Federal
Home Loan Bank
of Chicago

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VIA FEDERAL EXPRESS

Ms. Elaine L. Baker
Secretary to the Board
Federal Housing Finance Board
1777 F Street, N.W.
Washington, D.C. 20006

Dear Ms. Baker:

This letter responds to Chairman Korsmo's request on December 20, 2002 for comments by the Federal Home Loan Banks ("FHLB") on the ongoing changes in the financial services industry and the related corporate forms chosen by depository institutions belonging to the Federal Home Loan Bank System. The Federal Home Loan Bank of Chicago ("Bank") welcomes the opportunity to comment on this important topic.

The Bank believes that when a FHLB member institution is acquired and consolidated with another FHLB member institution from a different FHLB district, the merged institution should be permitted to retain its memberships in both FHLBs. In such a case, each institution has previously become a member consistent with Section 4 of the Federal Home Loan Bank Act ("Bank Act"), which is a gateway provision. Nothing in the Bank Act prohibits continuation of these memberships after a merger.

Mergers of financial institutions continue to proceed at a rapid pace, stimulated by the Gramm-Leach-Bliley Act of 1999, the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, and technological advances. The Congress has enacted a series of laws to remove previous geographic restrictions which inhibited competition in financial services. The Bank believes that, consistent with this clear Congressional goal, the former geographic legal and regulatory barriers which previously characterized the American banking system have largely disappeared.

Increasingly, FHLB members are consolidating across FHLB districts. This fact creates a membership issue only because a Federal Housing Finance Board ("FHFB") regulation requires that, upon the completion of the merger, the acquired institution's membership in its FHLB terminates. This regulation, whatever its original intent, now threatens the balance and structural logic of the FHLB System, which is based on a regional FHLB assisting housing finance in the communities in its region.

The Bank Act does not prohibit an institution from retaining membership in two FHLB's following an acquisition. Section 6(d) of the Bank Act outlines the termination of membership by an institution and provides for voluntary and involuntary withdrawal by a member from a FHLB. The merger of two institutions does not trigger either the voluntary or involuntary withdrawal sections. Voluntary withdrawal requires notice by the member to the FHLB. Involuntary withdrawal is triggered if the board of directors of a FHLB determines that a member (a) has failed to comply with a provision of the Bank Act or FHFB regulation; or (b) is insolvent or is subject to the appointment of a conservator or receiver. Upon the determination that a member has met one of these two requirements for involuntary withdrawal, the member must surrender its stock upon the expiration of the applicable notice period. There is no mention in the Bank Act of merger as a reason for termination of membership.

Section 925.24 of the FHFB regulations addresses consolidation of members. Subsection (b) states that "upon the consolidation of two member institutions which are members of different FHLB's into one institution operating under the charter of one of the consolidating institutions, the disappearing institution's membership terminates upon the cancellation of its charter." The Bank Act does not expressly prohibit an institution from maintaining membership in two FHLB's, but Section 925.24, implemented by the FHFB using its rulemaking authority, does. The FHFB has the power to amend its regulation based on the fundamental changes in conditions in the marketplace, which obviously have occurred, and preserve of the intent of the Bank Act to match housing finance activity in each district to its appropriate FHLB. In short, the FHFB can resolve this issue by revising its own regulation which causes the problem.

Generally, agencies are accorded broad discretion in exercising their rulemaking authority. In fact, the courts have routinely deferred to an agency's interpretation of its own statutes. Thus, the FHFB could amend its regulation regarding multiple FHLB memberships, reasoning that the current manifest trend toward consolidation in the financial industry across all the historical geographic FHLB districts necessitates this change.

While the Bank acknowledges that various operational issues are involved, the Bank believes that these issues are not difficult to address and therefore should not impede the FHFB's approval of multiple district membership in the case of the merger of two existing members.

When a FHLB member acquires an institution in another FHLB district and chooses to retain the disappearing institution's membership in that other FHLB, the consolidated member should be required to hold capital stock in both its FHLB as well as the disappearing institution's FHLB. The capital regulations require a member to hold capital stock in accordance with membership and activity formulas, notably reflecting outstanding advances and total mortgage assets. The Bank proposes that the amount of capital stock to be held by the consolidated member in the disappearing institution's FHLB be determined by a formula based on the percentage of the combined entity's mortgage assets contributed by each merging institution at the time of merger. A multiple district member would have to comply with the stock purchase requirements, both membership and activity-based, of each FHLB, as set forth in each FHLB's capital plan, to be a member of each FHLB. These percentages should be updated periodically; we would recommend not more frequently than annually, or less frequently than every two years.

Since the merged institution would be investing in the stock in both FHLBs, that institution should be entitled to vote in the directors' election and its officers eligible to become directors of both. Directors and officers of the combined entity should be eligible to serve as directors of either FHLB representing the members in the states that were the principal place of business of the entities prior to the merger. A multiple district member could have more than one officer or director run for, and if elected, serve on multiple FHLB boards; however, any given individual should not be allowed to serve on more than one FHLB board at a time.

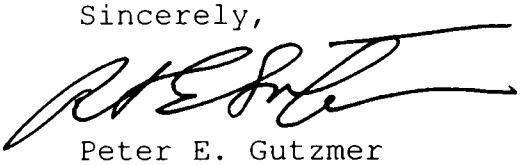
A multiple district member would be able to obtain advances from each FHLB in which it was a member. The FHLBs would enter into agreements that would ensure the proper collateralization of the outstanding advances. Currently, the FHLB System frequently has members with advances outstanding from two or more FHLB's, as the result of mergers and acquisitions. When this situation has occurred, the FHLB's involved have, by agreement, ensured that each FHLB is adequately collateralized. There is no reason why the FHLB's cannot continue this manner of cooperation.

FHLB operating activities, such as funds transfers, safekeeping, and deposit and check processing, would not be affected by allowing multiple FHLB memberships. Each member would be required to meet the requirements of the FHLB in which it holds a membership.

As can be seen, the operating issues are not particularly difficult and a satisfactory resolution to the issue of multiple FHLB membership can be readily achieved. However, the FHFB must take the first step in the process by revising Section 925.24 to allow a consolidating institution to continue the existing FHLB membership of the disappearing institution.

Thank you for the opportunity to comment on this matter. We would be pleased to provide any additional information which would be helpful.

Sincerely,



Peter E. Gutzmer
Senior Vice President,
General Counsel &
Corporate Secretary

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