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FEDERAL HOUSING FINANCE BOARD MEETING

OPEN SESSION

Wednesday, October 11, 2006

ANDERSON COURT REPORTING
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1 P R O C E E D I N G S

2 (10:00 a.m.)

3 CHAIRMAN ROSENFELD: Good morning,
4 everyone. I call this meeting of the Board of
5 Directors of the Federal Housing Finance Board to
6 order. Today we will have an opening session
7 followed immediately by a closed session where the
8 Board will receive updates of examination and
9 supervisory findings. We need to now vote to
10 approve the closing the latter portion of today's
11 meeting as required by the Sunshine Act and
12 Finance Board regulations. Since the closed
13 portion of today's meeting will contain sensitive
14 and confidential banking examination and
15 information, I would ask for a motion to seal the
16 transcript of this portion of the meeting.

17 Director Mendelowitz?

18 DIRECTOR MENDELOWITZ: Mr. Chairman, I
19 move to close the portion of today's MEETING at
20 which we will receive updates of examination and
21 supervisory findings, and further, that we
22 determine that the record and transcript of this

1 closed position of the meeting be kept
2 confidential.

3 CHAIRMAN ROSENFELD: Thank you for the
4 motion. Is there any discussion on the motion?
5 Do I have a second?

6 DIRECTOR BACINO: Second.

7 CHAIRMAN ROSENFELD: Thank you. Who
8 said that?

9 DIRECTOR BACINO: I did.

10 CHAIRMAN ROSENFELD: Thank you, Director
11 Bacino. The secretary will please call the roll
12 on the motion.

13 MS. WILLIS: On the item before the
14 Board, Director Bacino, how do you vote?

15 DIRECTOR BACINO: Yes.

16 MS. WILLIS: Director Castaneda?

17 DIRECTOR CASTANEDA: Yes.

18 MS. WILLIS: Director Mendelowitz?

19 DIRECTOR MENDELOWITZ: Yes.

20 MS. WILLIS: Director Montgomery?

21 DIRECTOR MONTGOMERY: Yes.

22 MS. WILLIS: Chairman Rosenfeld?

1 CHAIRMAN ROSENFELD: Yes.

2 The motion is carried, and the
3 subsequent portion of our meeting will be closed
4 and the transcript will remain closed and
5 confidential. Thank you. Let us now turn to the public
6 portion of today's meeting. The first item is the
7 appointment of two Federal Home Loan Bank
8 presidents who serve on the Financing Corporation
9 Directorate. Who will be making the staff
10 presentation?

11 MS. SWEENEY: This morning we are asking
12 the Board to consider the appointment of two
13 Federal Home Loan Bank presidents to serve on the
14 Financing Corporation Directorate for a term of
15 office starting November 10, 2006. The FICO
16 Directorate is composed of three members, the
17 Managing Director of the Office of Finance, and
18 two members who are selected by the Finance Board
19 from among the Bank presidents. The term of
20 office of the two directors currently serving on
21 FICO, Martin Heger and Michael Jessee, expire on
22 November 9th. We are recommending the appointment

1 of Pittsburgh Bank president John R. Price and
2 Topeka Bank president Andrew J. Jetter to succeed
3 these appointments.

4 For a little bit of background on FICO,
5 it is a mixed-ownership tax-exempt corporation
6 chartered by the former Federal Home Loan Bank
7 Board pursuant to the FSLIC Recapitalization Act.
8 The purpose of FICO was to function as a financing
9 vehicle for the FSLIC Resolution Trust Fund.
10 FICO was subject to the general oversight and
11 direction of the Finance Board. The operation of
12 FICO is under the management of the three-member
13 board designated at the FICO Directorate. The
14 primary function of FICO is to serve debt on the
15 bonds that were issued resulting from the savings
16 and loan bailout. No additional bonds have been
17 issued since 1989. Effective in 1991, the FICO's
18 ability to issue new debt was also terminated.
19 Outstanding FICO bonds which are 30 year
20 noncallable bonds with a principal amount of approximately
21 \$8.1 billion mature in 2017 through 2019. The annual
22 interest payments on the bonds is approximately

1 \$793 million. FICO has assessment authority to
2 collect from the FDIC insured institutions
3 sufficient to pay interest on the FICO bonds. The
4 FDIC acts as the collection agent for FICO. Each
5 Bank president is appointed for a 1-year term, and
6 no Bank president may be appointed for an
7 additional term until each of the other Bank
8 presidents has served.

9 Since 1987, we have gone through three
10 rotation cycles, and we are now at the top of the
11 fourth cycle. It actually started last year with
12 the appointment of Mr. Heger and Mr. Jessee. I
13 have drafted a proposed sequence for the balance
14 of the rotation cycle which is in your Board
15 package. The guiding priority in composing this
16 rotation sequence was to avoid primarily the
17 overlapping appointments with the Resolution
18 Funding Corporate Directorate, RefCorp, and the
19 Office of Finance Board of Directors whenever
20 possible. This recommendation is in compliance
21 with the statutory requirement that no Bank
22 president be appointed for an additional term

1 until each president has served as many term.

2 I can answer questions about the
3 functions of FICO, how often they meet and those
4 kinds of things, if you have those questions.
5 Otherwise, I have completed my presentation and
6 ask the Board for an action.

7 CHAIRMAN ROSENFELD: Thank you. Do any
8 Board members wish to comment or have questions? Pat, you
9 really wowed them. Thank you. If there is nothing else, I
10 will accept a motion to approve the resolution.

11 DIRECTOR MENDELOWITZ: I so move.

12 CHAIRMAN ROSENFELD: Do I have a second?

13 DIRECTOR BACINO: Second.

14 CHAIRMAN ROSENFELD: Thank you, Director
15 Bacino. Will the secretary please call the roll?

16 MS. WILLIS: On the item before the
17 Board, Director Bacino, how do you vote?

18 DIRECTOR BACINO: Yes.

19 MS. WILLIS: Director Castaneda?

20 DIRECTOR CASTANEDA: Yes.

21 MS. WILLIS: Director Mendelowitz?

22 DIRECTOR MENDELOWITZ: Yes.

1 MS. WILLIS: Director Montgomery?

2 DIRECTOR MONTGOMERY: Yes.

3 MS. WILLIS: Chairman Rosenfeld?

4 CHAIRMAN ROSENFELD: Yes. The motion is
5 adopted.

6 The second is an interim final rule,
7 enhancing protection for personally identifiable
8 information. Who will be making the staff
9 presentation?

10 MS. KAYE: I will, Janice Kaye, in my
11 role as the Privacy Act official, and David Lee in
12 his role as the Chief Privacy Officer for the Agency.
13 What we have done is in light of the depth of
14 sensitive personal information from various
15 government agencies and the fact that the
16 Department of Veterans Affairs was widely
17 publicized, the Office of Management and Budget
18 issued a memo asking agencies to review their
19 policies and processes for protecting personally
20 identifiable information which includes things
21 like home addresses, phone numbers and Social
22 Security numbers. As a result of that review, the

1 agency has already taken a couple of actions
2 including adding authentication and data
3 encryption to the agency's computer network, and
4 beginning this month, the Office of Management
5 will begin issuing new IDs based on government-wide
6 standards for federal employee IDs that have
7 additional verification information like an
8 employee's date of birth or a fingerprint. The
9 next steps in enhancing the protection of this
10 kind of information is to do an update to our
11 Privacy Act rule which is what is before the Board
12 today. We have looked at the rule issued by the
13 Department of Justice and made conforming changes
14 to our rule that are designed to enhance
15 protections for personally identifiable
16 information. The primary changes would add three
17 new sections. One concerning the physical and
18 administrative security of privacy protected
19 information. The second concerning the use and
20 collection of Social Security numbers. The third
21 is a new section that would lay out of the
22 responsibilities of employees under the Privacy

1 Act, which generally include properly safeguarding
2 the information and only accessing information
3 that you have a need to use in the course of your
4 official duties. And we are also making some
5 conforming changes, changing the office address
6 and those types of things, because the last update
7 to the rule was in 2003.

8 In conjunction with the changes of the
9 rule, we are also planning to update our Privacy
10 Act system of records. Under the Privacy Act,
11 every agency has to publish what are called
12 systems of records that describe the type of
13 Privacy Act protected information that the agency
14 collects and uses and it details what we collect
15 and how we use it. We are updating those records
16 to include things like the new office address and
17 making a couple of substantive changes. We are
18 including several new routine uses that the Office
19 of Inspector General asked us to include. A
20 routine use is a use that we publicize that we
21 need not to back to the person that the
22 information is about before using the information

1 for those purposes. We are adding two new
2 systems, one to cover exam work papers. We have
3 learned through our audit of privacy practices at
4 the agency that AHP examiners use and collect
5 personally identifiable information and they audit
6 AHP work at the Banks and that information may
7 include borrower names, incomes and addresses. We
8 are also adding a new system to cover the new ID
9 cards which will include personally identifiable
10 information. Once we have done those two things,
11 the last thing will be to send notice to employees
12 about their responsibilities under the Privacy
13 Act, which we plan to do annually.

14 Does anybody has any questions for
15 either David or me?

16 DIRECTOR MONTGOMERY: The IDs, that is
17 conjunction with the HSPD 12?

18 MS. KAYE: Yes.

19 CHAIRMAN ROSENFELD: Our addresses and
20 phone numbers and so on, is that protected?

21 MS. KAYE: Your home address and phone
22 number are, but your office number --

1 CHAIRMAN ROSENFELD: Why shouldn't your
2 home address be public?

3 MS. KAYE: For the purpose that we
4 collect it, that the government collects it, it is
5 not considered public information. We collect it
6 in order to pay you, in order to know where to
7 contact you, but it is not considered public
8 information.

9 DIRECTOR BACINO: I have one question.
10 When you talked about the encryption devices, we
11 have already implemented this, right?

12 MS. KAYE: That's correct.

13 MR. LEE: Yes, we have.

14 CHAIRMAN ROSENFELD: David, in light of
15 your ascendancy to this new position that you are
16 holding, did you get a raise?

17 MR. LEE: Absolutely.

18 CHAIRMAN ROSENFELD: I know there is a
19 lot of responsibility associated with this
20 position. If there is nothing else, I will accept
21 motion to approve publication of the interim final rule and
22 to allow staff to make technical and conforming changes to the

1 rule. Will someone make a motion?

2 DIRECTOR MONTGOMERY: So moved.

3 CHAIRMAN ROSENFELD: Thank you. Do I
4 have a second? Geoff, you're so good at it.

5 DIRECTOR BACINO: Second.

6 CHAIRMAN ROSENFELD: Thank you, Director
7 Bacino. Will the secretary please call the roll?

8 MS. WILLIS: On the item before the
9 Board, Director Bacino, how do you vote?

10 DIRECTOR BACINO: Yes.

11 MS. WILLIS: Director Castaneda?

12 DIRECTOR CASTANEDA: Yes.

13 MS. WILLIS: Director Mendelowitz?

14 DIRECTOR MENDELOWITZ: Yes.

15 MS. WILLIS: Director Montgomery?

16 DIRECTOR MONTGOMERY: Yes.

17 MS. WILLIS: Chairman Rosenfeld?

18 CHAIRMAN ROSENFELD: Yes. The motion is
19 adopted. The third item on the agenda is
20 reporting requirement for call reporting systems.
21 Who will be making the staff presentation?

22 MR. TERNULLO: The item that OS is

1 asking the Board to consider today is a
2 modification to the CRS Reporting Requirements,
3 the chapter of instructions contained in our Data
4 Reporting Manual. If you recall, the Board
5 approved originally placing this chapter in the
6 Data Reporting Manual last summer, in July 2005.
7 These changes if approved by the Board are to take
8 effect on November 1st for first reporting by the
9 Banks on a monthly basis for November 15th, first
10 quarterly reporting by the Banks in mid-February
11 2007.

12 This modification in front of you comes
13 as a part of a complete rewriting of CRS, the
14 application as well as a complete review of all of
15 the elements contained therein. Overall we
16 evaluated for inclusion nearly 2,500 elements. We
17 kept approximately 890 to 900 of them, compared to
18 the existing CRS which contained 673 elements. Of
19 the 220 or so element increase, more than half of
20 those are collected either from the Office of
21 Finance directly, in other words, the Banks
22 already report them, or they are captured in

1 another one of our reporting specifications,
2 principally, the AHP one approved by the Board
3 earlier this year.

4 Two important changes, though, have occurred
5 with CRS. First, the Finance Board will be
6 collecting more than half of its data from the
7 Office of Finance directly, we will not be collecting it
8 directly from the Banks, so we have this shift
9 away from direct Bank reporting. Additionally, we
10 have a shift away from monthly reporting to
11 quarterly reporting, more along the lines of what
12 other financial regulators do. Existing CRS,
13 approximately 58 to 59 percent of our elements are reported
14 on a quarterly basis. Assuming that these
15 instruction changes to into effect, we would be
16 capturing approximately 96 percent of our elements
17 on a quarterly basis. By 96 percent, I am talking
18 about those elements above and beyond what the
19 Banks already report to FRS. If you include the
20 tow together, we are still up past three-quarters
21 of our elements collected quarterly.

22 DIRECTOR CASTANEDA: Gary, what would be

1 the deadline for the Banks to report that
2 quarterly information?

3 MR. TERNULLO: Right now we are looking
4 at February 20th. That would be consistent with
5 the deadline that the Office of Finance is using
6 for their FRS reporting for year end.

7 DIRECTOR CASTANEDA: How many days after
8 the end of the quarter?

9 MR. TERNULLO: With the exception of
10 February, it will generally be 20 days after the
11 end of a quarter. February is a special case
12 given the implementation of the new systems and
13 the end of the year. One thing that we did do on
14 this project that I would like to highlight is the
15 consultation process with the Banks. We have gone
16 through well over 15 conference calls with various
17 groups in the Banks to hammer this out, to get
18 their feedback, and then objections if any existed
19 to what we were doing.

20 There were two groups within the Banks
21 that helped us tremendously on this. One was an
22 Inter-Bank Working Group headed by Peter Leung,

1 the chief risk officer in New York, and the
2 other was a controller's group coordinated by Don
3 Able in Cincinnati. Both of these groups
4 provided quite a bit of assistance in helping us
5 focus on where we ended up.

6 I will wrap up by summarizing the
7 elements of this that they we are asking you to
8 consider. First, the new specification represents
9 an increase of 220 elements. Although we are
10 casting it as a simple replacement of the existing
11 CRS, there are nevertheless some things we desire
12 to fix that are covered in the additional request.
13 Second, the shift from monthly to quarterly
14 reporting. Third, the shift away from direct Bank
15 reporting to collecting it from the Bank agent, in
16 this case, the Office of Finance. And finally,
17 the considerable amount of time that went into
18 discussing this with the Banks so that it is not
19 simply a mandate that we are imposing on them
20 without discussion.

21 As a last note, I would also like to
22 recognize how quickly this project came together

1 this year and recognize the efforts of OS staff,
2 and principally the project managers, Venu
3 Chalamgari and Tony Vitale, as well as the people
4 who spent a lot of time on the actual elements,
5 Pat Lagos, Jim Winning, Gary Seale, Chris Knox, Ed
6 Avila and some who I know I am forgetting. I
7 apologize for neglecting to mention them.

8 That is everything I had. I would be
9 happy to field any questions or defer to one of my
10 more expert colleagues in a particular area if the
11 question goes there.

12 CHAIRMAN ROSENFELD: Thank you. Does
13 anyone wish to comment or have any questions?

14 DIRECTOR CASTANEDA: Yes, I have some
15 comments, Mister Chairman. First of all, Gary, I
16 did want to compliment you and others, all the
17 names that you mentioned and the ones you forgot,
18 who are working so hard on this project. This is
19 a big undertaking, and I have been very impressed
20 by the comprehensiveness of your efforts, your
21 briefings, and your follow-up. When you gave us
22 the briefing last week, I think only one of the

1 Banks had reported and we had heard their feedback
2 on the cost and time estimate. Have you heard
3 from any of the other Banks?

4 MR. TERNULLO: Yes, we have. That was a
5 question that came up in several of the briefings.
6 We have heard from I believe eight banks now. Six
7 of the estimates have fallen into a fairly narrow
8 range between \$90,000 and \$140,000, with an
9 average somewhere of around \$110,000 to \$115,000.
10 One bank came through at approximately double that
11 estimate, another bank came through at about 3 to
12 3-1/2 times that estimate. It is difficult to
13 reconcile what the differences would be. There
14 may be particular parts of their infrastructure
15 that need to be addressed and some of the fixed
16 costs are being included in this particular
17 estimate, but it is difficult to say. I am
18 content in seeing that so many of them fall within
19 such a small range and that as a rule of
20 thumb in my mind would indicate a payback period
21 of about 2 to 3 years over just having a full-time
22 financial analyst create this information for

1 reporting.

2 DIRECTOR CASTANEDA: And I believe the
3 cost for the Finance Board is about half a million
4 dollars. Is that correct?

5 MR. TERNULLO: I total, I believe it is
6 \$550,000 to \$560,000 when done with this version.

7 DIRECTOR CASTANEDA: I would also ask
8 you then that you keep us informed of your
9 progress of and of any significant feedback you
10 get from the Banks and any problems you may run
11 into as you implement the new system. Again,
12 thanks, and you are doing a great job.

13 MR. TERNULLO: Thank you.

14 CHAIRMAN ROSENFELD: Allan?

15 DIRECTOR MENDELOWITZ: Thank you, Mr.
16 Chairman. I have a few questions that I wanted to
17 explore with you, Gary. One is, there are added
18 costs both to the Finance Board and to the system,
19 and any cost to the Finance Board is a cost to the
20 system, so we are probably talking together at
21 least a million and a half dollars. Could you
22 give us an idea of the benefit we get from this

1 added expenditure of resources?

2 MR. TERNULLO: The overall expenditure
3 if we include the IT portion is simply that the
4 old system is broken and it absolutely needs to be
5 replaced. It is written for an old environment.
6 It is written in lots of small pieces that do not
7 work well together. It is slow, and it does not
8 take advantage of the new technology that is out
9 there. So approximately \$500,000 to \$600,000 of
10 that, our portion, our expenditure, was necessary
11 anyway.

12 In terms of the remaining portion, that
13 pretty much comes down to the cost of the Banks of
14 collecting things in a new way of providing us
15 with new elements that we have asked for. In
16 general, I will give you the 30,000 foot answer,
17 and if there are more detailed questions, I will
18 refer them to my one of my colleagues behind me.
19 The general answer is that the system now allows
20 tying together of various schedules, it provides
21 data, and for lack of a better term, it gives you
22 the ability to drill down from the balance sheet

1 and the income statement into the composition of
2 an element. For instance, you might be able to
3 look at an element of assets, advances and know
4 what derivatives are associated with them, what
5 types of information relate to that that would
6 have only been captured in a summary form in
7 another schedule. The philosophy behind the
8 system is this tying together and drilling down.

9 DIRECTOR MENDELOWITZ: Will this permit
10 better real-time assessment of the risk on the
11 balance sheets of the Banks without having to
12 visit the Banks?

13 MR. TERNULLO: My answer to that would
14 be yes. I would defer the actual benefits if an
15 enumeration is required to Pat Lagos who has spent
16 a lot of time working on that particular part of
17 the system.

18 DIRECTOR MENDELOWITZ: One of the issues
19 that I was concerned about with data is the
20 quality of the data. Every time someone puts
21 fingers to a keyboard, there is an opportunity to
22 make an error in what is being entered, and I have

1 always felt that in a perfect world, data should
2 be as highly automated as possible. Any number
3 that needs to go into the system should be entered
4 once and then the automated system should be able
5 to access that number and manipulate it and insert
6 it wherever it happens to be needed.

7 Do you have an idea as to how much of
8 the data we will be collecting under this revised
9 system will be the result of these ideal automated
10 systems and how much of that data will still rely
11 on these sort of back of the envelope private
12 Excel spreadsheets, individual sort of working
13 undocumented and unverified processes?

14 MR. TERNULLO: I think that answer
15 changes over time. Certainly in the past we were
16 more accepting of spreadsheets and such. I think
17 one of the big benefits of collecting data
18 directly from the Office of Finance is that now
19 more than half of our data will be contained in
20 the core financial statements and therefore be
21 covered by Sarbanes-Oxley requirements, meaning we
22 can expect fairly good controls there both on the

1 IT side and also on their business processes
2 associated with it.

3 In terms of the data that we are
4 collecting directly from the Banks, we would still
5 like to see a good measure of control there. I
6 think that the solutions that the Banks have
7 offered under the estimates that have given us
8 involve repeatable processes that are not subject
9 to a financial analyst going in and running a
10 query or a different financial analyst running a
11 different query every time.

12 For the purposes of quarterly reporting
13 in February, I am not sure we are going to be
14 there yet. The Banks have said it might take them
15 longer than that to get there. For our purposes,
16 I think if we see progress and we see them getting
17 there, while we assume the data will be correct
18 when it comes in, we are not necessary assuming
19 they have a perfect solution to it the first time
20 or even perhaps the second time out.

21 DIRECTOR MENDELOWITZ: Do you have an
22 estimate of how long it will take the Banks to get

1 all their data up to a level that complies with
2 Sarbanes-Oxley, irrespective of whether it goes to
3 OF first?

4 MR. TERNULLO: I am not sure that they
5 would necessarily go to a Sarbanes-Oxley level for
6 some of our regulatory data. It is not all
7 equally critical and the controls that would be in
8 place may well, without my being able to sit here
9 and tell you what they are, may well be suitable from the
10 examiner's point of view to what the data are used
11 for. We would have to make that assessment as we
12 go, but the Banks have indicated that they believe
13 some strong measure of control does exist if for
14 no other reason than their auditor would expect
15 them to be able to do it.

16 DIRECTOR CASTANEDA: I have been asking
17 that question and my understanding is that a lot
18 of the Banks are way ahead of the game in
19 complying with the Sarbanes-Oxley. Not everybody
20 is there. I think going back to your first
21 question which is a very good one, we have to now
22 keep in mind that a lot of this financial

1 information which is half of the information that
2 we are going to be getting will be coming directly
3 from OF and that is the information that the Banks
4 have to provide the SEC, so I know they are going
5 to be very careful of their input and what are
6 they going to be putting in, but that is a very
7 good point.

8 CHAIRMAN ROSENFELD: Do any other Board
9 members which to comment?

10 DIRECTOR BACINO: Yes, just two
11 questions, Gary. The one is going to Board Member
12 Castaneda's question about cost, this is a
13 one-time cost, right? Is this an annual expense?

14 MR. TERNULLO: From the Finance Board's
15 perspective?

16 DIRECTOR BACINO: From the Banks'
17 perspective.

18 MR. TERNULLO: It should be very close
19 to a one-time cost. If they are indeed specifying
20 an IT solution as opposed to getting financial
21 analysts to do it by hand and ad hoc, it would
22 pretty much be a one-time cost. There may be

1 maintenance involved.

2 DIRECTOR BACINO: The second question
3 is, we are continually updating what we ask for to
4 take into account what the Banks are doing,
5 correct? That seems to be a big part of what this
6 is.

7 MR. TERNULLO: I'm sorry. Could you
8 repeat that?

9 DIRECTOR BACINO: We continue to update
10 the questions that we ask and the information that
11 we ask for based on the behavior of the Banks,
12 correct?

13 MR. TERNULLO: Correct.

14 DIRECTOR BACINO: That's all.

15 CHAIRMAN ROSENFELD: If there is nothing
16 else, I would accept a motion to approve the
17 resolution. Do I have a motion?

18 DIRECTOR BACINO: So moved.

19 CHAIRMAN ROSENFELD: Do I have a second
20 for the motion?

21 DIRECTOR MONTGOMERY: Second.

1 MS. MURADIAN: The Federal Home Loan
2 Bank of Seattle is requesting that the Finance
3 Board approve amendments to its capital structure
4 plan. Proposed amendments that have the most
5 significant overall effect on the capital
6 structure of the Bank are the establishment of an
7 excess stock pool and the issuance of Class A
8 stock. The Bank also is proposing to simplify the
9 calculations of the total stock purchase
10 requirement and to illuminate subclasses of Class
11 B stock.

12 The excess stock pool will allow a
13 member within certain parameters to utilize the
14 excess stock held at the Bank to capitalize
15 advance activities. The excess stock pool can be
16 used by a member only to support advances with a
17 maturity of one year or less, only after the
18 member has exhausted all of its own excess stock,
19 and only to meet the member advance purchase
20 requirements. The amount of stock in the excess
21 stock pool that will be made available to be
22 utilized by members will be limited to 50 percent

1 of the total amount of stock in the excess stock
2 pool. Further, no single member may utilize more
3 than 25 percent of the total amount of stock
4 available in the excess stock pool. And no single
5 member may use stock from the excess stock pool if
6 the member's aggregate outstanding advance balance
7 exceeds \$11 billion. The proposed amendment
8 includes a provision to sunset the excess stock
9 pool on October 1, 2008. In order to extend the
10 use of the excess stock pool beyond October 1,
11 2008, the Seattle Bank would be required to seek
12 approval from the Finance Board for the submission
13 of an amendment to its capital plan. In
14 conjunction with the establishment of the excess
15 stock pool, the Bank will increase the member
16 advance stock purchase requirement from the
17 current level of 2-1/2 percent to 4 percent of
18 outstanding advances.

19 The Bank also is proposing to amend its
20 plan to authorize the issuance of Class A stock.
21 Under the plan as currently approved, the Bank has
22 two subclasses of stock, Class B1 and Class B2.

1 The proposed amendments would eliminate the
2 subclasses of Class B stock, and all outstanding
3 Class B1 and Class B2 stock will be automatically
4 converted to Class B stock of equal par value
5 without any action on the part of the members.
6 Class A stock will have a par value of \$100 and is
7 redeemable at par for cash on 6 months' written
8 notice to the Bank. Class A stock would be issued
9 only to support advances and only after a member
10 has exhausted all of its Class B stock to meet its
11 total stock purchase requirement.

12 Finally, the Bank is proposing to
13 simplify the total purchase requirement
14 calculation. The Bank's current plan includes a
15 complicated formula that is both operationally
16 cumbersome for the Bank to administer and
17 difficult for members to understand. Under the
18 proposed amendment, a member's total stock
19 purchase requirement is defined as the greater of
20 the membership stock purchase requirement or the
21 sum of the MPP stock purchase requirement and the
22 member advance stock purchase requirement.

1 The proposed amendments to the plan are
2 consistent with the standards previously
3 established by the Finance Board and do not
4 present concerns. As such, we recommend approval
5 of the proposed amendments. Thank you, and I will
6 be happy to answer any questions.

7 CHAIRMAN ROSENFELD: Thank you very
8 much. Do any of the Board members have any
9 questions or comments? Director Mendelowitz?

10 DIRECTOR MENDELOWITZ: There are two
11 principal elements in these proposed amendments to
12 the capital plan. Some are permanent and some are
13 temporary. The permanent ones change the
14 structure of the capital stock from a B1/B2
15 structure to a Class A/Class B structure. The
16 temporary elements go to the creation of a shared
17 pool of stock so that members in fact can
18 capitalize advances with in effect borrowed stock
19 that is excess to another member. This is a plan
20 that is similar to the Cincinnati Bank's plan
21 which has a common pool of shared capital that
22 they loan out to members to capitalize advances.

1 In the Cincinnati plan, the shared capital is
2 permanent. In the proposed Seattle plan, the
3 shared capital is very temporary and very highly
4 restricted. There are percentage limits on how
5 much can be loaned out, there are percentage
6 limits on how much an individual member can borrow, there
7 are limits on the duration of the advances that
8 are being capitalized by the borrow capital.

9 Given that the Finance Board has already
10 gone on the record as approving shared capital to
11 support advances, and given that the Finance Board
12 obviously does not see this as a safety and
13 soundness reason, as a safety and soundness
14 concern, I am somewhat mystified by why the
15 Seattle plan is so tentative with respect to the
16 shared capital issue.

17 MR. POWERS: The Seattle Bank is having
18 difficulty right now selling any stock, so that is
19 the concern that they have, to utilize the excess
20 stock that they have and they believe that if they
21 are successful in implementing the proposed
22 business plan that in approximately 2 years or so

1 they will be back on the financial footing that
2 will allow them to sell the new stock and they
3 will be able to not have to rely upon the excess
4 stock. So they see it as a sunset provision to go
5 hand in hand with their financial projections in
6 order to deal with their financial condition. And
7 they believe they will be able to pay a dividend
8 and issue new stock within a 2-year horizon.

9 DIRECTOR CASTANEDA: Allan, let me ask a
10 question here. Is your question why is the Bank
11 only asking for a 2-year sunset?

12 DIRECTOR MENDELOWITZ: And so highly
13 restricted.

14 DIRECTOR CASTANEDA: But that was the
15 Bank's proposal, right?

16 MR. POWERS: It was the Bank's proposal.
17 It was the Bank's proposal. We did not put those
18 restrictions in.

19 DIRECTOR MENDELOWITZ: Had the Bank
20 proposed something less restricted? Before the
21 proposal came on, had they discussed anything with
22 the staff of the Finance Board as to what would be

1 acceptable or not acceptable?

2 MR. POWERS: Not that I am aware of, no.

3 DIRECTOR MENDELOWITZ: Steve, do you
4 know?

5 MR. CROSS: Not that I am aware of.

6 DIRECTOR MENDELOWITZ: We have discussed
7 at some length the issue of excess stock and what
8 that implies in terms of mission and stability of
9 capital stock, et cetera. When you are dealing
10 with B stock with a 5-year redemption period, B
11 stock does not represent the potential source of
12 instability to the capital structure of the Bank
13 in the short run. Secondly, as long as there is
14 excess stock on the balance sheet of the Home Loan
15 Bank of any significant amount, my personal view
16 is that a preferred us of that capital would be to
17 capitalize advances rather than other assets on
18 the balance sheet.

19 So I would like to get periodic updates
20 assuming we approve this on how it is working and
21 whether in fact the Seattle Bank would be
22 interested in submitting another request for an

1 amendment that would provide for a much less
2 restrictive shared capital plan. If in fact they
3 are able to grow their advance book using this
4 shared capital and it is successful going forward,
5 I have no a priori objections to doing that.

6 DIRECTOR CASTANEDA: I have a follow-up
7 question on Allan's. Do you know whether any
8 consideration was given to just seeking
9 authorization to issue the Class A stock that is
10 without creating this excess stock pool?

11 MR. POWERS: As a separate issue, that
12 was never brought to our attention that I am aware
13 of.

14 MS. MURADIAN: No, they did not
15 contemplate that.

16 DIRECTOR CANSTANEDA: Because at the end
17 of the day, I understand what they are trying to
18 do basically shifting from one class, from Fed funds to
19 advances, right?

20 MR. POWERS: Correct.

21 DIRECTOR CASTANEDA: Hopefully that will
22 have some incremental on the Bank's earnings.

1 What can really change the Bank's condition is if
2 they can bring actually new capital to increase
3 their advances.

4 MR. POWERS: I think part of their
5 long-term plan is to get themselves into a
6 condition where purchasing stock in the Bank would
7 be attractive to existing members and new members
8 and that is obviously with appropriate redemption
9 periods and the ability to pay a dividend. I
10 think that is where they are headed with this.

11 DIRECTOR MENDELOWITZ: I would like a
12 clarification on the issue of dividends, assuming
13 that some time in the not to distant future the
14 Bank will be in a position to pay dividends. I
15 may miss remember, but when I was briefed on the
16 Seattle plan, I thought I remembered being told
17 that dividends that might be paid on Class A stock
18 would not be stock dividends, but that dividends
19 paid on Class B stock could be cash or stock
20 dividends. But when I read through the underlying
21 documentation, the documentation says that
22 dividends may be paid on Class A stock as either cash or Class

1 A dividends stock, and Class B as either cash or
2 Class B stock.

3 Which is the situation? I apologize if
4 I miss remembered.

5 MS. MURADIAN: The capital plan does
6 provide for cash or stock dividends on Class A
7 stock. However, the Board, and it is within your
8 Board package as one of the exhibits, resolved
9 that they would not issue once they were permitted
10 to issue dividends, stock dividends on Class A
11 stock.

12 DIRECTOR MENDELOWITZ: As a separate
13 resolution. In other words, what we approved says
14 they can pay stock dividends on A, their board has
15 taken an action which says that they are not going
16 to pay stock dividends irrespective of what is
17 permitted by the plan, but because that commitment
18 is just a board resolution on the part of the Bank
19 that does not require or approval or nonapproval,
20 in the future they could reverse it.

21 MS. MURADIAN: They cannot reverse it
22 without coming to the Finance Board, without

1 seeking approval by the Director of the Office of
2 Supervision.

3 MR. JENNINGS: That was part of the
4 resolution that said that that would be the case.

5 CHAIRMAN ROSENFELD: Do any of the Board
6 members wish to comment or have any questions?

7 DIRECTOR BACINO: First, Mike, Christina
8 and Tom, I know you guys have worked on this for a
9 while, so I commend you for your efforts. I think
10 while we sit here today you can look at the plan
11 and while it may or may not be a foolproof idea on
12 getting this Bank back to perfect financial
13 health, I think it is a good step in the
14 rehabilitative process. And I think it is
15 important for us to realize that they did not get
16 in this trouble overnight and it is not going to
17 be solved overnight. You can put on 20 pounds in a year
18 and you cannot take it off in a month. So I think it
19 is incumbent on us to remember that these things
20 did not come up overnight and the solutions are
21 not going to come up overnight.

22 One of the things you said during the

1 briefing, Mike, that really interested me was, for
2 the most part this plan in a worst-case scenario
3 if it did not work does not cause much harm to the
4 Bank and is not going to cause much harm to the
5 Finance Board. Is that correct?

6 MR. POWERS: That is correct.

7 DIRECTOR CASTANEDA: That is a very good
8 point.

9 DIRECTOR BACINO: That is all I had,
10 sir.

11 CHAIRMAN ROSENFELD: If there is nothing
12 else, I will accept a motion to approve the
13 amendment.

14 DIRECTOR BACINO: So moved.

15 CHAIRMAN ROSENFELD: Who did that?

16 DIRECTOR BACINO: I'm going back to back
17 on the motions here.

18 CHAIRMAN ROSENFELD: Do I have a second?

19 DIRECTOR CASTANEDA: Second.

20 CHAIRMAN ROSENFELD: Thank you, Director
21 Castaneda. Will the secretary will please call the role?

22 MS. WILLIS: On the item before the

1 Board, Director Bacino, how do you vote?

2 DIRECTOR BACINO: Yes.

3 MS. WILLIS: Director Castaneda?

4 DIRECTOR CASTANEDA: Yes.

5 MS. WILLIS: Director Mendelowitz?

6 DIRECTOR MENDELOWITZ: Yes.

7 MS. WILLIS: Director Montgomery?

8 DIRECTOR MONTGOMERY: Yes.

9 MS. WILLIS: Chairman Rosenfeld?

10 CHAIRMAN ROSENFELD: Yes. The motion is
11 adopted. This ends the open portion of the
12 meeting, and we will reconvene in closed session
13 in 3 minutes.

14 (Whereupon, at 10:40 a.m., the OPEN
15 SESSION was adjourned.)

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