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FEDERAL HOUSING FINANCE BOARD MEETING

OPEN SESSION

Wednesday, October 11, 2006

ANDERSON COURT REPORTING  
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Alexandria, VA 22314  
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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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