

FEDERAL HOUSING FINANCE BOARD

OPEN BOARD MEETING

Wednesday, November 12, 2003

10:10 a.m.

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

MEMBERS PRESENT:

John T. Korsmo, Chairman
John C. Weicher
J. Timothy O'Neill
Franz S. Leichter
Allan I. Mendelowitz

PARTICIPATING STAFF:

Arnold Intrater
General Counsel

Mary H. Gottlieb
Board Secretary

Ellen Hancock
Joseph McKenzie
Thomas Hearn
Office of Supervision

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Capital Plan Amendment for the Federal
Home Loan Bank of Dallas.

Consideration of an amendment to the Dallas capital plan to include an identification process for shares of Class B stock that are subject to a members' stock redemption notice.

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Approval of the 2004 Administrative and
Non-Administrative Budget for the Financing
Corporation.

12 CFR Section 995.6(b) requires the Finance Board to approve the budget submitted by the Financing Corporation each year.

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P R O C E E D I N G S

CHAIRMAN KORSMO: This meeting of the Federal Housing Finance Board will please come to order. We have a very quick agenda, I think, today in anticipation of a much more protracted meeting perhaps in December.

Two items on our agenda. The first, item number 1, is a capital plan amendment for the Federal Home Loan Bank of Dallas. Is that you, Ellen?

MS. HANCOCK: Yes.

CHAIRMAN KORSMO: Miss Hancock?

MS. HANCOCK: Thank you, Mr. Chairman.

Good morning. The Finance Board approved the Federal Home Loan Bank of Dallas' capital plan on June 12, 2002. The Bank's approved plan authorizes an all-Class B stock structure.

On September 2nd of this year the Bank successfully converted to its new capital structure. On June 26th the Bank's Board of Directors considered and approved an amendment to the Bank's capital plan and submitted it to the Finance Board for approval. The Bank is proposing to amend the section of its capital plan that addresses redemption of capital stock. The section states that a member may request redemption of Class B stock by providing a written stock redemption notice indicating the

number of shares to be redeemed. The Bank is proposing to amend this section to require members submitting redemption notices to specify not only the number of shares of Class B stock to be redeemed but also the dates that the shares were issued to the member.

The amendment also provides that if the member fails to properly identify the shares, the member will be deemed to have requested redemption of the most recently issued shares that are not already subject to a pending redemption notice.

The Bank is making the proposed change to provide members with greater control of the potential tax consequences from the redemption of stock. Given that the Bank pays stock dividends, the amendment does not affect the capital or safety and soundness of the Bank.

The proposed amendment is consistent with Finance Board rules concerning redemption of stock. Among other things, these rules require the Bank to assure that no more than one redemption request for a particular share of stock is outstanding, but the regulations do not impose other criteria on how the Bank may identify shares for redemption.

The Finance Board has previously approved capital plans that require members to identify specific shares of

stock to be redeemed and establish default procedures for identifying such shares if members fail to do so.

Based on the technical nature of this amendment, we find that the plan, as amended, remains consistent with the safe and sound operation of the Bank and should provide for adequate capital to support the Bank's business activities.

We'd be happy to answer any questions.

CHAIRMAN KORSMO: Thank you. Are there any questions either for Ms. Hancock or for Mr. Hearn? Questions? Director Mendelowitz.

DIRECTOR MENDELOWITZ: I just had a quick question about the circumstances of the conversion. Was some of the stock prior to conversion the result of stock dividends?

MS. HANCOCK: Yes, the Bank has paid stock dividends.

DIRECTOR MENDELOWITZ: Prior to conversion?

MS. HANCOCK: Yes, yes.

DIRECTOR MENDELOWITZ: And when they converted from the old capital structure to the new, was their new B stock classified as to whether it was, in fact, paid-in capital versus stock dividends?

MS. HANCOCK: Meaning the issuance of new Class B stock?

DIRECTOR MENDELOWITZ: Yes, does the new Class B stock have an average basis based on stock dividend versus paid-in or, in fact, is the new B stock segregated in a way where a certain amount is the result of paid-in capital and a certain amount is clearly identified as the result of prior stock dividends; that is, stock dividends before conversion?

CHAIRMAN KORSMO: So that the amendment only really applies prospectively, rather than--

DIRECTOR MENDELOWITZ: Right, exactly, exactly.

MS. HANCOCK: Do you have any comment on that?

MR. HEARN: I don't know.

MS. HANCOCK: I don't know but I can find out for you. I really don't know.

CHAIRMAN KORSMO: One would assume that at the time of conversion they traded old stock for new stock and all the basis was kicked up to the--oh I guess that's not necessarily true.

MR. HEARN: Director Mendelowitz, I think what your question gets at is what is the tax basis for--

MS. HANCOCK: The prior...

DIRECTOR MENDELOWITZ: Correct.

MR. HEARN: For stock that's been held for a long time prior to conversion and has many stock dividends, the basis would have dropped down.

CHAIRMAN KORSMO: Was conversion a taxable event?

MS. HANCOCK: No, no.

CHAIRMAN KORSMO: So that would suggest that it carries with it the old basis.

MS. HANCOCK: That would be my inclination, that it carries with it the basis, but I don't know that for sure but I will find out.

DIRECTOR MENDELOWITZ: Okay.

CHAIRMAN KORSMO: Any other questions?

DIRECTOR O'NEILL: I asked a version of this at the briefing. Of the 12 Banks, how many have said it's first-in, first-out versus those that would say last-in, first-out? And which of the plans? As Stephen Cross said some of them would be in the capital plan and some of them might be just other policies that are not the capital plans. Do you know?

MS. HANCOCK: Well, prior to the Dallas amendment--we know where Dallas is--there were five Banks that in their capital plans did address this issue and there are two Banks that have established as the default--they pretty much all say that the member needs to identify the specific

shares and then if the member does not identify the specific shares, then the Bank will identify the shares.

Two Banks have the first-in or the oldest stock would be what they would redeem and then three other Banks have the most recent stock would be the first to be redeemed, which is what Dallas has.

CHAIRMAN KORSMO: As a default position.

MS. HANCOCK: As only the default position.
Hopefully the member would do this.

CHAIRMAN KORSMO: That would defeat the tax consequence purpose of this.

MS. HANCOCK: Well, as I understand it, this is in order to provide Banks with the most flexibility in determining how they would like to handle it. The Banks that don't really address this are ones that pay cash dividends. I believe this is an issue for a stock dividend because if you pay a stock dividend, then you're going to affect the basis of your stock. So that would explain why not everybody has felt that they want to address it.

DIRECTOR O'NEILL: Thank you very much.

CHAIRMAN KORSMO: Any other questions?

If not, the chair would entertain a motion to approve the resolution amending the capital plan.

DIRECTOR O'NEILL: So moved.

CHAIRMAN KORSMO: Director O'Neill.

Any discussion of the motion? Any discussion of the motion? We've dragged this out as long as we possibly can.

If not, the secretary will please call the roll.

MS. GOTTLIEB: On the resolution amending the capital structure plan of the Federal Home Loan Bank of Dallas, Director Leichter, how do you vote?

DIRECTOR LEICHTER: Yes.

MS. GOTTLIEB: Director O'Neill?

DIRECTOR O'NEILL: Aye.

MS. GOTTLIEB: Director Mendelowitz?

DIRECTOR MENDELOWITZ: Yes.

MS. GOTTLIEB: Director Weicher?

DIRECTOR WEICHER: Aye.

MS. GOTTLIEB: Chairman Korsmo?

CHAIRMAN KORSMO: Aye. The motion has carried. The resolution amending the capital plan of the Federal Home Loan Bank of Dallas is approved.

Thank you, Ellen and Tom. Appreciate it.

Joe?

The second item on our agenda is approval of the 2004 administrative and non-administrative budget for the Financing Corporation. Dr. Joe McKenzie.

DR. MCKENZIE: Good morning, Mr. Chairman and members of the Board.

The Financing Corporation or FICO is a mixed-ownership government corporation chartered by the former Federal Home Loan Bank Board pursuant to the Federal Savings and Loan Insurance Corporation Recapitalization Act of 1987. The purpose of FICO was to function as a financing vehicle for FSLIC resolution funds.

Pursuant to the act, FICO issued approximately \$8.2 billion of long-term obligations. FICO sold these obligations in the public capital markets. It also issued stock to the Federal Home Loan Banks. With the proceeds from the issuance of the stock, FICO purchased zero-coupon Treasury securities whose face value is expected to repay the FICO obligations at maturity.

FICO is subject to the general oversight of the Finance Board. Its day-to-day management is under the direction of a three-person Board of Directors, two Federal Home Loan Bank presidents selected by the Finance Board to one-year terms, and the managing director of the Office of Finance. FICO has no paid staff but relies on the Office of Finance for its staffing.

FICO pays interest on its bonds by assessing FDIC-insured banks and thrifts using a statutory formula. The

FDIC collects this assessment for FICO. FICO pays its administrative expenses by assessing the Federal Home Loan Banks.

Section 995.6(b) of the Finance Board's regulations requires FICO to submit its annual budget to the Finance Board for approval following approval by the FICO director. FICO submits two categories of expenses for approval--administrative expenses, such as service contracts, legal fees, professional fees, and other operating expenses which are paid for through assessing the Federal Home Loan Banks, and non-administrative expenses, such as issuance costs, custodial fees, and FICO interest on the bonds. As I noted earlier, the interest is collected by the FDIC through quarterly assessments on insured depositories.

FICO transmitted its approved 2004 administrative and non-administrative budgets to the Finance Board on November 3rd. For 2004 FICO has requested the Finance Board approve an administrative budget of \$14,000 and a non-administrative budget, exclusive of the interest on the obligations, of \$5,000. This total budget request is the same as last year.

The FICO budget presents no unusual issues and we recommend its approval.

And lastly, I would just like to note that the interest on these bonds is \$793 million a year, so while we are presenting a \$19,000 budget for approval, there is a \$793 million statutory item that lies right behind this budget.

I'd be happy to answer any questions.

CHAIRMAN KORSMO: Dr. McKenzie, I think, as I recall looking at the numbers, they don't actually spend the \$19,000.

DR. MCKENZIE: No--they spend--last year--in 2003 they're projected to spend something around \$5,000.

CHAIRMAN KORSMO: And the assumption is that they don't assess it unless they spend it.

DR. MCKENZIE: That's correct.

CHAIRMAN KORSMO: So this just authorizes the expenditure should it be necessary or the assessment should be necessary.

DR. MCKENZIE: The largest budget item is contingencies for legal fees, should they need to seek an opinion of bond counsel or something of that nature.

CHAIRMAN KORSMO: Any other questions of Dr. McKenzie? Any other questions?

Seeing none, is there a motion to approve the budget for the Financing Corporation?

DIRECTOR WEICHER: So moved.

CHAIRMAN KORSMO: Dr. Weicher has moved. Is there any discussion on the motion? Any discussion on the motion?

Hearing none, the secretary will please call the roll.

MS. GOTTLIEB: On the approval of the 2004 administrative and non-administrative budget for the Financing Corporation, Director Leichter, how do you vote?

DIRECTOR LEICHTER: Yes.

MS. GOTTLIEB: Director O'Neill?

DIRECTOR O'NEILL: Aye.

MS. GOTTLIEB: Director Mendelowitz?

DIRECTOR MENDELOWITZ: Yes.

CHAIRMAN KORSMO: Director Weicher?

DIRECTOR WEICHER: Aye.

MS. GOTTLIEB: Chairman Korsmo?

CHAIRMAN KORSMO: Yes. The motion is carried and the budget is adopted.

Are there any other items to come before the Board? Any other items to come before the Board?

Seeing none, thank you for your patience and this meeting is adjourned.

[Whereupon, at 10:18 a.m., the meeting was adjourned.]