FEDERAL HOUSING FINANCE BOARD

OPEN MEETING

Wednesday, May 10, 2006
Washington, D.C.

The Board meeting convened, pursuant to notice, at 10:03 a.m., at 1625 Eye Street, N.W., Washington, D.C.

MEMBERS PRESENT:

RONALD A. ROSENFELD, Chairman
FRANZ LEICHTER
ALICIA R. CASTANEDA
BRIAN MONTGOMERY
ALLAN I. MENDELOWITZ

ALSO PRESENT:

MR. CHRIS BOSLAND
MR. CHARLES JONES
MR. J.P. GREEN
MR. DARIS MEEKS
MR. BILL GLAVIN
MS. SHELIA WILLIS
MR. JOHN KENNEDY
MS. PAT SWEENEY
MR. NEIL CROWLEY
MR. MARK PRETZAT
MR. CHRISTIE SCIACCA

P R O C E E D I N G S

CHAIRMAN ROSENFELD: Good morning, everyone. I call this meeting of the Federal Housing Finance Board to order.

Today, we'll have an open session followed immediately by a closed session where the board will receive updates of examination and supervisory findings.

We now need to vote to approve closing the latter portion of today's meeting, as required by the Sunshine Act and the Finance Board regulations. And since the closed portion of today's meeting will contain sensitive and confidential bank examination information, I would ask for a motion to seal the transcript of this portion of the meeting.

Director Mendelowitz.

MR. MENDELOWITZ: Mr. Chairman, I move to close that portion of this meeting, and further that this board determine that the record and transcript of this closed portion of the meeting be kept confidential.

CHAIRMAN ROSENFELD: Thank you for the motion. Is there any discussion of the motion? Any discussion?

[No response.]

CHAIRMAN ROSENFELD: Seeing none, the secretary will please call the role on the motion.

SECRETARY WILLIS: On the item before the Board, Director Leichter, how do you vote?

MR. LEICHTER: Yes.

SECRETARY WILLIS: Director Castaneda?

MS. CASTANEDA: Yes.

SECRETARY WILLIS: Director Mendelowitz?

MR. MENDELOWITZ: Yes.

SECRETARY WILLIS: Director Montgomery?

MR. MONTGOMERY: Yes.

SECRETARY WILLIS: Chairman Rosenfeld?

CHAIRMAN ROSENFELD: Yes.

The motion is carried and the subsequent portion of our meeting will be closed. The transcript will remain closed and confidential. Thank you.

Let us now turn to the public portion of today's meeting, the single item for consideration is a resolution for approval of the designation of Federal Home Loan Bank directorships.

Who will be making the staff presentation?

MS. SWEENEY: I will, Pat Sweeney.

CHAIRMAN ROSENFELD: Thank you, Pat.

MS. SWEENEY: Good morning.

Each year the Finance Board is required to allocate the elective directorships of each of the Federal Home Loan Banks among the states in the bank's districts. The calculation for allocating the directorships are based primarily on the amount of bank stock owned by the members in each state.

However, the calculations may be adjusted under a provision called the grandfather clause, which requires each state to have at least as many directorships as it had in 1960, and under another provision that authorizes the Finance Board to increase the size of the board--of the banks--with banks that have five or more states.

Staff recommends that the Board of Directors approve the 2006 designation of bank directorships as set out in the resolution and two attachments provided in your board books and summarized as follows:

First of all, to designate the minimum required allocation of elective directorships by state for a total of 111 statutory seats, which is 2 more than last year's total.

To approve 8 discretionary elective directorships currently allocated by the board, which is no change from last year's total.

And to maintain the 10 discretionary appointed directorships currently allocated by the board.

The Finance Board conducts the annual allocation of directorships in accordance with the mathematical formula known as the method of equal proportions. The first step in apportioning the eight directorships, elective directorships per bank is to assign one directorships per state. The balance of the eight directorships remaining, if any, is then assigned using the method of equal proportions.

Directorships are assigned according to this formula based largely on the amount of stock held by members in that state at the end of the prior year.

This year, the application of the method of equal proportions and the grandfather provision results in a total of, again, of 111 minimum required elective directorships being allocated.

This number reflects the gain of one seat in the Chicago and Pittsburg banks. These changes are based on increases in the amount of bank stock held by the members in the states of Illinois and Delaware, respectively, relative to the amount of stock held by members located in other states in these districts.

For Pittsburgh, the stock held by members in Delaware, increased by approximately 22 percent due primarily to the advances driven stock requirements of several institutions, Lehman

Brothers Bank, ING Bank, Citicorp Trust Bank, and GMC Bank.

For Chicago, stock held by members in Illinois increased approximately 9 percent, due primarily to the stock holdings of one very large new member, Harris Bank.

The banks of Boston, Topeka, and San Francisco were also impacted by the fluctuations in stock holdings under the method of equal proportions such that directorship allocations in these three districts have changed. However, the total number of elected director seats remains constant in each of these districts.

For the Boston Bank, the directorships allocations for Rhode Island and Connecticut have increased and decreased by one seat respectively. The change in stockholdings for Rhode Island of approximately 58 percent was due primarily to Bank of America, Rhode Island stock holding support of its advances activity. Bank of America was the largest borrower in the district with approximately

21 percent of the district's total advances at year end.

For Topeka, the directorships allocations for Oklahoma and Nebraska have increased and decreased by one seat, respectively. The increase in stock holdings for Oklahoma was due primarily to Mid First Bank's 45 percent increase in advance activity during 2005. Mid First is the bank's top borrower and accounts for almost 20 percent of the district's total advances. The decline in Nebraska was due primarily to the merger of Commercial Federal Bank into an out of district institution.

For the San Francisco Bank, the directorship allocations for Nevada and California have increased and decreased by two seats respectively. This increase in stockholdings for California--for Nevada was due exclusively to Washington Mutual Bank's redesignation of home office from Stockton, California to Henderson Nevada. For the seven other banks the application this year of the method of equal proportions and the grandfather provision results in no change in the current number of elective directorships for the state to which they are allocated from last year.

For any bank whose district includes five or more states, the Bank Act authorizes the Finance Board to increase the number of elective directorships up to 13 and increase the number of appointed directorships up to three fourths the number of elective directorships.

The Banks of Boston, Atlanta, Des Moines, Dallas, and Seattle, are the only banks to which this discretionary authority applies. In prior years the Finance Board created additional elected and appointed directorships for each of these banks. At present the Finance Board has approved a total of 18 discretionary directorships, 8 elective and 10 appointive for these five banks.

The approval of these directorships is purely a matter of discretion for the Board and is not dependent on the amount of stock held by the members in any particular state or any other factor.

As a part of this Board package, a resolution has been drafted to preserve the 18 discretionary seats, 8 elective and 10 appointive, for the 2006 designation of directorships. The Board, however, has the discretion to decline to reauthorize any or all of these directorships if it so chooses. Four of the proposed 8 discretionary elective seats, if approved by the Board, would be up for election this year.

The resolution, with attachments, has been provided for the Board action. The effective date of the designation would be January 1, 2007. Attachment 1 to the resolution provides the minimum required allocation of elective directorships for each state, the allocation of appointive directorships for each district, plus the proposed discretionary directorships for both appointed and elected directors in the five districts that are eligible for discretionary seats.

Attachment 2 to the resolution includes a matrix for each Board of Directors which serves to preserve and maintain an historical record of the term and sequence of the staggering of directorships.

That concludes my presentation. And Neil Crowley and I are ready to answer any questions.

CHAIRMAN ROSENFELD: Thank you.

Any questions, comments? Al?

MR. MENDELOWITZ: Mr. Chairman, thank you.

I realize this is a fairly arcane issue and I really want to impose on the good will of my colleagues on the Board to raise what may appear to an outside observer to be arcane and all that not significant. But there is an issue that I've been grappling with since I got briefed by the staff last night on this. And because of the governance of Sunshine, we haven't had a chance to sit and deliberate on it. So if I can prevail upon your patience, I'd like to use this meeting of the Board to do that.

The formula that's used to allocate elected directors is called the method of equal proportion. And my understanding of what the objective of this formula is is to basically have the number of elected directors from each state roughly proportional to the amount of outstanding shares of required capital. Is that a correct interpretation?

MR. CROWLEY: Yes, I would say so.

MR. MENDELOWITZ: And if it turns out that when we apply the formula, it's an arcane formula because there's proportions, there's grandfathers, there's all sorts of things, if there's anything that looks like a gross inequity, do we have a way of dealing with it? For example, the director's representation of their members is sort of not in proportion to most of the states, is there anything we can do to fix it?

MR. CROWLEY: For five banks, the answer is yes. For the other seven, the answer is no. For any Federal Home Loan Bank that has five or more states, the statute authorizes the Finance Board to increase the number of elected directorships up to 13 from the base of 8 and also if it does that, to increase the number of appointed directorships to a number equal to three quarters of the elected seats. That's a discretionary power of the board.

MR. MENDELOWITZ: Does the Board have the discretion to assign a discretionary seat to correct what might appear to be a gross inequity with respect to fair representation of the members of a home loan bank in any particular state, which is what you said; right?

MR. CROWLEY: Yes.

MR. MENDELOWITZ: Okay. Good.

Now, Mr. Chairman and my colleagues on the Board, what I did last night was to go through the entire system and identify how many shares of required capital each elected director represents on the board of the bank that that state belongs. And I did that. I looked at the entire system, of course. And for discussion purposes, I really just singled out two groups of banks. One group is the six states to whom we are granting discretionary directors, and then the members of the Boston Home Loan Bank.

And it turns out that there are six states, one of whom is in the Boston Bank, and five of them are in other banks, that have discretionary directors proposed by the staff in the submission they've given to us. Massachusetts, Alabama, North Carolina, and Missouri, Texas, and Washington State. And when I look at the shares that are represented by the directors from each of these states what was learned is the following: Massachusetts has 8.7 million required shares that are used in the formula for determining the number of elected directors. The formula based on equal proportions and grandfathering, grants Massachusetts three elected directors. So that based on the formula, each elected director, if we only gave them the three that they're entitled to under the formula, would represent 2.9 million shares of stock.

Well, we must have felt that 2.9 million shares of stock was too much for a director to represent, because the proposal adds one discretionary director to Massachusetts bringing the proposed total of elected directors in Massachusetts to four. Which means that each director would represent 2.18 millions shares.

And I wondered whether that was an anomaly. And I went through and I identified the other five states that get discretionary directors. And what I found is that before the discretionary director, each director in Alabama represents 1.8 million shares. After the addition of a discretionary director, each director represents about 9/10ths of a million shares, 800, 900,000 shares.

In North Carolina before the designation of a discretionary director, each director represents 1.9 million shares. We add a, the proposal would add a discretionary director so that each director would represent .96, less than one million shares.

In the case of Missouri, each director would represent 3.9 million shares. I think I made a mistake in my calculations.

Does Missouri have two elected from the formula or one?

MS. SWEENEY: It has one from the formula.

MR. MENDELOWITZ: Right. Okay. One from the formula. I'm sorry. There's an error in my calculations.

Each director under the formula would represent 3.9 million shares. And with the addition of the discretionary director, each director represents 1.9 million shares.

In Texas, each director before the allocation of discretionary director would represent 3.4 million. And the staff proposes adding two discretionary directors, so that each director would represent 2.3 million shares.

And in the case of Washington State before the allocation, each director would represent 2.9 million shares and the staff proposes two discretionary directors so that each director represents 1.6 million shares.

So we have a proposal before us in which the staff recommends that six states, where each director represents significantly less than 3 million shares, get additional discretionary directors. So in point of fact, for these six states, the elected directors under the proposal would represent anywhere from less than 1 million shares up to a total of 2.3 million shares.

So that based on this proposal, I get a feel for what it is that the staff thinks is appropriate proportional representation and the use of discretionary seats to sort of equalize representation.

And this is really important because when you get to the Boston Bank, there is one anomaly throughout the whole system that stands out. There is one state that has only one elected director and has substantially more shares that that one elected director has to represent than any other state in the country. And that is the state of Connecticut. And I'm a little diffident bringing it up, because I am from Connecticut. And so I don't want people to think that this is self-serving.

But notwithstanding that diffidence, I'm bringing it up because each director--there's only one assigned by the method of equal proportion--represents 4.45 million shares. That is more than twice what any other director represents in the states that receive discretionary directors.

And if you look at the other states, you find that each of the assigned directors from the formula represents 2.69 million shares, in Rhode Island; 1.75 million shares in Maine; .35, 350,000 shares in Vermont; and 1.3 million shares in New Hampshire.

If we were to use the authority that the statute has given us to try to use appointed directors--I'm sorry--discretionary elected directors to sort of equalize the situation, we could assign one discretionary director to Connecticut, which would make the average of shares represented each of the two directors from Connecticut equal to basically 2 1/4 million shares. That would still be more than what would be represented by each director in the states that already receive discretionary directors in the staff proposal.

So I would, I realize this was somewhat of a long winded, you know, presentation, and I apologize for that. But I really would like to call upon my colleagues on the Board to hopefully support a modification to the staff proposal to add one discretionary director in Connecticut.

CHAIRMAN ROSENFELD: Are there any other comments from any of the other, questions from any of the other Board members?

Seeing none, I would ask the Secretary to call the role to vote to support the or to oppose the proposal by the General Counsel's Office? Pardon?

MS. SWEENEY: Yes.

CHAIRMAN ROSENFELD: Yes.

MR. CROWLEY: Has there been a motion?

MR. MENDELOWITZ: What I'd like to know is I'd like to get reaction from my colleagues on the Board with respect to the data that was presented and whether they think that this represents a reasonable basis for modifying the staff proposal to include one additional discretionary director for the Bank of Boston from Connecticut.

CHAIRMAN ROSENFELD: Do any of the other directors have any comment? Yes?

MR. LEICHTER: Let me just add. I think I'm on.

MS. CASTANEDA: You're on.

MR. LEICHTER: I think, Allan, you made an interesting argument and meritorious. I will confess in all my years on the Board, I've never understood the formula and how it's applied, and so on. I do look at, you know, what the total number of directors are. I do rely on the staff. I don't remember any other occasion where the Board of Directors has not supported the staff, which seems to have a particular insight into this.

And I guess we would never allow Pat Sweeney to leave the board, because she may be the only person in the world that fully understands the formula. So I'm just going to go along with our past practice and the faith that I have in our staff and support their recommendation.

CHAIRMAN ROSENFELD: Any other director?

MR. MONTGOMERY: So from an historical perspective, the Board has never done this before, is that--

MR. MENDELOWITZ: Oh, we've done it every year. Connecticut, for example, for the past, I don't know, 10 or 15 years, Connecticut has always had two elected directors. For a long period of time, until last year, one elected director was discretionary. Last year, because of the equal proportions formula, they got two elected directors.

So we removed the discretionary director because we thought two was the right number for Connecticut based on the number of outstanding shares. So that if we restore the discretionary director in Connecticut, we would be restoring the status quo that's existed for 15 years.

CHAIRMAN ROSENFELD: Uh--

MS. CASTANEDA: I do want to make some comment.

CHAIRMAN ROSENFELD: Director Castaneda?

MS. CASTANEDA: Allan, I do believe that you have raised an interesting point and one that, frankly, have only had the opportunity to consider very briefly you just gave us that information this morning.

I agree with Director Leichter that it's very unclear to me what rationale the Finance Board used in allocating these discretionary seats. Since I've been here, I think we had have largely just left the allocation and change. However, I think the information that you have put forward at least raises the question of whether there is any reason for the present allocation.

It seems to me, also, that what you are suggesting that we take a different approach with respect to one bank, Federal Home Loan Bank of Boston, that would necessarily make the whole picture more or less appropriate for all the other banks. Indeed, I do believe then there are some other banks with states that are losing seats under this year allocation.

And I'm very hesitant to make a last minute change for one bank without considering the situation of the other banks. I think you're also saying today, then, Boston has the fewest directors per share. There remains a fairly large discrepancy across other states, too, if we use your measure.

So I think, Mr. Chairman, in the interest of time and letting the banks begin their election process quickly, as well as ensuring we treat all the banks fairly, I cannot endorse your proposal today.

But I would like to suggest that staff, and I guess, you, Pat, could assist this Board by looking into during the coming year in advance of next year's elections process to see if we can make this allocation, update discretionary seats on a more consistent basis.

CHAIRMAN ROSENFELD: Yes, Allan?

MR. MENDELOWITZ: I certainly don't want to put the staff on the spot. I would say that, and I don't want to put them on the spot, but I would say if your concern is supporting the staff, if the staff gave their personal views on what we should be doing, I think there's a fair amount of support for giving a discretionary director to Connecticut. That's number one.

Number two, when you talk about the inequities in the system, I've looked throughout the entire system. There is no state that has only one director that has anything close to the amount of shares that are held as required stock in the state of Connecticut. The only inequity, in terms of numbers of shares per elected director that is, sort of looks somewhat extreme, is the case of the San Francisco Bank. The San Francisco Bank is very, very large. It has only three states. And as a result, because of the way the formula works, one state gets one elected director, I believe, and the other states get three or four. So given the size of the bank and the numbers of shares outstanding, you're going to wind up with each elected director there representing, you know, a large number of shares.

Furthermore, San Francisco is a bank that only has three states in the district. So that this Board does not have any authority, whatsoever, to adjust the allocation with discretionary seats.

MS. CASTANEDA: But that's why we only have eight directors.

MR. MENDELOWITZ: Right. Because there's only three banks, I mean, three states in the bank. And I really do believe that because if you look at the banks that have five or more states, if you look at the banks that--for which we have the ability to appoint a discretionary director, you look at the equity of the allocation of number of shares per elected director, there is only one state that this issue jumps out at and cries out at us for us to take, to use our discretionary authority to adjust what is, in fact, an unequitable distribution.

And I think, you know, it's an easy thing for us to do, Mr. Chairman. And it's not--and I think it's the right thing.

CHAIRMAN ROSENFELD: Any other--

MR. LEICHTER: Just one question if I may ask the staff. Have we had a request from the Boston Bank to add a discretionary seat to Connecticut?

MS. SWEENEY: Yes. The letter was received. It was drafted by Ellen McLaughlin, the general counsel of the Boston Bank. And it does request that Connecticut have two directorships, one guaranteed and one discretionary seat. A copy of that letter was distributed to all of the Board members.

CHAIRMAN ROSENFELD: I'm sorry. It was distributed previously?

MS. SWEENEY: Previously, right. It is not in the binder.

MR. KENNEDY: It is not in the binder. It was distributed previously.

MR. MENDELOWITZ: Have any other states asked for--

MS. SWEENEY: Yeah.

MR. MENDELOWITZ: Have any other banks asked for the designation of any discretionary directors?

MS. SWEENEY: We've received no correspondence from any of the other banks.

MR. MENDELOWITZ: So that no state, no bank, other than Boston, feels that they need a discretionary seat?

MS. SWEENEY: Typically there isn't, we don't have a discussion like that. So I don't think that a bank would necessarily be looking in that direction. So we don't solicit.

MR. MENDELOWITZ: Right. So, in other words, this is something that the bank felt was pretty important because on their own initiative, the issue jumped up, they took the initiative to write to the Board. The data I presented, I think, supports their request.

CHAIRMAN ROSENFELD: I'm sorry. Any other comments or questions?

MR. MENDELOWITZ: Can I ask another question?

CHAIRMAN ROSENFELD: Sure.

MR. MENDELOWITZ: Did Connecticut lose members or required stock over the coming year--past year?

MS. SWEENEY: No. it did not use members and, in fact, the stock in the state of Connecticut increased by 9 percent.

MR. MENDELOWITZ: So we have a state where, you know, this is not a market outcome, in other words. We have, in the case of Connecticut, a stable membership base with stable advance business from the Boston Bank.

MS. SWEENEY: Fact increase.

MR. MENDELOWITZ: And in fact increased by 10 percent.

MS. SWEENEY: Right.

MR. MENDELOWITZ: So that, I mean, clearly, we're not bucking any market trend. What we have here is, I think, a strong case.

CHAIRMAN ROSENFELD: I think that this Board over the last number of months has done some excellent work in some very important areas.

I would suggest that we, together with staff, continue our efforts at doing good work by trying to come up with a formula for designating directors, which is at least comprehensible, if not more equitable and more appropriate.

I, too, support the staff's proposal. Although Allan's work, I think, is important and reflects a good deal of thought, my feeling is that we ought not use our discretion to correct what the formula in this instance produces, number one. Number two, the Boston Bank does not lose any directors. They maintain the same. And quite frankly, I think the whole situation, the whole issue has absolutely nothing to do with governance, which is a subject much more important to me than where people's shares are or where their shares come from.

So that's my comment. If that provokes any other comments, I'll be happy to take them. If not, we'll call the role.

MR. MENDELOWITZ: Mr. Chairman, I would like to respond to your point about governance.

I think it is important for two reasons. One is, you need good directors for good governance, obviously. We've talked about how to do that. You also need a sufficient number of directors for good governance. And right now, every one of the banks has a diminished number of directors because we're not appointing public interest directors. This Board isn't fulfilling its statutory responsibility.

And so when we have a proposal, like the one I'm making, that I think is grounded on, you know, good analysis of an equity issue, and at the same time it would increase the number of directors to help fill the hole that exists--

CHAIRMAN ROSENFELD: By one.

MR. MENDELOWITZ: By one, but it's better than zero. One is better than zero. I think that that's something worth considering.

Secondly, when the shareholders of publicly traded companies elect their directors, good corporate governance says that every shareholder gets a vote. One share, one vote. And so that the votes that get cast are, in fact, directly proportionally to the outstanding shares and who owns those shares.

Now, we have restrictions on us because of the vagaries of the statute, the grandfathering provision, the numbers restrictions, all these other things. So we don't get a perfect one share, one vote, but we do hopefully strive to achieve an approximation of one share, one vote. And the proposal I'm making today definitely advances, without a doubt, that proposal, one share--to strengthen, you know, something that's closer to one share, one vote than what we have. And I think that that is good governance because it gives the people who own the bank an appropriate say in how it's managed and how it's overseen and, you know, how safe and how sound the bank is being run.

CHAIRMAN ROSENFELD: Okay. Seeing nothing else, would the Secretary call the role?

MR. KENNEDY: Mr. Chairman, we need to--someone needs to make a motion first.

CHAIRMAN ROSENFELD: Oh. I will accept a motion to approve the resolution as suggested by the staff and allow the staff to make technical and conforming changes to the rule.

MS. CASTANEDA: Yes.

CHAIRMAN ROSENFELD: Director Castaneda, thank you.

CHAIRMAN ROSENFELD: Is there a second?

MR. LEICHTER: Yes.

CHAIRMAN ROSENFELD: You second?

MR. LEICHTER: Yes.

CHAIRMAN ROSENFELD: I'm new here.

Will the Secretary call the role?

SECRETARY WILLIS: On the item before the Board, Director Leichter, how do you vote?

MR. LEICHTER: Yes.

SECRETARY WILLIS: Director Castaneda?

MS. CASTANEDA: Yes.

SECRETARY WILLIS: Director Mendelowitz?

MR. MENDELOWITZ: No.

SECRETARY WILLIS: Director Montgomery?

MR. MONTGOMERY: Yes.

SECRETARY WILLIS: Chairman Rosenfeld?

CHAIRMAN ROSENFELD: Yes.

The motion is adopted.

This ends the open session of the meeting.

We will reconvene in closed session in five minutes.

[Whereupon, at 10:30 a.m., the open session of the meeting adjourned.]