
4 starting the advent of a loan loss reserve policy, but
5 clearly if we had uncollateralized advances as a result of
6 these kinds of asset, or stock transfers, there would be the
7 possibility of a need for broader loan loss reserves on the
8 advances, barring other credit protections that might be put
9 in place by the System. So that's an overview from an
10 accounting standpoint of our observations on the prototype
11 of the top 10s and maybe give Horacio a minute to just talk
12 about some observations on the tax side.

13 MR. SOBOL: Thank you. I think as you mentioned
14 before, Chairman Apgar, the prototypes were a good idea for
15 us to have to give us a better set of criteria to focus on,
16 however, again, I'll be speaking mostly in generalities
17 because there were a lot of details that were missing from
18 those prototypes. The issues basically remain the same as
19 what we've been discussing over the last few months. To put
20 it as basically as I can, they really focus on the
21 recapitalization or implementation of the plan and the
22 decision whether to implement with a two-class System or
23 one-class System.

24 What it boils down to is the receipt of a
25 redeemable or putable preferred share is generally going to

1 be taxable to members on the exchange of their current
2 shares in the System. And as we've heard some members and
3 panelists here discuss earlier, the true value of those
4 putable or redemption rights is a little questionable.
5 However, we're dealing with a relatively new tax statute
6 here. It's only three years in effect and there hasn't been
7 much guidance or authority or testing of the statute, so
8 we're erring on the side of conservatism to make sure that
9 we don't say something that's okay and then later the
10 service comes out with guidance and says no, even though
11 there is a great chance that they may not be actually
12 redeemable or putable, the slight instances where they are
13 make it qualified as this type of class.

14 So taking that into consideration, as I mentioned
15 earlier, the receipt of redeemable and putable shares, which
16 are preferred shares, which in a one-class System, it's hard
17 to have a preferred, one stock that's preferred over another
18 if there's only one class could cause a current tax impact
19 to the members. This impact is probably not just
20 detrimental to members of Banks who have been receiving
21 purely stock dividends, this really is going to impact
22 members of Banks who have been receiving cash dividends as
23 well. However, the members of Banks who, which have
24 typically been paying dividends in the form of stock
25 dividends will likely bear a larger burden because, again,

1 trying to put it basically, their basis in their current
2 shares has been diluted by the additional stock dividends
3 that they have received. So when they receive current Class
4 A shares if that's what they receive on the recap, the fair
5 value of those shares against the basis of the shares
6 they're retiring or turning in would, there would be a
7 greater disparity so, therefore, the tax amount could be a
8 larger amount.

9 In addition, a few of the plans, the prototypes
10 that we have reviewed had called for possible payments of a
11 dividend of the current retained earnings to either the A or
12 the B shares and something that we haven't discussed before,
13 these dividends would likely be taxable as well in the
14 recapitalization.

15 In summary, a one-class System appears to be safe
16 for members from a tax perspective, although it may not
17 achieve all the business objectives that the member Banks
18 and Federal Home Loan Banks would like to realize from the
19 implementation of the new regs, while a two-class System may
20 be safe depending upon the aspects of the Class A and B
21 shares. If the Class A shares are not entirely preferred
22 shares or they participate to the extent that the common
23 shares do, then there may be abilities to issue Class A and
24 Class B shares and still try to minimize the tax impact to
25 the current members.

1 MR. APGAR: Thank you. Well, we've been deferring
2 questions from Tim, and maybe you'd like to start this round
3 off.

4 MR. O'NEILL: Okay. I'm going to focus my
5 questions on different people, but if any of the other
6 people want to chip in as I go through my list, go ahead and
7 I'll do a few and turn it back over to you. I'm going by
8 the top 10 list that the staff put together, on the first
9 question, I agree with Commissioner Apgar that commonality
10 kind of works at cross purposes to all of the flexibility
11 that I think that the Board did a very good job of putting
12 in the capital regulation, so for the Bank presidents, I
13 would just like each of your views about where you think the
14 balance should be between flexibility and commonality.
15 That's rather an abstract question but I still want your
16 view on that if you would.

17 MR. CHRISTMAN: I'll start off and pass it down
18 the line. I think that's a very difficult question, this
19 commonality question, for me to sort out. I certainly
20 believe that the 12 Banks are really in the best sense of
21 the word, "laboratories," in which good ideas can, have and
22 will emerge, and I think we ought to be continuing to move
23 in a direction that encourages that and permits that in the
24 regulation, as I think the statute suggests should happen.

25 I also think, as I said earlier, that all the

1 efforts that have really been mounted, really beginning in
2 the last couple of months to encourage dialogue and
3 discussion and voluntary efforts by the Bank presidents,
4 efforts by outside groups like ACB, efforts by the Finance
5 Board have been very positive and productive and should
6 continue. When you get beyond that, though, I'm not sure
7 what, I'm not sure how you operationalize commonality, you
8 know. I'm not sure what the Banks can and should do amongst
9 themselves nor what the Finance Board can and should do to
10 make more operational this notion of commonality, which
11 suggests to me obviously a common plan or a single plan or a
12 unified plan.

13 So I'm, you know, that's not a definitive answer,
14 those are just some feelings and thoughts I have and I'd be
15 interested in what Jay and Alex have to say.

16 MR. ROY: My conversations with members in our
17 district and other districts, as well, leads me to suspect
18 that commonality is a code word for avoiding tradability of
19 stock. I think it speaks to the concern about uncertainty.

20 I think it speaks to the potential for district hopping,
21 and I think a concern that our members have, almost
22 universally, is a concern about unpleasant valuations of
23 their stockholders, which for most of them is the most
24 significant asset they have in their balance sheets. So my
25 suspicion is that commonality is a code word for concern

1 about tradability.

2 MR. POLLOCK: When I was an undergraduate, I think
3 a sophomore, I read a great essay called "Essentially
4 Contestable Propositions," those being interesting
5 questions, which you could debate forever but it didn't
6 matter how long you debated them, you could never answer
7 them because they were essentially contestable.

8 MR. APGAR: We've got all day, Alex.

9 MR. POLLOCK: Well, here's an essentially
10 contestable proposition. Are the 12 Federal Home Loan Banks
11 12 things, or are they one thing? Obviously, the more you
12 think, they're one thing, the more you want commonality.
13 The more you think they're 12 things, the more you want
14 uncommonality. The Federal Home Loan Bank Act as it existed
15 until 1999 as far as capital concerned, obviously imposed
16 total commonality but statute. And now we have some other
17 possibilities.

18 And I think in terms of the answer you could get
19 people to agree upon, may I quote my colleague, Jay Roy, who
20 said it all, which is, "Of course we want commonality, and
21 there'll be 12 different definitions of 'commonality.'"

22 MR. O'NEILL: Maybe a more specific point on that.
23 One new option that we have added is the, to the idea of
24 stock purchase is the idea of a membership fee. And that is
25 something new, something that we have added to it. I guess

1 I would ask each of you what do you think of the membership
2 fee as opposed to the stock purchase, which is the way that
3 we have gone to this time?

4 MR. POLLOCK: I must say, Director O'Neill, I
5 myself am very attracted to the idea of a membership fee for
6 the following reason: In the historical Federal Home Loan
7 Banks, you have a bundled purchase. You bought stock, as we
8 have discussed many times, and for a long time you'd buy a
9 bunch of things together, and there's no price
10 discrimination of the components of the purchase. So you
11 buy membership rights and some amount of borrowing and a
12 financial investment. As a matter of theory, and I'm not
13 sure that this would work in practice at all, as a matter of
14 theory it's an interesting question as to what someone would
15 pay to be a member of a Federal Home Loan Bank as an
16 unbundled purchase, as a way of testing what is the value of
17 a membership.

18 So as a matter of financial theory, it appeals to
19 me to test, to be able to have the possibility of testing
20 out the question, what is a membership separate from a
21 financial investment worth? And would anybody pay anything?
22 Or if so, how much would they pay to be a member? It
23 strikes me as it might be interesting to play around with.
24 I would guess practically it would not play a large role,
25 but who knows?

1 MR. ROY: I think it's a bad idea, I guess. From
2 the members' perspective, I can't imagine why they'd be
3 willing to exchange an investment, in which they should
4 anticipate their money back plus a return, for an
5 unrefundable expense that reduces their earnings. From the
6 Federal Home Loan Bank's perspective, we need stock, we need
7 capital, and membership fees are a particularly inefficient
8 form of capital formation because they have to pass through
9 the affordable housing and REFCORP taxes, if you will, so
10 that only something like 74 percent of every dollar winds up
11 being added to retained earnings. So if you're into
12 membership fees for capital formation, it's inefficient.
13 From the member's perspective, it seems to me to be
14 disadvantageous compared to the outright investment. So in
15 short, I don't think too much of the membership fee idea,
16 Tim.

17 MR. CHRISTMAN: I don't really have anything to
18 add to what Jay has outlined. I think as a mandate, it's
19 not of benefit and as an option, it's not likely to be
20 utilized.

21 MR. O'NEILL: Well, the reason it kind of gives me
22 pause is that some of the groups that the System is
23 currently close to, say, for example, mortgage Bankers, they
24 might try to use the membership fee as a way to gain access
25 to the System, and to me, that kind of complexity kind of is

1 a negative, in contrast to Alex Pollock's point that it
2 would be a good exercise to see exactly whether anybody
3 would put a price at joining the System. So I guess my view
4 is that a membership fee is one of those things that it was
5 good that we gave you that flexibility, but maybe it's a
6 point where maybe if there is such a thing as too much
7 flexibility, this is one of the points maybe where there's
8 too much.

9 MR. CROWLEY: Mr. O'Neill, if I may, the issue of
10 a membership fee, I don't think would open up to your
11 concern of mortgage Bankers coming in. Simply put, mortgage
12 banks are not among the types of institutions that Congress
13 has said are eligible to apply for membership. And until
14 Congress changes that, I don't think that, even if a fee
15 structure is authorized or incorporated by any of the Banks,
16 I don't think a mortgage bank or any other nondepository
17 institution that's not currently authorized to be a member
18 could join the System.

19 MR. APGAR: Does anyone have any questions they
20 want to ask at this stage of the PricewaterhouseCoopers
21 people?

22 MR. LEICHTER: I guess not. I'm going to need to
23 digest what's been said before I can ask a meaningful
24 question.

25 MR. APGAR: Just in terms of this tax treatment,

1 obviously you need to see the entire, or a lot more details
2 than we presented in the prototypes. And of course the
3 reason we used the prototypes was we didn't want to, in a
4 public setting, have the Bank, the Finance Board will be
5 discussing provisional plans of members of the individual
6 Banks. But as a general matter, it does seem that there is
7 room to maneuver within an all B class structure to
8 significantly reduce if not eliminate the tax consequences
9 of this recapitalization. Is that a fair statement?

10 MR. SOBOL: Within an all B Class structure, yes,
11 there's a lot of room to maneuver.

12 MR. APGAR: And then within the dual structure,
13 there are scenarios which you can imagine could clearly
14 trigger tax consequences, and then there's also parameters
15 which you could adjust to minimize the tax consequences even
16 within a dual structure, although it would be hard to
17 imagine avoiding them entirely, perhaps.

18 MR. SOBOL: Correct. I think, though, that
19 eliminating them or moving to the far end of minimizing them
20 may bring you outside of what the Bank's objectives would
21 be.

22 MR. APGAR: Yes.

23 MR. SOBOL: On differentiating the two classes.

24 MR. APGAR: Right. Because again, in this chicken
25 and egg scenario, we know that the answer to these questions

1 won't be finalized until the plans are finalized, but we
2 wanted to make sure that we allowed sufficient flexibility
3 so it wasn't inevitable that there was no way to go other
4 than through a scenario in which there were substantial tax
5 consequences. It may be that for other business reasons,
6 the Banks do go that route and make other adjustments in
7 their plan to compensate the members for whatever issues
8 around the taxes that arise, but our job, I think, is to
9 make sure that we provide the flexibility so that they can
10 choose in some ways as to how to organize and how to manage
11 whatever tax consequences this, these various scenarios
12 impose. Yes sir?

13 MR. LEWIS: I'd point out that to that end, these
14 prototypes are general in nature.

15 MR. APGAR: Yes.

16 MR. LEWIS: As of, in terms of the, some of the
17 issues that are important to the sort of middle ground you
18 were looking for in trying to maximize the possibilities in
19 the A/B structure. I want you to know, though, that in
20 addition to just talking on these prototype level issues.

21 MR. APGAR: Yes.

22 MR. LEWIS: We have had discussions with our tax
23 people, Horacio and his colleagues have had discussions with
24 several of the Banks who have been exploring what-if
25 scenarios.

1 MR. APGAR: Yes, for sure.

2 MR. LEWIS: To try and look for ways to have
3 attributes for the A structure that would make them as tax
4 efficient as possible and we'll continue to do that as those
5 opportunities arise with them so that's the good news,
6 though, I think, is that the way that the regulation is
7 written based on the fact that these additions have been
8 identified early that many of those, as much flexibility as
9 probably could be given to try and cut down those roads are
10 currently embedded, and I don't know that we'd have any
11 additional comments on ways to change the regulations to
12 opening up, within the constraints set out in the law.

13 MR. APGAR: Of course. And the point is as you go
14 further in terms of depth with the more detailed plans that
15 are emerging from particular members, we might encounter
16 issues again, the unintended consequences where, again, we
17 might identify some tweaks to the regulation that would help
18 in balancing these sort of competing interests.

19 MR. LEWIS: And also, for example, in writing the,
20 I'll call them the transition rules, but the
21 exchange-related provisions. Words were added to the
22 regulation to the effect of any other type of cruel
23 exchange. And so to the extent that there would be a
24 structure envisioned, or could be envisioned, that would be
25 a way to minimize tax consequences, we ask for wording to

1 that effect or suggest that a wording to that effect be
2 added to the regs, but we'll give the Finance Board an
3 opportunity to look at those on a one-by-one basis and there
4 are a variety of address concerns that permit them if they
5 were.

6 MR. APGAR: Right. Flexibility down the line.
7 Yes.

8 MR. LEICHTER: No, just to followup, as I
9 understand it then, from what you're saying is that there's
10 nothing in the regulations itself or the proposed
11 regulations that you see that would create difficult
12 accounting or tax problems.

13 MR. LEWIS: Well, nothing that the regulation,
14 well, it's a difficult, let me put it to you, let me say it
15 a different way, and that is that the law had already put
16 some pretty high hurdles from an accounting and tax
17 standpoint, but the charge, I think, was to look at the way
18 the regulation was being drafted and to suggest whether they
19 were additions that were being made similar to these top 10
20 issues that the Banks have raised, which seem to not be
21 required in order to implement the law but which might have
22 unintended accounting and tax consequences.

23 We think that in the earlier phases of this, most
24 of those issue were raised such that the reg has either been
25 written to incorporate them or they're on the top 10 list

1 that we're talking about today, so above and beyond that, we
2 don't have other ideas at this point that would have to
3 baked into the regulation. But one thing that from an
4 accounting standpoint that could be a possibility is that,
5 and this may be another reason for an extension you're
6 considering, is that if those Banks that decide to proceed,
7 talking to some of the standard setters on the accounting
8 side, if their intentions in writing this liabilities equity
9 standard and trying to assess the impact on the Banks and
10 found that they were particular elements of the current
11 capital structure or the planned capital structure that were
12 appealing or would be critical from the FASB standpoint to
13 getting particular treatment, then obviously the opportunity
14 for people to comment to the Finance Board before final
15 regulation might be a plus. But that's just one other
16 consideration. Obviously, you can't keep these things open
17 forever, because FASB would take quite a long time to write
18 its rules, but it's just a consideration.

19 MR. APGAR: But it seems like to the extent
20 possible, we'll try to be busy reading the FASB tea leaves
21 and this preliminary document to make sure we don't see
22 anything that is beginning to emerge that gives us pause.

23 MR. LEICHTER: Yeah, and if FASB somewhere along
24 the line, and as you say, that may not be in the next six
25 months, it may not be in the next 12 months, we don't know,

1 but if it then comes up with something where the regulations
2 present a problem, that obviously can always be visited
3 again by the Board and I'm sure would be, so I guess it's
4 fair to say that, really, to make a more definitive
5 statement on tax consequences and accounting issues, you're
6 going to have to look at something more than just the
7 prototypes. You're going to need something that comes close
8 to being a final plan.

9 MR. LEWIS: The final plans, as well as, you know,
10 the ongoing taking a snapshot at that point in time as to
11 where the accounting rules are in their development. Those
12 two things will lead to a final decision. But reading draft
13 plans is very helpful. We've actually looked at a couple of
14 draft plans, and that's very helpful in computing.

15 MR. APGAR: Alex? Tim jumped back down, I just,
16 you can pass it off, I'll pass it right back to Alex if he'd
17 like to comment.

18 MR. POLLOCK: I'd just like, if I may, to get
19 clarification of our colleague at Pricewaterhouse, in a
20 two-class structure, those old shareholders taking Class B
21 shares, which would be the common shares value, would not
22 trigger tax liability.

23 MR. SOBOL: They should not trigger a tax
24 liability.

25 MR. POLLOCK: So it isn't a question of how many

1 classes there are in the structure. It's which Class you
2 get back.

3 MR. SOBOL: Right.

4 MR. POLLOCK: So in the two-class structure, one
5 of the choices that the investor would have to consider
6 would be which way I want to go, would also have to think
7 about, well, what do I want to do in terms of triggering a
8 tax payment on past stock dividends, which I took as a book
9 income but not as a, not as a tax book income. On that, if
10 I could go one step further, Mr. Chairman.

11 MR. APGAR: Sure.

12 MR. POLLOCK: You mentioned there could be a cash
13 dividend pay issuance. That's a little hard thing for me to
14 imagine, how the assumption of values moving at par.

15 MR. SOBOL: Excuse me?

16 MR. POLLOCK: How the assumption of values on all
17 these things are par.

18 MR. SOBOL: Not detailed in the prototypes here
19 but in some of the plans we have reviewed, they were some
20 that included a dividend of the current retained earnings at
21 the time of implementation, which would be in the form of
22 cash and, therefore, taxable.

23 MR. POLLOCK: Oh, sure.

24 MR. SOBOL: Okay.

25 MR. APGAR: Tim, do you have additional questions

1 that you'd like to ask?

2 MR. O'NEILL: Yes. Number two dealing with
3 operating capital ratios. Is it enough to, and I think this
4 is for the Bank presidents, is it enough to move from a
5 target to a range or are there other problems dealing with
6 capital operating ratios in addition to that one, if you can
7 give me your answer on that.

8 MR. POLLOCK: My opinion is the so-called
9 operating ratio is something which should be eliminated
10 entirely. We ought to have a normal capital regulation
11 which sets minimum capital requirements like everybody
12 else's capital structure and other than that, there
13 shouldn't be anything.

14 MR. ROY: I just ditto that, Director O'Neill, and
15 just go further to say that range is very little better than
16 a point estimate. It ought to be allotted.

17 MR. CHRISTMAN: Just to clarify one thing. In
18 some of the early material that we shared with the Finance
19 Board, we suggested adopting a range rather than a ratio,
20 but this was several months ago. But on further analysis
21 and consideration, there's really, obviously it would be
22 better than what you have now but there's really no merit in
23 keeping it in at all and it should be eliminated.

24 MR. O'NEILL: Okay. This is a question to the
25 staff. Question three. Is it true that the staff has no

1 problem with allowing this buy and hold provision as an
2 option? Is that right or not? This is on the third.

3 MR. BOTHWELL: Well, I think it's premature for
4 the staff to put forth its positions on any of these top 10
5 concerns or issues. I mean we've just collected them. We're
6 in the process of analyzing them and sorting through them,
7 so I think at the end of the process, we're in the middle of
8 the comment period, still a couple weeks to run, so.

9 MR. APGAR: There are some prohibitions for us
10 announcing what our final decision is on elements of the
11 rule, so we take that, but the fact that we have it on our
12 list suggests that we think we understand the issue, we're
13 trying to articulate the issue, and we'll use that as our
14 guidance as we will in other comments to decide where we are
15 on it.

16 MR. O'NEILL: But all three Bank presidents would
17 urge that we do move to allow the buy and hold as an option,
18 is that right for the three Bank presidents?

19 MR. ROY: Yes, particularly if it's collateral, if
20 it's collateral against which an advance has been made.

21 MR. O'NEILL: Okay.

22 MR. ROY: To have that collateral stripped out
23 from under you, presents some unusual challenges.

24 MR. O'NEILL: Okay. Again, I guess to the staff,
25 or though, I guess based on the last answer, maybe I'm doing

1 this backwards, but I'll ask again. And this is number
2 four, regarding to do par rather than a negotiated price.
3 Does the staff have a problem with allowing this as an
4 option or, again, Jim, or is the staff not there yet?

5 MR. BOTHWELL: Again, I would say that the
6 response would be the same for all 10 of these.

7 MR. O'NEILL: And the Bank presidents would like
8 the ability as an option to do it at par. Is that right?

9 MR. ROY: For that not to be precluded.

10 MR. O'NEILL: Okay.

11 MR. APGAR: Again, we're more into making sure we
12 don't preclude things that have a legitimate purpose, as
13 opposed to being asked the question are we for it. That's a
14 higher standard. Are we going to mandate it? That's a
15 higher standard.

16 MR. O'NEILL: Well, that's why I said in both of
17 these to allow them an option.

18 MR. APGAR: Is it an allowable flexibility? We're
19 considering whether it's an important flexibility to allow.

20 MR. O'NEILL: Obviously, you know, there are other
21 things that we want to make sure that stay in place, but I'm
22 just asking whether allowing those two as an option. On
23 number five, Neil, I understand that there is a statutory
24 problem with allowing the fifth top 10 question. Could you
25 explain what the statutory problem is with number five?

1 MR. CROWLEY: I'm not sure I understand what the
2 statutory problem is that you're referring to.

3 MR. BOTHWELL: I think I know what this issue is.
4 This is, I think, an issue with the proposed rule. The
5 intent in the proposed rule, I think, explicitly says at the
6 beginning of it that the Federal Home Loan Bank can
7 authorize A, it can authorize B, it can authorize A and B.
8 It's one of the options that, the three options that they
9 have. There is another section where it talks about
10 membership investments, and there, I think it says that a
11 Bank can require a member to purchase A as a condition of
12 membership. But if it hasn't authorized A, how can it
13 require the purchase of A?

14 MR. CROWLEY: Clearly, Gramm-Leach authorizes each
15 Bank to issue one or both classes, and if a Bank were to
16 authorize only B, the member would not have an option to buy
17 A because it did not exist. But whatever option, the member
18 has an option of buying A or B, assuming both Classes are
19 authorized.

20 MR. APGAR: I take that to be under the set of
21 issues where there was a request made that we go through and
22 make sure that we, "scrub the rule".

23 MR. SMITH: It's a drafting issue.

24 MR. APGAR: Yes. To make sure that the B-only
25 option isn't precluded by some other sections, and since,

1 admittedly, the B-only option was something that arose later
2 in the discussion, I think it's a fair comment that we will
3 be going through the rule and evaluating any issues that may
4 emerge around a B-only option and make appropriate decisions
5 about that.

6 MR. POLLOCK: Mr. Chairman, there is a statutory
7 provision relevant to five, which is, read it today again,
8 which is that in any Bank that authorizes both A and B.

9 MR. APGAR: Right.

10 MR. POLLOCK: In effect, it says you cannot
11 require the purchase of B. But what it does, what it says
12 literally is you must give the member an option of buying
13 either or any combination, the effect of which is you can't
14 require them to buy B if you have both.

15 MR. APGAR: Right. If you have both, you can't
16 require, but the point at hand is if you only have B, what
17 are the, what are the rules? And that's what we were
18 talking about going through to clarify any wording in the
19 rule, or not clarify, but see if there's any lack of clarity
20 as we go through that review.

21 MR. O'NEILL: On number six, I guess first to the
22 staff, am I correct in stating that the staff is at the
23 present time up in the air on the sixth issue? Is that
24 right?

25 MR. BOTHWELL: Again, you know, this is, we are

1 evaluating the comment and the concern and we will, take
2 some time, given the motion that was made at the beginning
3 of the meeting, come forth with a revised rule for the
4 Board's consideration.

5 MR. APGAR: Maybe here's a time for me to use my
6 lame effort at making a joke at the ACB meeting, where I
7 said that if we engaged in predecisional activity, i.e.,
8 announced our intentions relative to the rule although the
9 comment period was still underway, we could all end up in
10 jail, that would reduce the comment, that we'd reduce the
11 quorum. And lead us all into a fix. Then some people
12 thought that was a good idea, and so I pulled back from that
13 but, again, this is not.

14 MR. LEICHTER: You'd create commonality.

15 MR. APGAR: Yeah, right. We do not mean to be
16 evasive here, but there are, all he's repeating is the fact
17 that we are still in the rulemaking period and we are not
18 announcing decisions with respect to any issue. The fact
19 that it appears in the top 10 list is because we've
20 identified an issue, we're working on our ideas about that.

21 And we can certainly elaborate any questions now
22 that we understand the issues if we think, you could ask us,
23 we think we understand why the members or the Banks are,
24 think this is important, so do we get it, as to what the
25 issue is, but I don't think we're likely to answer the

1 question of what our opinion is and how we're going to
2 resolve the issue.

3 MR. O'NEILL: All right. To the Bank presidents,
4 am I correct in stating that all you're asking for with
5 respect to this requested change is maximum flexibility for
6 the Federal Home Loan Banks and its Board of directors to
7 deal with the many tax and accounting uncertainties? Is
8 that, does that kind of capsulize where the Bank presidents
9 are at this point?

10 MR. CHRISTMAN: This was, you know, just to put,
11 maybe put this in a little broader context, the 10 issues
12 that Scott and Jim raised earlier in the session relate
13 largely, not entirely, but largely to a similar set of
14 issues that the Bank presidents conference developed based
15 on input from all 12 Banks. So, you know, I think there,
16 and this was one of them. And of the 10, probably seven or
17 eight are on both lists. So, you know, in each case,
18 obviously these are issues that I think it's fair to say the
19 Bank presidents, CFOs, believe to be important.

20 In this case, what's behind this is simply to, in
21 this period of uncertainty regarding what direction we're
22 going to go, tax, accounting, legal issues as you referred
23 to, Tim, let's not put any more requirements on Class A than
24 is required by Gramm-Leach-Bliley. Let's not go any further
25 than that, and limit it to that point, thereby guaranteeing

1 maximum flexibility. So that's what's behind number six.

2 MR. O'NEILL: Okay. On number seven, again to the
3 staff, is this another one that you're up in the air on at
4 this point? Number seven?

5 MR. BOTHWELL: Yes, I think that's a true
6 statement for all 10.

7 MR. O'NEILL: Okay.

8 MR. APGAR: We could say we've made up our mind,
9 we're just not going to tell you. I like Jim's answer
10 better.

11 MR. O'NEILL: And to the Bank presidents, how
12 strongly do you feel about issue number seven?

13 MR. CHRISTMAN: I don't know. I think, again,
14 we're probably of the same mind on it. I'll just, since the
15 microphone's closest to me, I'll speak. The feeling is if
16 the voting rights issue is dealt with appropriately, the
17 ownership rights issue is not an issue.

18 MR. O'NEILL: This one, I guess, to Neil, and you
19 and I were there at the ACB when Tom Vartanian gave his
20 view. What is the Finance Board's latest legal thinking
21 regarding Section 6, Section 7 and the status of the
22 implicit repeal?

23 MR. CROWLEY: The latest thinking of the Finance
24 Board is in the proposed rule. The latest thinking of the
25 staff is still a work in progress. We are well aware of the

1 issues that Tom raised at that meeting and we have been
2 aware of them from the outset. As I think I indicated a
3 little while ago, at the time in late May when we were
4 finalizing the proposed rule, we had heard from J.P. Morgan
5 and from others about the importance of the Class B
6 stockholders being able to control the Board and how that
7 related to the success or lack of success of the offering.

8 Largely because of that, we opened this issue up
9 as widely as we possibly could, with the intent to elicit
10 comment from all interested parties. We recognize that
11 there are parts of Section seven that remain in existence
12 though in conflict with Section six, and we are waiting to
13 get the comments, and we have yet received none on that
14 issue before we decide what to do, but right now things
15 stand as they stood when we published the proposed rule.

16 MR. O'NEILL: Okay. Am I correct in thinking that
17 if there's further legal review in this area, that might
18 modify the proposed 20 percent voting rights cap?

19 MR. CROWLEY: Sure. If, for example, we were to,
20 or you were to come to a determination that there should not
21 be any implied repeal, then by definition that brings into
22 play the average cap, and that would be the voting cap as it
23 is under pre-Gramm-Leach provisions of the Bank Act. And
24 whether there might be another alternative there is going to
25 depend on whether we perceive there still to be an

1 irreconcilable conflict and what we think best addresses
2 that.

3 But in the absence of that finding, then we would
4 give effect to Section seven in that there would still be a
5 cap. Now, whether it's a debt cap or another cap is not yet
6 resolved.

7 MR. O'NEILL: Thank you. That's a great answer on
8 a very abstruse point. On number nine, I don't think that
9 this proposed change came from the Federal Home Loan Banks.
10 Was this a concern, this is again for the staff, of the ACB
11 roundtable? If not, where did this concern originate?
12 Number nine.

13 MR. BOTHWELL: Maybe Scott can talk specifically
14 about the origination of nine, but I'd just like to say that
15 this list is a composite of concerns we heard from members
16 and trade associations and Federal Home Loan Banks, it's not
17 just the Banks.

18 MR. APGAR: But is it fair to say that at least
19 the people represented here perceive this as being a newer
20 issue compared to ones that have been known to them for some
21 time, so it's a fair question as to in what context this
22 issue arose.

23 MR. SMITH: Actually, in the preamble to the
24 proposed rule, we requested comment on this particular
25 issue, and since then we have heard from a couple of Banks

1 about it. They have brought this issue up as it's an
2 important one to think about. We have, I think, yet to hear
3 much in the way of proposed solutions to this issue, but
4 it's been raised as a concern.

5 MR. O'NEILL: And to the Bank presidents, how, I
6 think I heard from your earlier comments that this isn't a
7 huge problem from your perspective. Is that right?

8 MR. POLLOCK: I'm not sure, if I may speak first,
9 Director O'Neill, that I know that it is.

10 MR. APGAR: Maybe we should all elaborate on what
11 you've heard the concern expressed by some.

12 MR. SMITH: Sure. In a situation where a
13 particular Bank is raising its capital principally through
14 an activity-based stock purchase requirement, and yet it
15 might also wish to participate in, say, a large AMA
16 transaction, you know, fair percentage, then there would be,
17 that participation would be coming to the Bank as an asset
18 for which it could not charge an activity-based capital
19 requirement on, because it would extend to a member outside
20 its district. So that's the issue. How do you deal with
21 capitalizing assets that cross district lines?

22 MR. O'NEILL: Now that you know a little more
23 about what it's about, what do you think about that issue as
24 one that matters a lot or a little to the Bank presidents?

25 MR. POLLOCK: It's interesting, if you think about

1 it in the MPF context where we have a lot of participations
2 moving among Banks, it's an interesting notion. I haven't
3 thought about it specifically, but I would say it's worth
4 thinking about as a question. Clearly, we have, not that
5 participations are new to the Federal Home Loan Banks, they
6 aren't, but we may have a level of participating in each
7 other's assets which is significantly greater than we had in
8 the past, and there's some stress between the movement of
9 those assets and the historically conceived capital rules,
10 which really don't anticipate that as a question.

11 MR. O'NEILL: Okay, as far as 10, first to the
12 staff, am I correct in stating that the staff is still
13 looking into this request to change at least the 95 percent
14 MVE requirement, and if that's the case, how long before you
15 might come to a recommendation on the issue?

16 MR. SMITH: Yes, staff is still looking into this
17 issue and we're attempting to go through what might be
18 described as a dry run to test the implementation of this.
19 At the same time, we understand that the Banks have
20 contracted with a consultant, who is pursuing along similar
21 lines and it's, in our preliminary discussions we expect to
22 have access to that discussion between the Banks and the
23 consultant and to listen in to hear what's going on, as
24 we're all interested in learning to try to make this a
25 better rule.

1 MR. O'NEILL: And for the Bank presidents?

2 MR. ROY: We've been at work with the Net Risk
3 organization in working through modeling to kind of get at
4 this issue, Tim. I don't know off the top of my head which
5 date that Net Risk is supposed to complete their work, but
6 it's fairly soon. A matter of weeks, I would think, a few
7 weeks, at which point, we'd get back to the staff with our
8 findings.

9 MR. CHRISTMAN: Yes, you know, you mentioned the
10 market value and the 95-percent issue but, you know, the
11 operating risk charge, the methodology for creating, for
12 calculating market risk, I mean there are, Alex mentioned a
13 couple of issues around credit risk earlier. There are
14 multiple, I just want to make sure.

15 MR. APGAR: We just don't focus on that one.

16 MR. CHRISTMAN: Yeah, there are multiple issues
17 under the umbrella of risk-based capital that need to be
18 examined, and to me, this is the biggest single area that
19 needs work in the whole regulation over the next period of
20 weeks and months.

21 MR. APGAR: Okay. Very good.

22 MR. POLLOCK: May I just make a comment?

23 MR. O'NEILL: Yes.

24 MR. POLLOCK: I certainly agree with Mr. Christman
25 that the market risk or the risk-based capital also requires

1 work. My own view of the 95 percent is this is another
2 requirement which should be simply eliminated. When you,
3 the entire exercise or effort of doing a market risk,
4 risk-based capital calculation is through a cash-flow
5 scenario which is subject to stresses, which is, I think, a
6 superior method, or through a mark to market, which I think
7 is an inferior, but either way, you're estimating fairly
8 unlikely scenarios and putting up enough capital to protect
9 against them.

10 Well, if you now say in addition to that we have
11 this 95-percent rule, what you have now done is double
12 counted the down scenario, which has now happened which
13 you've already provided capital to cover. Now, let's say
14 it's happened and you're at 95 percent. Now, we're going to
15 double up the capital, which seems to me simply incorrect.
16 So this is one I would say should just be eliminated as one
17 of the fixes on the risk-based capital requirements.

18 MR. O'NEILL: Now, on the accounting and FAS
19 issues, did I hear the staff right that you think that these
20 are outside of this discussion? And what do you mean by
21 that?

22 MR. SMITH: Well, if I may speak here, but all we
23 mean by it, these are issues that would not have to be dealt
24 with right away, the FASB 133 goes into effect next year,
25 correct?

1 MR. LEWIS: That's correct.

2 MR. SMITH: And these are issues that affect the
3 balance sheet whether we're under the current capital
4 structure or a new capital structure, so in that sense,
5 those discussions are occurring and we're trying to deal
6 with a new regime is under way and it's not really going to
7 be affected one way or the other by this capital rule.

8 MR. LEWIS: That's correct. And that standard is,
9 this item has actually been on the agenda for a couple of
10 months now. We've worked, I think adding it here just
11 heightens the awareness of the fact that there are a number
12 of accounting-related issues that dovetail with the
13 regulatory issues.

14 MR. O'NEILL: Okay. And as to the one issue that
15 was not on your top 10 list but was on the Federal Home Loan
16 Bank presidents conference list, and that was number 10, and
17 again, I guess to Neil first, I understand that there might
18 be a statutory problem that exists with Section 608 of
19 Gramm-Leach-Bliley, which is perceived as having a potential
20 for an open-ended capital stock assessment to be imposed
21 upon the members. And I know that Alex Pollock brought this
22 up earlier. What is the statutory problem in this one?

23 MR. CROWLEY: I think it's the language of the
24 statute that requires the Banks to monitor their capital
25 levels and to monitor their stock purchase requirements as

1 set forth in the capital plans and make certain that they're
2 sufficient to fly with the risk-based capital requirements.

3 To the extent that there's a problem or a shortfall, they
4 can adjust those stock purchase requirements. They're
5 required to adjust those stock purchase requirements.

6 And the statute says that the member shall comply
7 promptly with any stock purchase requirement. That's
8 adjusted under that provision. The difficulty that you
9 have, I mean, the member is put to the choice of saying no
10 thank you, I'd like to withdraw my membership, or buying the
11 additional capital, but that's in the statute, that's not in
12 the regulation.

13 MR. ROY: And that is a problem.

14 MR. CROWLEY: We cannot change that in this
15 rulemaking.

16 MR. O'NEILL: So you agree that there is a problem
17 in Gramm-Leach-Bliley. In your combined wisdom, have you
18 come up with any innovative way of getting around that
19 statutory problem?

20 MR. CHRISTMAN: Well, one approach that we talked
21 about within our Bank would be simply to deal with it. I
22 mean these are issues that will be dealt with by each Bank
23 as necessary and would require an amendment to the capital
24 plan, presumably. And so the Finance Board could simply in
25 regulation perhaps suggest a process by which any additional

1 stock requirement should be determined by an individual
2 Bank's Board of directors. In other words, have the
3 regulation deal with the process in very general terms, by
4 which individual Banks would have to deal with this, which
5 in turn would require an amendment to the capital plan,
6 which I believe would have to then be approved by the
7 Finance Board anyway.

8 So let's not get into micromanaging with specific
9 regulations that, you know, get too anticipatory in
10 speculating as to how this might occur but just suggest a
11 process by which it would occur, which should in turn
12 alleviate any, if there are any members who are going to pay
13 attention to this in the first place, then that should
14 alleviate their concerns.

15 MR. POLLOCK: If I may, I have a somewhat
16 different view of that. I don't think there's any way to
17 alleviate the concern, at least as a risk matter. As Mr.
18 Crowley rightly said, there's the statutory language, and it
19 seems to me, at least, very clear statutory language. So I
20 think the only clear thought I have is it better be a good
21 disclosure in the offering memorandum.

22 MR. LEWIS: I just feel like maybe the silver
23 lining, if there is any for this issue is, as I mentioned
24 earlier, that it could be an important consideration in the
25 decision on liability versus equity, because if in fact the

1 continual reevaluation of purchase requirements would say
2 that, therefore, the Banks, at least to that extent were not
3 required to redeem, let's say if it was, if a redemption was
4 coincident in such a reevaluation, you know, depending on
5 how strictly that language that we saw is meant to be by the
6 FASB and whether it survives to the end document, it could
7 be an important element of this whole discussion. Just a
8 thought.

9 MR. O'NEILL: Thank you for letting me get all my
10 questions out.

11 MR. APGAR: Okay. Anyone have any other
12 questions? We've kept our guests a very long time and we
13 appreciate all their hard work and we know there's other
14 folks here who have been sitting here listening attentively
15 for a long time, and I'm sure they'll e-mail us and write us
16 all the other things that they would have said if they had
17 been sitting up front here. Yes?

18 MR. POLLOCK: May I make one final statement, Mr.
19 Chairman?

20 MR. APGAR: Sure.

21 MR. POLLOCK: If I could have the microphone. For
22 the record, nothing I have said here should be construed as
23 a capital plan of the Federal Home Loan Bank of Chicago.
24 There is no such plan, there are a lot of ideas in
25 discussion, there is no plan.

1 MR. APGAR: These are just capital musings.

2 MR. POLLOCK: Capital musings.

3 MR. APGAR: Yes.

4 MR. POLLOCK: By the management.

5 MR. APGAR: Yes.

6 MR. POLLOCK: Not a capital plan of the Bank. I
7 imagine that's true of my colleagues as well.

8 MR. APGAR: But we all appreciate you sharing your
9 thinking, knowing that you're all in the preliminary phase
10 of working through these kinds of things.

11 MR. ROY: And I think we should say on the record
12 as well, and I think I can speak for my colleagues, that the
13 staff and the Board deserve a lot of thanks and kudos for
14 the work that's already been done. It's, I think it's
15 progressive, it's positive, it's thoughtful, it's in the
16 right direction, and we really appreciate the spirit that
17 we've experienced here and in recent weeks of working
18 together to come up with a regulation that's going to serve
19 the System well in years to come, so I just wanted to get
20 that on the record as a word of appreciation to all of you.
21 Thanks. Thanks a lot.

22 MR. APGAR: Sure. The staff appreciates that
23 they're a good group people working hard on this. Okay.
24 Any final comments, Jim?

25 MR. BOTHWELL: No. Just, Mr. Chairman, you did

1 move at the beginning of the meeting to add to the agenda
2 item.

3 MR. APGAR: Right. If you move to this second
4 item on the agenda as amended, it's a consideration of a
5 recommendation to extend the comment period of the proposed
6 capital rule, and Jim and Neil will present the staff
7 recommendation on this matter.

8 MR. BOTHWELL: Well, this will be easy for me, so
9 I'll just ask Neil.

10 MR. CROWLEY: I'll briefly summarize it, and I
11 don't think it will take three hours to discuss. This item
12 relates to the outstanding rule, and as you're well aware,
13 Gramm-Leach required us to issue final rules no later than
14 one year post enactment, which is November 12th. And on May
15 22nd of this year, we issued a proposed rule, the comment
16 period of which is scheduled to close on October 11th of
17 this year. We have received in recent weeks a fair number
18 of requests that we extend the period for receiving
19 comments.

20 There's been no real uniformity as to the length
21 of time suggested, but lots of folks have suggested that we
22 need additional time, especially to resolve the tax
23 accounting and regulatory capital treatment of the new
24 stock. It appears clear, both today and from other
25 discussions we've had, however, that definitive guidance on

1 any of those issues is not apt to come, however long we
2 extend the proposed rule, or the comment period, but staff
3 believes there is some good reason to extend the period to
4 allow people, especially the Banks and their members to
5 consider the rule and to give us some meaningful comments.

6 And so toward that end, we are proposing to extend
7 the comment period to November 20th, which is an additional
8 40 days beyond the 90-day comment period as initially
9 contemplated. This means, obviously, that we will not be
10 able to comply with the statutory mandate to have the final
11 rules in place by November 12th, but staff has discussed
12 with House and Senate Banking staff our proposal to extend
13 the comment period to November 20th, and we have received no
14 objection from House and Senate Banking staff on that issue.

15 MR. APGAR: Very good. I have to concede that the
16 central issue in our deliberation was who worked
17 Thanksgiving weekend, but again, with the idea that we're in
18 this dilemma until we actually move ahead with the final
19 rule, until final decisions of the plan can be made, we
20 can't resolve this. It struck me that this was time enough
21 to let people who have good processes going on continue to
22 reach out to the members and finalize their comment.
23 Recognizing the fact that this will be a work in progress
24 even after we issue our final rule, and you're working on
25 the details of your capital plan, and we're, I know I speak

1 for myself and for Franz, I recognize the fact that as
2 issues emerge down the road, of course we'll have to be
3 prepared to continue to consider and make the rule, final
4 rule workable, a balance of flexibility but needs the broad
5 needs of the System. And so we think that this will be
6 enough time to get us to that first stage of getting the
7 comments in so we can prepare a final rule.

8 MR. O'NEILL: Could I at this point offer an
9 amendment to the staff proposal?

10 MR. APGAR: You may.

11 MR. O'NEILL: I have talked privately to Bill and
12 Franz about this, and my amendment would extend the comment
13 period from November 20th until April the 12th, which is six
14 months from its current period. And let me just say briefly
15 why I still think that it's necessary for it to be six
16 months rather than an extra 40 days. I think when we talk
17 about this, the staff has done great work. Obviously
18 PricewaterhouseCoopers has done great work. Obviously the
19 12 Banks, both the management and the Boards of directors
20 have done great work.

21 But as we saw during the ACB roundtable, the other
22 main player in this are the 7,500 members of the System, and
23 I think it was either Alex or J. Roy who said that as far as
24 the membership is concerned at this point, basically the
25 stance is one of confusion. And I think first that, and

1 obviously Franz, this was before you came to the Board, but
2 I think that what we put out as a proposed rule was a very
3 good rule, a very expansive rule and one that I'm
4 tremendously proud of. And I think that if we give the
5 membership the time to look at this, that the membership
6 would agree with the staff and the Banks and the Board of
7 directors that this is a good thing and they should fully
8 embrace this.

9 The problem I have is if you cut things off
10 prematurely, there might be a sense among the membership
11 that we're trying to pull some kind of fast one, which, as
12 we all recognize here, is not the case, but that might be
13 the way it's viewed by the membership. And there are three
14 things that have happened since Gramm-Leach-Bliley that
15 neither the Congress nor the Finance Board, at least this
16 Board member, thought of when we, Gramm-Leach-Bliley came up
17 with that one-year time frame.

18 First, the Board member that was the most
19 conversant with the capital plan, Chairman Morrison,
20 resigned. Secondly, for a while it was only Commissioner
21 Apgar and myself, so we couldn't move forward because we
22 didn't even have a quorum. And now, Franz, the third thing,
23 you are now here and I know that you're up to the task of
24 getting up to speed quickly on all of this, but to me, this
25 is an incredibly complex matter and I don't think anybody

1 would think less of you, giving you a little extra time to
2 come up to speed on all the issues.

3 So those are the three things that were not
4 anticipated by the Congress when it came up with that
5 one-year time frame. There are two other things that were
6 thought of that I think additionally should recommend
7 caution. First, not only is this incredibly complex, but as
8 some people say, this \$30 billion recapitalization dwarfs
9 any initial public offering that's been out in the U.S.
10 economy to date. So that urges caution.

11 The last thing is that this really goes beyond
12 safety and soundness to whether the Federal Home Loan Bank
13 System will exist in the future or not. So I applaud the
14 staff and you, Mr. Apgar, for the 40 days extension, but I
15 hope that maybe I could have convinced one of the two of you
16 during this presentation to go with a larger extension.

17 And if the answer is that I have not convinced you
18 here, I will continue working on you every day to see if I
19 can convince you, because I think that this is something
20 that none of us want to delay. And I certainly don't want
21 to delay this myself. But I think this is something that we
22 should do right on the front end, just so you know what my
23 amendment is about.

24 My amendment is to extend the comment period for
25 six months until April 12th, and then to compress the

1 three-year transition period into two and a half years so
2 that the overall level for the entire process is exactly the
3 same, we just end up having an additional six months for
4 comments. So that is my amendment, and I would be happy for
5 either of your comments.

6 MR. BOTHWELL: Can I make one comment. As I read
7 the statute, the three years is in the statute, so you can't
8 really compress that transition period.

9 MR. APGAR: Right. But the spirit of this is that
10 after the rule is finalized, there's a 270-day time frame
11 for producing the capital plans and that we would still be
12 the expectation that the transition would be done by the
13 total three-year period, so I understand the meaning of his
14 proposed extension.

15 MR. LEICHTER: Tim, let me say you've certainly
16 made a forceful presentation and I appreciate the
17 consideration you've shown me, but I certainly don't want it
18 to be said that Franz Leichter was such a slow learner that
19 he had to hold up the capital plan for this System. I think
20 there are sound reasons that we need to move ahead. I think
21 there's also sound reasons for allowing a reasonable delay,
22 and I think the 40 days certainly provides that.

23 I think what we really need to do is to fine tune
24 and refine some of these prototypes, and I'm really very
25 impressed by the work that the Banks have done, the

1 presentation made here by the president certainly gives me
2 confidence that I think within this deadline, people are
3 going to be able to come up with their comments and that the
4 staff will then consider it and the Board will consider it.

5 And I think, as Chairman Apgar has said, and certainly that
6 expresses my view and I think your view too, that this Board
7 is going to continue to be very responsive to the concerns
8 and considerations that are raised by the Banks, and that
9 we're going to work together on this.

10 I mean in a certain sense like the old revival
11 song, we're in the same boat together and if you rock one
12 end, you're going to rock the other, so I think we all have
13 the same commitment to the viability of what is an excellent
14 System and I think that will continue and I think working
15 together in this timetable I think we're going to be able to
16 do this.

17 MR. APGAR: We have talked at length on this
18 matter. I just want to restate what I've said to you is
19 we're not going to let the time frames get in the way of
20 issuing a rule that will work for the System, that balances
21 these issues of flexibility and commonality, and at the end
22 of the day, we'll know in 40 days whether or not we've got
23 sufficient comments and be able to move ahead or not. But
24 my sense is we need to give a little bit of an extension to
25 get folks time to finish their round of work now, a deadline

1 that's not too far out so that they understand the urgency
2 of moving forward, and then shift the ball squarely to our
3 court till we decide whether or not, how much time it's
4 going to take us as a staff and Board to come up with what
5 is the response to what I think are a wide range of
6 questions that we heard and will continue to hear over the
7 next 40 days.

8 So I'm clearly in favor of working to get a good
9 rule and I don't perceive there's anything about this time
10 frame that will prohibit us from exercising our
11 responsibility.

12 MR. O'NEILL: Well, I thought I heard that you
13 were still open as you saw as the comment date closed.

14 MR. APGAR: What I meant to say is the relevant
15 issue is not when we hear all the comments, but how long it
16 takes us to come up with a response to those comments, and
17 so we clearly have to articulate how, we have to know what
18 the list is for us to judge the work that we do. That's why
19 I've been insistent that the members and the staff, you
20 know, not wait till the comments are in, but start. And so
21 it's not as if we're talking about, they've been at work at
22 this now, you know, hard for several months.

23 I anticipate they'll be at work hard for several
24 more months, and we hope to, by this extension, increase the
25 quality and range of insightful comments we can get to help

1 us finalize our work.

2 MR. O'NEILL: Well, what happens if we go with the
3 40 days? As I think I know now that I have not convinced
4 either of you yet. What if we go the additional 40 days and
5 we get to the time to shut it down and we still don't have
6 that many comments from the members of the System? What
7 would be your view at that point?

8 MR. APGAR: Well, first of all, we've heard the
9 Bank presidents talk about their aggressive plans to go out
10 and seek members' comments. Ultimately, the members are
11 their Board of directors and they're responsible to their
12 members. Any plan they formulate has to be in consultation
13 with the members. And so I perceive that we'll have ample
14 member input, and certainly we're doing everything possible
15 to do that through meetings with the, with the various
16 groups, ICBA, ACB, ABA, all the other groups.

17 So I believe we'll have ample opportunity here
18 from the members both through the Banks and their Board of
19 directors plus directly in communication with them.

20 MR. O'NEILL: I'm happy that you mentioned the
21 ABA. While I was in my bed, I saw that the ABA wrote a
22 letter to you signed by Ed Yingling asking for an extension.
23 I guess if I could, I would ask that that be part of the
24 record of this after my remarks, just have the letter part
25 of the record.

1 MR. APGAR: I believe this letter was written the
2 day of, if not before, the day we met with the ABA and had a
3 very good meeting clarifying many misperceptions that were
4 among their, relative to these, understanding the rules, so
5 I think we did a long way of addressing those concerns, but
6 obviously we need to continue to work with all the groups
7 that reflect.

8 MR. O'NEILL: If you could just put this letter in
9 the record after my remarks. Well, I guess we'll come to a
10 vote on my amendment.

11 MR. APGAR: Okay. So the motion is to amend the
12 proposal to extend it as was outlined by Director O'Neill.
13 All in favor.

14 MR. O'NEILL: Aye.

15 MR. APGAR: All opposed.

16 MR. LEICHTER: Nay.

17 MR. APGAR: No. Okay, that amendment fails. I
18 think we should vote on the motion itself, which is as
19 articulated by the staff to extend the comment period for
20 the, until November the 20th. All in favor of that final
21 motion.

22 (There was a chorus of ayes.)

23 MR. APGAR: Okay. So we're, we'll extend the rule
24 for, until November the 20th. I hesitate to use the word 40
25 days, noticing the rain outside. We don't want to

1 inadvertently start something here. But let me, let me
2 assure you, and I know Tim shares these views, and Franz,
3 that we're working in a very complex situation. We think
4 it's important to move this process along but to do it in a
5 way that provides ample opportunity for comments.

6 We know that whatever we do in terms of finalizing
7 the rule will only be final to the extent to which we incur
8 some unanticipated consequence down the line that will
9 require further Board deliberation, and I assure you that as
10 long as I'm here we'll continue to listen to make sure that
11 even after we promulgate a final rule on these matters,
12 we're attentive to all the implementation issues to make
13 sure that this works for the benefit of the members, the
14 Banks and the overall System. So with that, the meeting's
15 adjourned.

16 (Whereupon, at 5:13 p.m., the hearing in the
17 above-entitled matter was adjourned.)

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REPORTER'S CERTIFICATE1
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DOCKET NO.: N/A
CASE TITLE: FHFB Board Meeting
HEARING DATE: September 19, 2000
LOCATION: Washington, D.C.

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 Federal Housing Finance Board.

Date: September 19, 2000

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