

FEDERAL HOUSING FINANCE BOARD

OPEN MEETING

Wednesday, October 9, 2002

1777 F Street, N.W.
Second Floor Boardroom
Washington, D.C.

The Board meeting convened, pursuant to
notice, at 10:00 a.m., before:

PARTICIPANTS:

JOHN T. KORSMO, Chairman

JOHN C. WEICHER, Director

ALLAN I. MENDELOWITZ, Director

FRANZ S. LEICHTER, Director

J. TIMOTHY O'NEILL, Director

ARNOLD INTRATER, General Counsel

ELAINE L. BAKER, Secretary

ELLEN HANCOCK

STEPHEN M. CROSS

NEIL CROWLEY

PATRICIA SWEENEY

THOMAS JOSEPH

JIM WINNING

A G E N D A

1. Amendment to the Federal Home Loan Bank of
Seattle Capital Plan

The FHLBank of Seattle is requesting Finance Board approval of amendments to its Capital Plan. The amendments relate to the removal of the sufficiency test from the Plan and other modest changes. 3

2. Amendment to the Federal Home Loan Bank of Indianapolis Capital Plan

The FHLBank of Indianapolis is requesting Finance Board approval of amendments to its Capital Plan. The amendments relate to the methodology used to identify the shares to be redeemed, repurchased or transferred. 21

3. Federal Home Loan Bank of Dallas Request for an additional Elective Director from the States of Texas

The FHLBank of Dallas has requested Finance Board approval of one additional elective directorship for the state of Texas, to maintain the balance between appointive and elective directorships. 27

4. Appointment of Financing Corporation Directors (Tentative)

Board action to appoint two Federal Home Loan Bank Presidents to serve a one-year term of office on the FICO Directorate, as prescribed by Section 21(b) of the Bank 75

P R O C E E D I N G S

CHAIRMAN KORSMO: The meeting of the Federal Housing Finance Board will please come to order. Oh, I feel like I'm hurting the table.

Good morning. I suspect everyone is aware that October is Historic--or, excuse me, it's Hispanic Heritage Month. What you're probably not aware of is that today, October 9, is Leif Ericcson Day. So those of us of Norwegian heritage will appreciate you recognizing that item today.

We have several items before us that I believe we can handle expeditiously today. They represent the changes to two bank capital plans, consideration of permitting a new elective director for the Federal Home Loan Bank of Dallas, and appointment of new directors for the Financing Corporation.

Item one on our agenda is amendment to the Federal Home Loan Bank of Seattle Capital Plan. Today, we're acting on the first amendments to bank capital plans. Amendments to capital plans are new, of course, just as the capital plans themselves are new, but these should be seen as welcome requests from banks and as ways

for banks to learn and benefit from the analysis and experience occurring at other banks. The changes sought by Seattle are largely a matter of fairness. The Finance Board approved Seattle's capital plan on March 13th of this year, making it the first of the new capital structures to be voted on by the Board.

Our thinking as a Board certainly evolved as subsequent plans were studied and approved. As a consequence of being first, Seattle was burdened with provisions not imposed on any other bank. The most notable was a restriction advocated by the Finance Board which constrained the ability of the board of directors of the Federal Home Loan Bank of Seattle to effectively manage their own capital compliance, as mandated by Gramm-Leach-Bliley.

When Seattle agreed to this requirement under pressure of a tight deadline for implementing their new plan, they sought and received our assurance that these amendments would be in order and could be sought if another bank succeeded in winning approval of a plan without the disputed restrictions on acquiring capital and on imposing activity charges.

That has, obviously, been the case. We, of course, in the wake of approval of the Seattle Plan, approved 11 others, all of which were substantially different than this particular item and in other items than what was approved in Seattle's original request.

So, with that and my own statement that I believe their request is in good order, which I don't think anyone argues, let me call on Stephen Cross to present this agenda item. Dr. Cross?

DR. CROSS: Yes, Mr. Chairman, and members of the Board, when the Seattle request came in, I asked staff from the Office of Supervision and from the Office of General Counsel to review the proposed amendments to determine whether they are legal, whether they are within the range of provisions that were incorporated in other approved capital plans, and whether they were consistent with continued safe and sound operation of the bank.

Ellen Hancock, Jim Winning, and Tom Joseph were the three staff members who did the analysis on this bank, and Ellen will give a brief review of that analysis, along with information about follow-up conversations with the bank. Jim Winning will talk about the safety and

soundness consideration, and all three of them will be available for any questions that you or other members of the Board might have. Ellen?

MS. HANCOCK: Good morning. I will briefly summarize the proposed amendments that the bank is asking for approval of: The first proposed amendment is to revise the ranges for the stock- purchase requirements for advances and for mortgage-purchase program, or MPP, transactions. Specifically, for the advances requirement, the bank is proposing to change the range minimum point from 3.5 percent to 2.5 percent; and for the MPP requirement, to change the range minimum point from 4 percent to zero. The bank is also proposing to remove the test for sufficiency of capital from the plan.

Other proposed amendments are: To add a provision that access to the bank's products and services would be suspended if a member fails to comply with any requirement of the plan; to add a provision that would allow the bank to make general offerings of Class B-1 stock at par to members from time to time with participation on a voluntary basis; to add a provision to allow members to waive the five-day waiting period before

the bank could repurchase excess or purchased stock for which the member has filed a redemption notice; add a provision to give the bank a lien on any proceeds from a redemption of stock if the bank believes that the member is under collateralized in any of its obligations to the bank; and the last amendment would allow the transfer of excess stock between members and their affiliates.

Staff has reviewed the bank submission and finds that these proposed amendments are in compliance with Finance Board rules.

As requested at the briefing, staff has talked to the bank regarding the timing of Finance Board consideration of the proposed amendments. On Monday, we spoke with Norm Rice, Kelli Bono, and Steve Horton. Bank management indicated that the bank was not intending to undertake any operational changes that require amendments to be approved in October. However, they saw no reason for delay since the analysis had been completed. And, given that several of the amendments simply re-established provisions that the bank originally had in its plan; and that the rest of the proposed amendments are items that had been approved by the Finance Board in other capital

plans, the bank did note that delay of provision addressing transfer of excess stock among member affiliates could have an adverse effect on membership, since a number of members with affiliates were interested in having the ability to transfer excess stock as soon as possible.

MR. WINNING: There does not appear to be any safety-and-soundness issues associated with the proposed amendments to the capital plan. The bank is not actually applying any requirements other than what they always anticipated to apply, particularly to the activity ranges. So there's no impact on capital there. For the other provisions of the capital plan that there are amendments to, there are no conditions precedent to engaging those provisions, so there's no capital impact there.

Otherwise, the bank has actually implemented its capital plan. In particular, they've carried out the redemption or the repurchase of stock, which was the main kind of activity having to do with the implementation. It did that successfully and actually raised more capital than they expected to raise.

We also looked at the bank's latest report of examination. There are no safety-and-soundness issues there. It just called into question the sufficiency of the capital. Also, it compared the bank's actual financial results to the projections that they submitted when they submitted their capital plan to the Finance Board for approval. In general, they are on track with those projections. Total assets is about what they expected; mortgaged-backed securities and MPP loans are also pretty close to what they expected. Like I said before, their capital's actually above what they anticipated, so their capital ratio, in general, is above what they expected. Their earnings are strong and should be at a level that would be satisfactory to stockholders.

The risk-based capital requirement is actually materially lower than what they had anticipated and is, actually, a fairly small fraction of their actual risk-based capital. So there are no safety-and-soundness issues that are apparent that should have an impact on consideration of the amendments.

CHAIRMAN KORSMO: Mr. Joseph, do you have anything to add?

MR. JOSEPH: No.

CHAIRMAN KORSMO: Is there anything else?

DR. CROSS: That concludes our presentation and we're available for comments and questions.

CHAIRMAN KORSMO: Thank you, Steve, Ellen, and Jim and Tom. Let me open the floor for any questions that any members of the Board may have of the staff in this regard? Director O'Neill?

DIRECTOR O'NEILL: Would it be good for us to move that the--

CHAIRMAN KORSMO: Well, let's see if there's any questions before we move to a motion, because once we move to the motion, then the discussion will be confined to members of Board. Director Mendelowitz?

DIRECTOR MENDELOWITZ: When did this request get received at the Finance Board?

MS. HANCOCK: I believe that the letter was dated September 23.

DIRECTOR MENDELOWITZ: That was the date of the letter, so we got it several days later, so when did the staff begin working on it?

MR. JOSEPH: I think we saw it the first time on Wednesday before the World Bank meeting, and I just don't remember--

MS. HANCOCK: Was that the 25th?

MR. JOSEPH: Yeah, that would have been the 25th.

MS. HANCOCK: September 25th, Wednesday.

DIRECTOR MENDELOWITZ: So, basically, the staff has had all of a week or a week and a half to analyze this and make its recommendations?

MS. HANCOCK: Well--yes.

DR. CROSS: The staff completed their analysis in a week and a half and, as I suggested separately in our briefing, I asked the staff to look at those--at the three issues and, frankly, I told them that they needed to spend the time that they felt was necessary to complete the analysis and to let us know if the time was going to be insufficient to complete the analysis. They completed the analysis last Thursday, I believe it is.

That said, you know, I really think it's worth noting that they did put in extra time and energy to get it done in that period of time. Not because they had necessarily any concerns about what was in front of them,

but it's our responsibility to check the "i"s are dotted and the "t"s are crossed and they did that during that period of time.

DIRECTOR MENDELOWITZ: So, I want to be careful how I say this because, as the regulator of the Home Loan Banks, they're not our customer in a regulatory sense, but to use the jargon of the business world and the organizational world, they, in effect, are our external customer, and timeliness is always defined as the needs of the external customer. If the external customer needs it in a week, providing it in two weeks is not a very good turnaround time. If the external customer needs it in a month and we provide it in a week, you're wasting effort and time working on something that should--you know, when you could be working on something with higher priority. So, I commend you for the rapid turnaround and the extra effort that you all put in to try to, you know, develop your recommendations within the time frame that was consistent with the needs of the external customer.

CHAIRMAN KORSMO: Any other questions of the staff? Any other questions of the staff? Seeing none, is there a motion?

DIRECTOR WEICHER: Mr. Chair?

CHAIRMAN KORSMO: Oh, excuse me, Director Weicher.

DIRECTOR WEICHER: Thank you. Mr. Winning, would you restate what you said at the end about the risk-based capital?

MR. WINNING: The risk-based capital requirement -- as of the end of August -- we don't have September, yet--was \$429 million. The amount of capital that they had then was not necessarily fully reflective of the implementation, because I think there was still some back and forth, but at that point their capital, which would all go to the risk-based requirement, was approximately \$2.6 billion. Their capital as of the end of September was approximately \$2.3 billion, and I would expect the risk-based capital requirement to be in that same range.

DIRECTOR WEICHER: Thank you.

DIRECTOR MENDELOWITZ: If I could ask you, Mr. Winning, to clarify again. Is there any bank where the binding constraint on capital might be risk-based capital, rather than the leverage requirement?

MR. WINNING: I would say at this point we had not necessarily calculated it out for all the banks, but it appears that the risk-based capital constraint is not binding.

DIRECTOR MENDELOWITZ: Typically, risk-based capital is a quarter of the capital required for leverage.

MR. WINNING: Definitely smaller.

DIRECTOR MENDELOWITZ: Yeah, so that in reality the risk-based capital is interesting from a management perspective--

MR. WINNING: Yeah.

DIRECTOR MENDELOWITZ: --it's interesting when you try to understand the risk that's on the balance sheet of the bank, but in terms of meeting minimum capital requirements, it's virtually irrelevant because of the binding constraint, clearly, is a leverage requirement which requires much more capital than the risk-based calculation?

DIRECTOR WEICHER: As well as being interesting to all those people, it's interesting to me. That's why I asked about it.

CHAIRMAN KORSMO: Any other questions? I apologize for cutting in there too quickly.

DIRECTOR WEICHER: I didn't stick my hand up right away.

CHAIRMAN KORSMO: I was in this mode and I guess I got to this side before I got to that side. Seeing none, Director O'Neill?

DIRECTOR O'NEILL: Yes, if I could move the Seattle Capital Plan Amendment as it appears in the Board Book.

CHAIRMAN KORSMO: We have a motion. Is there any discussion of the motion? Dr. Mendelowitz?

DIRECTOR MENDELOWITZ: Mr. Chairman, I'd like to say that I have a good level of confidence in the leadership of the Seattle Bank and its board of directors. And there are, in fact--out of the full list of changes that they are requesting, there are a number of proposals that I, in fact, support and if they were separated out and we voted on them independently, I might vote for them. Unfortunately, I cannot support all of them at this time.

Consistent with what I've said about other capital plans and how I've voted in the past, I could

support such proposals, meaning the full range of proposals, when they are consistent with and linked to actual changes in the bank's business and risk-management plans. However, those conditions have not been met for all the requested changes and I just wanted to say because of that, I will be voting against the resolution.

CHAIRMAN KORSMO: Is there any other discussion of the motion? Director Leichter.

DIRECTOR LEICHTER: Yes, thank you, Mr. Chairman. I'm somewhat conflicted on this particular resolution and these amendments to the Seattle Capital Plan. I first want to commend the Seattle Bank because they were really the first ones out of the starting gate in the capital plan race, if you will. They got their capital plan done; they implemented it. I have the greatest respect and admiration for the leadership of that bank and President Norman Rice and his staff and I think they've really done an excellent job.

As I've stated before, I'm very leery to have any bank have an AMA capital requirement that goes to zero. I think that raises some safety-and-soundness issues to my mind, and I think it also raises questions as

to whether we're changing the character of the system, the character of the bank because the cooperative nature of the system may be undermined. And, as a consequence, I voted against some of the capital plans that had a zero capital requirement for AMA. I did vote for the Dallas plan, which also had a range from zero to whatever it was. But I pointed out that that plan was consistent with the Dallas business plan and that the Dallas operation didn't envisage holding a large mortgage portfolio.

As I think was pointed out by my colleague Allan Mendelowitz, here we have a change in the capital plan but no change in the business plan. So that we don't have a situation that is parallel to the one in Dallas and we also have, in this plan, which gives me some concern, that by amending the plan to put in a provision for additional stock offerings, it seems to envisage at least the possibility that Seattle will try to do what Chicago has done, which I criticized and which I think is contrary to the way the System has operated in the best interests of the System and the safety and soundness relying, to a large extent, on an investor class.

I appreciate that Seattle at this time is not planning to implement these particular changes. They're looking for the authority to do it. It seems to me that the better approach would be to come to the Board at such time as its business model changes and it needs, in fact, the authority that it is asking for at this time.

I guess my conflict comes because the Board has made changes in the governing principles after the Seattle Plan was approved. And Seattle was held to a standard that was different than was applied to 10 of the other banks. And I can appreciate Seattle saying, well, since you've changed the rules, it's only fair that we should be able to take advantage of these rules as the other banks have. I understand that argument, but in the last analysis, I think I need to come down on what I consider is in the best interest of the System, the best interest of the Seattle Bank. I don't mean to impose my judgment on that of the very competent board of directors, but I think the latitude that was given by the Chairman's memo of April 23rd, with which I've expressed my disagreement in the past, just compels me to say that much as Seattle has an argument in presenting amendments that conform to

what other banks are doing, I've indicated that I don't feel that capital plans that have no capital requirement for AMA are in the interest of the System, in the interest of the banks. They do raise safety-and-soundness concerns. And for that reason, I'm going to vote against this plan.

CHAIRMAN KORSMO: Is there any other discussion? As tempting as it is to engage on this subject, I'll just--for the sake of time, I'll refer to exchanges that Director Leichter and I had in the minutes of the May, June, and July meetings. Dr. Weicher.

DIRECTOR MENDELOWITZ: Joke 26.

DIRECTOR WEICHER: I just want to say I think the point that Director Leichter made about holding Seattle to a different standard than other banks because they were--am I anywhere near this--because they were--just to complicate the lives of the people who are transcribing this--because they were quick to get their plan done, does seem to me to be inappropriate.

I certainly share the concern that we all have about the safety and soundness of individual banks and the System as a whole. I don't have any feeling that the

changes that are being proposed here are likely to have any effect on either the Seattle Bank or the System as a whole. And it seems to me that we are, and that these-- I'd see these as minor, in one sense, conforming amendments and I see no reason not to vote for them and get on with it.

CHAIRMAN KORSMO: Is there any other discussion? Seeing none, the question is on the motion to approve the amendments to the capital structure plan for the Federal Home Loan Bank of Seattle. The Secretary will please call the roll.

MS. BAKER: On the motion before the Board, Director Leichter?

DIRECTOR LEICHTER: No.

MS. BAKER: Director O'Neill?

DIRECTOR O'NEILL: Aye.

MS. BAKER: Director Mendelowitz?

DIRECTOR MENDELOWITZ: No.

MS. BAKER: Director Weicher?

DIRECTOR WEICHER: Aye.

MS. BAKER: CHAIRMAN KORSMO?

CHAIRMAN KORSMO: Yes. The motion is carried and the amendments to the capital structure plan of the Federal Home Loan Bank of Seattle are approved.

The next item on our agenda is -- actually I was going to say a series, but I believe it's just one amendment to the Federal Home Loan Bank of Indianapolis Capital Plan. Again, I turn to Dr. Cross to brief us on this particular agenda item.

DR. CROSS: These amendments were adopted by the board of the Indianapolis Bank on September 19th. I believe that we received them on September 23rd, and as with the Seattle amendments, I asked staff to consider them to determine whether or not the changes were legal within the range of provisions in other approved plans and consistent with safety and soundness. Again, Ellen Hancock, Tom Joseph, and Jim Winning did the bulk of the analysis. In this case I'll turn the floor over to Tom Joseph to describe that analysis.

MR. JOSEPH: The Federal Home Loan Bank of Indianapolis is requesting approval of amendments to its capital structure plan that would allow members to identify the specific shares of stock that are to be

redeemed, repurchased or transferred, and other amendments that would make some nonsubstantive corrections and conforming changes to the version of the plan approved by the Finance Board on July 10, 2002.

Staff believes that the proposed changes are consistent with Finance Board rules and do not raise any safety-and-soundness issues. Staff is, therefore, recommending that the Finance Board approve the amendments as requested by the bank.

The changes to the redemption, repurchase, and transfer provisions address the potential tax consequences for members of these transactions. Specifically because the bank is likely to pay stock dividends in the future, a member's tax basis in different shares of its bank stock is likely to vary. By allowing the member to identify the specific shares of stock involved in a redemption, repurchase or transfer transaction, the bank affords the member greater control over the tax consequences of these transactions.

For example, the member can decide whether it wishes to target stock with a high or low tax basis for a redemption, repurchase, or transfer.

The amendments also establish default procedures for identifying the shares of excess stock that will be redeemed or repurchased by the bank, should the member fail to identify those shares.

The bank worked closely with its outside tax counsel in developing these amendments. Staff believes that the proposed amendments comply with all Finance Board rules. Our rules do not address how a bank should identify the excess stock that may be redeemed or repurchased or transferred. And the rules generally allow a bank to establish criteria for such identification in its capital plan. I also note that other capital plans have provisions for identifying the specific shares of stocks that would be involved in these transactions.

While the amendments do not alter the stock purchase requirements or the ranges associated with these requirements, staff did perform a safety-and-soundness analysis on the proposed amended plan. Jim Winning will briefly describe that analysis and the results for us.

MR. WINNING: Like Tom said, there's no apparent safety-and-soundness issue with this amendment because there's no apparent impact on the amount of stock--the

capital of bank. Still, we looked at the bank's performance. The bank is, in general, on target to meet the financial projections that they put in when they submitted their capital plan. Total assets are on target, mortgage-backed securities and MBP, again, is relatively on target. Capital is about what they expected and the earnings of the bank are very strong. There don't appear to be any safety-and-soundness issues that would imperil the bank's capital or imperil the success of the capital plan.

DR. CROSS: We're free to take questions.

CHAIRMAN KORSMO: Any questions for the staff on this issue. I'm sorry, Dr. Mendelowitz?

DIRECTOR MENDELOWITZ: I just want to clarify. What we're talking about here is a change that, in effect, is primarily concerned with tax avoidance.

MR. JOSEPH: Well, being able to control it. Under the old--or under the plan as originally approved, the bank deemed that the first acquired shares would be the first ones that would be taken back and that would establish a certain tax basis and tax treatment. In this way, the member has the ability to decide--I mean, it may

well, yeah, I mean, it's going to minimize its taxes, one would assume.

DIRECTOR MENDELOWITZ: That's fine. I was just clarifying it. All we're dealing with here is a change to the capital plan--

MR. JOSEPH: Right.

DIRECTOR MENDELOWITZ: --that has nothing to do with safety and soundness or the capital structure of the bank.

MR. JOSEPH: Right.

DIRECTOR MENDELOWITZ: All it's doing is, after examining the plan that they submitted and we approved earlier in the year, they reached a conclusion that the provisions in the plan would produce an unnecessary adverse tax consequence for their members and this change was requested specifically to eliminate that unnecessary and avoidable adverse tax consequence.

CHAIRMAN KORSMO: Or minimize it.

DIRECTOR MENDELOWITZ: Or minimize.

CHAIRMAN KORSMO: Any other questions? If not, is there a motion to approve the request for amendment to the Federal Home Loan Bank of Indianapolis Capital Plan?

DIRECTOR LEICHTER: I'll move.

CHAIRMAN KORSMO: Director Leichter moves approval of the resolution. Is there any discussion of the motion? Any discussion of the motion? I'm looking the wrong way. Director Weicher.

DIRECTOR WEICHER: Not a thing.

CHAIRMAN KORSMO: Any discussion of the motion? Hearing none, the question is on the motion to approve the amendment to the Federal Home Loan Bank of Indianapolis Capital Plan. The secretary will call the roll.

MS. BAKER: On the motion before the Board, Director Leichter?

DIRECTOR LEICHTER: Yes.

MS. BAKER: Director O'Neill?

DIRECTOR O'NEILL: Aye.

MS. BAKER: Director Mendelowitz?

DIRECTOR MENDELOWITZ: Yes.

MS. BAKER: Director Weicher?

DIRECTOR WEICHER: Aye.

MS. BAKER: Chairman Korsmo?

CHAIRMAN KORSMO: Yes. The motion is carried, the resolution is adopted, the amendment to the capital

structure plan of the Federal Home Loan Bank of Indianapolis is approved.

Item number 3--thank you, incidentally, Dr. Cross, Ellen, Jim, Tom. We appreciate your hard work on both of these issues.

Item number 3 on our agenda is a request from the Federal Home Loan Bank of Dallas for an additional discretionary elective director for their Board of Directors from the State of Texas.

Pat Sweeney and Neil Crowley are here to present this agenda item. Who am I calling on, Pat?

MS. SWEENEY: I guess so.

CHAIRMAN KORSMO: Pat, it is.

MS. SWEENEY: The staff is presenting a proposal to the Board of Directors of the Finance Board for approval of a request from the Federal Home Loan Bank of Dallas for an additional elective directorship to be designated for the State of Texas with a term of office beginning 1 January 2003.

Section 7 of the Bank Act requires the Finance Board to annually designate the elective directorships for each state of each Federal Home Loan Bank. It gives the

Finance Board the discretion to increase the number of elective directorships to a maximum of 13 in any district containing 5 or more states. And it authorizes the Finance Board to increase the number of appointive directorships in such districts to a number not exceeding three-fourths the number of elective directorships. The Dallas district contains five states, thus making it eligible for discretionary seats.

I'll give you a bit of history on where Dallas has come with its directorships. In 2002, annual designation of directorships, the Finance Board increased the number of appointive directorships for the Dallas Bank from six to seven, while making no change in the number of elective directorships.

In October of 2000, the Dallas Bank requested the Finance Board to approve a tenth elective directorship. The Finance Board approved this request resulting in a board with 10 elective directorships and 7 appointive directorships.

Then in March 2002, the Finance Board increased the number of appointive directorships of the Dallas Bank, this time from 7 to 8, the number of elective

directorships remain the same at 10. These increases were done under the discretionary authority conferred by Section 7A.

In June 2002--again, during the annual designation of directorships--there was no change to the Dallas board in either appointive or elective directorships. Now, recently, the Dallas Bank has submitted a request for the approval of one additional elective directorship--that would make it 11--to the board to be designated for the State of Texas.

There's nothing in the Bank Act nor the Finance Board regulations that would preclude the Finance Board from adding an additional directorship at this time. Alternatively, the Finance Board could decide to address this matter next year as part of the annual scheduled designation of directorships. The choice of whether and when to approve these directorships is entirely up to the discretion of the Board.

If the Finance Board were to approve an additional directorship, it would have to make the determination as to which state to designate the

directorship and the term of office consistent with its staggering of terms as provided by Gramm-Leach-Bliley Act.

Since more than half of the stock in the Dallas Bank is owned by members in the State of Texas, the Dallas Bank has requested that the additional elective directorship be designated for Texas. Dallas has also asked that the Finance Board provide a one-year term for this position.

If the Finance Board approves this discretionary directorship, as requested, the following scenario would occur: Because Dallas director elections are already in process--and these directorships would be commencing in 2003--the new elective directorship would have to be filled through an affirmative vote of the majority of the Dallas Bank and that would happen after the Board convenes in 2003.

If the Finance Board were to retain the directorship during 2003 designation, the directorship would be filled by a vote of the members of the Board--of the bank during the 2003 election.

CHAIRMAN KORSMO: It should be the bank board of directors would fill this vacancy.

MS. SWEENEY: They would fill the seat for the one-year appointment.

CHAIRMAN KORSMO: It would run for a term of January 1, 2003, but presumably, they are not going to do this until sometime after that.

MS. SWEENEY: That's right and it would--

CHAIRMAN KORSMO: And so, it would end December 31 of 2003?

MS. SWEENEY: 2003, right. And then during the designation process--

CHAIRMAN KORSMO: Our regular process?

MS. SWEENEY: Yes.

CHAIRMAN KORSMO: I'm sorry for interrupting.

MS. SWEENEY: Thank you for the clarification. So, at this time, staff has prepared a resolution for the Board recommending the approval of a one-year appointment of an elective directorship for the State of Texas, and that concludes my presentation. If there are any questions, I'll be happy to take them.

CHAIRMAN KORSMO: Neil, do you have anything to add to--

MR. CROWLEY: No, I believe Pat's covered it all.

CHAIRMAN KORSMO: Are there any questions?
Director O'Neill.

DIRECTOR O'NEILL: This is not so much a question as we should profoundly thank Pat Sweeney and Neil Crowley for doing all this because in the past, I have gone into these matrices in little bit of detail. And, as a matter of fact, I remember Commissioner Weicher, when we went over to preview on these matrices and the complexity is daunting. So the fact the two of them can do all this work for us, we should be profoundly thankful.

DIRECTOR WEICHER: I'll second that. I think the most comprehensible part of the process is the mathematical formula.

[Laughter.]

CHAIRMAN KORSMO: Excuse me, are there any other questions for Pat or for Neil? Allan?

DIRECTOR MENDELOWITZ: The first question I have is, if I understand what you're saying, the reason why the Dallas Bank asked for this extra elective director is it

felt that there were too many public-interest directors relative to elective directors; is that correct?

MR. CROWLEY: Nobody from Dallas has said that to me. I can infer that, but Dallas has in the past expressed a desire to increase the size of--to add the other directors.

DIRECTOR MENDELOWITZ: Okay, so that before the last action of this Board in October of 2000, when there were an appropriate balance there were 7 public-interest directors and 10 elective directors. And that meant that the public-interest directors represented 70 percent of the membership, correct?

MS. SWEENEY: In October?

DIRECTOR MENDELOWITZ: Yeah, of 2000.

MS. SWEENEY: Of 2000, it would be 9/7, 9 elective directorships to 7--

CHAIRMAN KORSMO: Therein the confusion.

DIRECTOR MENDELOWITZ: Okay. Let me back up. But whatever it was, whenever it was, we increased the number of public-interest directors. Okay. The last time I checked it was 7 and 10, right? So public-interest directors were 70 percent relative--there were 7 public-

interest directors for 10 elective directors, right? So the ratio was 70 percent public-interest directors compared to the total of elective directors, right? And our guidance says there should be three-quarters public-interest directors, right?

DIRECTOR O'NEILL: That's not guidance. That's in the statute.

DIRECTOR MENDELOWITZ: It's in the statute, okay, good. Thank you, Director O'Neill. Whenever it comes to the history of the details of this, we've got one source that can always be relied on.

Okay. So the 7 public-interest directors were lower than the three-quarters specified in the statute, right?

MR. CROWLEY: Well, what the statute says is if we have a district that has five or more states--

DIRECTOR MENDELOWITZ: Right.

MR. CROWLEY: --the Board of Directors of the Finance Board can increase the number of elective directors up to as many as 13.

DIRECTOR MENDELOWITZ: Right.

MR. CROWLEY: And if it wants to, it can also increase the number of appointive directors up to a maximum or not exceeding three-quarters of the number of the elective directors.

DIRECTOR MENDELOWITZ: Right.

MR. CROWLEY: A few years ago, this Board looked at that issue, and it adopted a rule that said when you come up with something other than a whole number in determining the number of appointive directorships, you round to the nearest whole number.

DIRECTOR MENDELOWITZ: Right.

MR. CROWLEY: So that when you have a fraction, you're going to round.

DIRECTOR MENDELOWITZ: Now, does the rule say we round up or round down?

MR. CROWLEY: To the nearest.

DIRECTOR MENDELOWITZ: To the nearest.

CHAIRMAN KORSMO: So, assuming we're ever going to have a half, we're still confronted with the same problem.

DIRECTOR MENDELOWITZ: The question is do we get the top half or the lower half. Okay.

DIRECTOR O'NEILL: Actually, to be specific, I think when it came to a half, because, normally, we had 10, and so the question was do we want seven or eight, and I think a previous chairman said that when you are exactly in the middle between seven and eight, we could round up to eight and that's what gets us into this predicament because now people say, well, if you want to have it 75--three-quarters, the best thing to do if we have eight is to make it 11 and that's closer to three-quarters than--as a matter of fact, this I haven't done. If you have 11, what is 8 of 11--

DIRECTOR MENDELOWITZ: It's 72.3 percent.

CHAIRMAN KORSMO: So we're short, in essence.

DIRECTOR O'NEILL: But that is a lot closer.

DIRECTOR MENDELOWITZ: So this is all about--

MR. CROWLEY: I think the standard rounding convention would be, if it is at .5, you round up and I believe that was discussed in the preamble to our rules.

DIRECTOR MENDELOWITZ: Well, that's arithmetic standard procedure. That's what I remember learning in grade school. If you're at .5, you round up, if it's to an even number and you round down if it's to an even

number. You always round to the even number, up or down. So, basically, this is all about getting the proportion of public-interest directors relative to elective directors as close as possible to the three-quarters specified in the statute.

MR. CROWLEY: Not necessarily. The statute does not require three-quarters.

DIRECTOR MENDELOWITZ: Right.

MR. CROWLEY: It allows you, you could keep them or you could have 13 elective directors and keep the appointive directors at six. This is truly discretionary, and the three-quarters is a cap on the upper limit.

DIRECTOR MENDELOWITZ: Okay.

MR. CROWLEY: It's not something that you have to--that you're required to do. You can do it.

DIRECTOR MENDELOWITZ: But if what's motivating this request is the ratio of public interest to elective directors, we could achieve the objective of the Dallas Bank by just eliminating one public-interest director. I mean, that's an option, right? Did the staff consider that option in developing the recommendation to the Board?

MR. CROWLEY: We have a problem in that the Board has already acted to set--earlier this year the Board set the size of the Dallas Bank at 10 elected and 8 appointed. You know, those folks have not taken office yet, but I did not view it as a staff prerogative to recommend undoing something that the Board had just done a few months ago.

DIRECTOR MENDELOWITZ: No, no, wait a minute--

MR. CROWLEY: In the designation of directors--

DIRECTOR MENDELOWITZ: But I'm talking about there's no public-interest directors designated yet that are going to take office on January 1.

MR. CROWLEY: No, no.

CHAIRMAN KORSMO: But the slots are there.

DIRECTOR MENDELOWITZ: We're talking about, you see--but we're talking about a slot for an elective director that starts January 1.

MR. CROWLEY: We would create a new directorship.

DIRECTOR MENDELOWITZ: Effective January 1, so we could achieve the same objective by just cutting one of the public-interest director slots that was supposed to be

filled on January 1 and we'd solve the problem that the Dallas Bank was concerned about, which was a larger number than the 75 percent of public-interest directors relative to elective directors.

MR. CROWLEY: Mathematically if that's what you wanted to do.

DIRECTOR MENDELOWITZ: But, again, Mr. Chairman, I'm raising this because this is--we've talked about the importance of the Board setting policy. And the issue of whether we should meet the statutory requirement by either increasing the number of elective directors or decreasing the number of public-interest directors, really, is a policy issue that I think the Board should have deliberated on and given guidance to the staff before they made any recommendation to us on how to respond to the--

CHAIRMAN KORSMO: I think Mr. Crowley's point on this is we already had established the standards for this year. Now, whether we want to revisit the standards for next year is a different question. But I think his point is that given the decisions we've already made on this point this year about the number of appointive directors who are in place, the way to address this issue probably

isn't at this point to go and say to somebody who already is in place for a term-certain, we're eliminating your position.

DIRECTOR MENDELOWITZ: Oh, Mr. Chairman, I agree with you absolutely. I'm talking prospectively about 2003.

CHAIRMAN KORSMO: Correct.

DIRECTOR MENDELOWITZ: The elected director that Dallas is requesting is for a term that would begin January 1, 2003.

CHAIRMAN KORSMO: Correct.

DIRECTOR MENDELOWITZ: There are public-interest directors whose terms are expiring on December 31, 2002.

CHAIRMAN KORSMO: That is correct.

DIRECTOR MENDELOWITZ: So that we're all talking about the same thing which is setting the number of elective directors and appointive directors beginning January 1, 2003.

CHAIRMAN KORSMO: No, we sort of are. We've already made the decision about the number of elective-- oh, excuse me, appointive directors for 2003 when we adopted the numbers, whatever that was.

MS. SWEENEY: Which is eight.

CHAIRMAN KORSMO: Yeah.

DIRECTOR MENDELOWITZ: When was that adopted?

MR. CROWLEY: Well, I think that it--I may be causing some confusion here. I recognize that we haven't identified individuals for those terms, but I think that we have created the slot. The Board has decided that there will be--

CHAIRMAN KORSMO: For 2003.

MR. CROWLEY: --eight appointive directorships and there may be two or three of them who will expire and we don't know who will be in the position when it is established, but I believe the seat exists.

DIRECTOR MENDELOWITZ: So, I believe it is a policy issue because whether we want to eliminate an unfilled position for 2003 or--

CHAIRMAN KORSMO: No, we've already made that decision. See, that's the problem. We've already made the decision for 2003. Now, if we wanted to do it prospectively for 2004, which indeed we will be doing here at some point after the first of the year, then we can address that.

DIRECTOR MENDELOWITZ: Well, I view the issue of, you know, it being closed at the point at which someone is selected by the board to fill a position. I don't think it would be appropriate.

CHAIRMAN KORSMO: I know you do, but unfortunately hasn't been the practice as I think Mr. Crowley tried to explain to us --

DIRECTOR MENDELOWITZ: Right.

CHAIRMAN KORSMO: -- is that the slots have been established for 2003 even though the vacancies that will open up on December 31st of 2002 necessitating appointments for 2003 have not yet--those appointments have not yet been decided in terms of individual names.

DIRECTOR MENDELOWITZ: Because I've heard absolutely nothing about filling slots for the 2003 period. I have seen no names, I've had no discussion with anyone on this Board. You've had no discussion with me. My view is that no action has been taken to appoint anyone to fill any slots for 2003. So, as a practical matter, the fact that we've already designated x-number of public-interest slots for January 1, 2003, they have not been filled. And because they haven't been filled before, as a

policy matter, could we visit this without doing any harm, that's my point.

CHAIRMAN KORSMO: Whether or not it's without any harm or not would be in the eye of the beholder, but you're absolutely correct, we certainly could decide to change the decision we made earlier in the year about the number of elective directors of the Dallas Bank for the year prospectively.

Director Weicher's been trying to make a comment here for some time.

DIRECTOR WEICHER: Well, I think this discussion confirms my earlier point that the mathematical formula is the most comprehensible--the only comprehensible part of this whole process.

I just wanted to ask a question. As we made clear in New York--I am not a lawyer, this is the economist half or 40 percent of the Board. But the language in Section 7(A)--I haven't gone back to look at the U.S. Code--authorized the Finance Board to increase the number of appointive directorships in such districts to a number not exceeding three-fourths of the number of

elective directorships. Is that literally what the statute says?

MR. CROWLEY: Yes.

DIRECTOR WEICHER: Okay, so that it doesn't-- okay, that's my question and if we--I'm not sure if we're having questions or discussion at this point, but that's at least my question.

CHAIRMAN KORSMO: Well, I think the point is-- getting back to Dr. Mendelowitz's comment, as a Board, we could make the policy decision to lower the components-- the component part of the board of directors that is made up of appointive directors. All the statute envisions-- and please correct me if I'm wrong here, Neil--is that the appointive directors can't be more than a number equivalent to three-quarters of the number of elective directors.

We could have no--am I wrong about that--we could have no appointive directors or we could have two or--

MR. CROWLEY: Six.

CHAIRMAN KORSMO: Six is the minimum.

MR. CROWLEY: Yes.

CHAIRMAN KORSMO: So we could go in each case, we could go to six. And I think you're right, that's a policy decision at some point maybe we want to consider, but I don't know that that's the issue on the table today.

DIRECTOR WEICHER: Well, if we are talking about the substance, as opposed to asking the staff questions, then I want to just make a couple points. One is, I think the staff acted exactly right in forwarding this to us under the statute that seems to me to be the appropriate thing to do and, as we have said, it's perfectly free for us to do what we will under the statute, but I'd rather have the staff making a recommendation to us that's consistent with the statute than making a recommendation to us that says we think you should do something, you should undo something that you've just done. It's a free country and if that's your opinion, that's fine, but I'd rather proceed on this basis.

The second thing, it seems to me--again, I'm not a lawyer, but if this is what Section A says, then I go at it the other way than even discussing it mathematically. If we have eight, then eight is three-quarters of 10 and two-thirds, and so it is not three-quarters of 10, it is

more than three-quarters of 10, and, therefore, it seems to me by my nonbinding interpretation of the statute, we should have 11. I recognize we could go back to seven as a matter of policy on the appointive side. As a matter of policy I would propose to go back to seven and I'll--if we ever have such a recommendation or motion, for what it's worth, I'll vote against it. And, therefore, as I read it, we essentially need to go to 11. Maybe the statute has been glossed by all you lawyers so that we can treat eight as seven and a half, but I treat it as eight and that's the point of my question. If that's what the statute says, then we start with eight and we get to 10 and two-thirds.

MR. CROWLEY: That is what the statute says.

DIRECTOR WEICHER: And in that case we don't have the rounding--we never have the rounding problem. We can always get to--and we will never-- not with any number that I can think of as a likely sized Board of Directors, we'll never get to that problem.

CHAIRMAN KORSMO: Given the minimums of the next one.

DIRECTOR O'NEILL: And I think that for those that have five states or more, which are five, that this will be precedent setting, and I think very quickly the other four that have eight appointive directors will get requests in here quickly, so that they will have 11 because, as Director Weicher says, this is very close to two-thirds. But it's under two-thirds, which is what the statute says. So I think that we should expect in Dallas, in Atlanta, in Seattle, and in Des Moines that we should expect the same thing soon.

One other thing and this is an issue that we haven't heard about for a while because the devolution is over, but this is something that was devolved from the Finance Board to the banks. I remember when Pat Sweeney, all of her time was spent doing the elections before that was devolved down to the banks. So, since we have devolved this down to the banks, that's the reason I'm going to vote in favor of this because to do otherwise would get us back in something that has been devolved down.

CHAIRMAN KORSMO: We've wandered into the area of discussion. Are there anymore questions of the staff before we move to discussion? Director Leichter?

DIRECTOR LEICHTER: Well, this discussion certainly shows the ability that we have in Washington to take any issue, seemingly as simple as it might be, and make it complex to the point of incomprehensibility.

CHAIRMAN KORSMO: Not unlike these federal election laws dealing with fund-raising. Thank you, Director Leichter for pointing that out.

DIRECTOR LEICHTER: I have a question. I mean, it seems to me that partly what's happened is you keep leap-frogging between the public-interest directors and the elective directors. And my question is, since now the public-interest directors will not be equal to three-quarters, are we in the situation where somebody could argue that you could appoint another appointed director--

CHAIRMAN KORSMO: Except we'd have to go to 12 before they'd get to the point where 8 isn't already at the maximum.

DIRECTOR LEICHTER: Well, eight--I'm sorry, eight you said was 72.5 percent.

DIRECTOR MENDELOWITZ: 12 and nine is a perfect 75 percent.

DIRECTOR LEICHTER: 12 and nine, which exactly leads to my question that we don't want to continuously have this leap-frogging so that--

CHAIRMAN KORSMO: But the statute does anticipate that. They limit the number of elective directors to 13 as a maximum.

DIRECTOR LEICHTER: That's right. We could--13 would end the process, but we're not at that yet. I just want to--I just wanted to know whether we're--we may face the situation where then somebody says, well, appoint another public interest director and then we'd have to come back and then they'd come and have another elective director.

DIRECTOR O'NEILL: I think what the Chairman was saying is that the only way that we would get another appointed director is if a bank said, I want 12, so it would be the bank that would do something first and then we would have the ability to do it. So my guess is that no bank is going to go to 12 because nobody wants 9.

DIRECTOR LEICHTER: I understand what you're saying, Tim. I guess, in a way, you've answered my question, but yes, this leap-frogging process can continue and, maybe, as a policy we would decide it would be good to have every bank at the statutory maximum number of elected and public-interest directors. But it just seems to be that we've had sort of an agreed-upon number that we've had at the banks that have five states in their district. And Dallas seems to be sort of in this leap-frogging where we added a public-interest director and, as a consequence, now we've got to add an elected director. And I just wonder whether we're at the end of the process and what my colleague Tim O'Neill says, well, maybe but not necessarily because the bank may come and ask us for some more.

CHAIRMAN KORSMO: Let me point this out again. Are there any more questions of the staff before we-- because we should have this discussion probably after there's a motion on the floor. Director Weicher?

DIRECTOR WEICHER: There really is a question, Mr. Chairman, and I apologize earlier, I wasn't sure whether we had gone to questions or discussion or not.

CHAIRMAN KORSMO: No, no, that's fine.

DIRECTOR WEICHER: I think I have understood from what you all have been saying that we have a legal requirement for a minimum of six appointive directors and a legal requirement for a maximum of 12 elective directors--

MR. CROWLEY: Thirteen.

DIRECTOR WEICHER: Maximum of 13 elected directors. Then here are our options. Six appointive directors, requires eight elective directors, at least; seven appointive directors, requires 10 elective directors; eight appointive directors, requires 11 elective directors; nine appointive directors, requires 12 elective directors; and if we go to 13 elective directors, we still are at nine. So we have five--

DIRECTOR MENDELOWITZ: No, no, we have 10 because that's exactly .76 percent.

DIRECTOR WEICHER: That's exactly .75. It's more than--

MR. CROWLEY: You can't exceed 75.

DIRECTOR O'NEILL: There was one thing you said wrong. Because of the rounding--

DIRECTOR WEICHER: I'm so proud of myself.

DIRECTOR O'NEILL: Because of the rounding we can have eight and 10, rather than seven and 10, which is--

DIRECTOR WEICHER: Not the way I understand the statute. If the statute says no more than three-quarters, then eight is what drives it and requires 10.67, which is 11. I told you mathematical formulas.

DIRECTOR O'NEILL: What happened was, when there's a fraction, we rounded up.

CHAIRMAN KORSMO: Is there a question for staff in there somewhere?

DIRECTOR WEICHER: That was my question.

CHAIRMAN KORSMO: Well, let's let the staff--I mean I appreciate Director O'Neill's historic perspective on this, but let's let the staff respond to the question.

MR. CROWLEY: I'm not sure that I got exactly the question you're asking.

DIRECTOR WEICHER: Oh, they did. The question was; was it a minimum of 6 appointive directors and a maximum of 12 elective directors and the answer was--that

was my question and the answer was, yes, six is right, no, 12 is wrong, it's 13. That was my question.

MR. CROWLEY: Thirteen is, I mean, the standard board is six appointive and eight elective--

DIRECTOR WEICHER: Right, but the statutory limit is 6 and 13.

MR. CROWLEY: --in these states--no, no. Once you get into the districts with five or more states, then the maximum to be elective goes up to 13--

DIRECTOR WEICHER: Right.

MR. CROWLEY: --and the maximum for the appointed goes up to three-quarters of whatever number you have selected for your elective directors.

DIRECTOR WEICHER: Ah, so then--

MR. CROWLEY: If you have 13 it's three-quarters of 13 in your--

DIRECTOR WEICHER: So the previous question was--so Director O'Neill was right and I was wrong or my understanding of the statute was wrong. In these states, it does work from the number of elective directors down and not from the number of appointive directors up.

MR. CROWLEY: Correct.

DIRECTOR WEICHER: I stand corrected.

DIRECTOR O'NEILL: What this all goes to show is that the Congress giving us any discretion is fraught with controversy.

CHAIRMAN KORSMO: Shhh, don't be making that statement. Dr. Mendelowitz?

DIRECTOR MENDELOWITZ: I actually have several questions for the staff. The first is, what is the legal or regulatory requirement for the Board to use when deciding where to place a discretionary elective directorship? In other words, there are a total of five states in the Dallas region and what is the guidance that regulation statute gives us as to where to place a discretionary director?

MR. CROWLEY: The short answer is that there is none. It is discretionary--

DIRECTOR MENDELOWITZ: Okay.

MR. CROWLEY: --in every sense of the word, both as to the creation of the additional seats and as to the means by which you allocate that seat.

CHAIRMAN KORSMO: Seats nine through 13.

MR. CROWLEY: Correct.

CHAIRMAN KORSMO: I'm sorry.

DIRECTOR MENDELOWITZ: So, it's totally discretionary.

MR. CROWLEY: It is discretionary.

DIRECTOR MENDELOWITZ: So it is up to the board members in their collective judgment to decide what state to place it in?

MR. CROWLEY: Correct.

DIRECTOR MENDELOWITZ: Now--

CHAIRMAN KORSMO: There is a formula for providing the first eight--

DIRECTOR MENDELOWITZ: Right, I understand that.

CHAIRMAN KORSMO: --but seats nine through 13.

DIRECTOR MENDELOWITZ: I've got it. Let me ask you a question. There are five states in the region and under the statute, each state gets at least one director, elective director on the board of directors. Now, how many, on average, how many members does a director from-- an elective director from Texas represent, currently on the board of the Dallas Bank?

MR. CROWLEY: Do you have that?

MS. SWEENEY: I don't have that.

MR. CROWLEY: I mean, the statute isn't--

DIRECTOR MENDELOWITZ: No, no, I'm just asking--
it's an arithmetic question. Not a statute--

MR. CROWLEY: How many members are there--

DIRECTOR MENDELOWITZ: Yeah, on average, how
many members does each elected board member from Texas
represent with respect to the, you know, number of Texas
members?

CHAIRMAN KORSMO: Well, let me help Neil.
There's 401 active members in Texas, there are five
directors, so they represent 80.

DIRECTOR MENDELOWITZ: Eighty, okay.

CHAIRMAN KORSMO: --institutions on average.

DIRECTOR MENDELOWITZ: Okay. Good. And in New
Mexico, how many members does the elected director
represent?

MS. SWEENEY: Fifty-three.

DIRECTOR MENDELOWITZ: Fifty-three, okay. And
in Mississippi, how many members does an elected director
represent?

MS. SWEENEY: Eighty-seven.

DIRECTOR MENDELOWITZ: Eighty-seven, okay. Now, in Louisiana how many members does an elected director represent?

MS. SWEENEY: There are two directors for the State of Louisiana; there are a total of 128 members.

DIRECTOR MENDELOWITZ: One hundred twenty-eight, so it's 64, okay. And for the state of Arkansas, how many members does an elected director represent?

MS. SWEENEY: There are a total of 142 and Arkansas has one seat.

DIRECTOR MENDELOWITZ: Okay, so, basically, each elected director from Arkansas represents 142 members. Each elected director from Louisiana represents 64 members, that's less than half. Each elected director from Mississippi represents 87 members, which is, you know, close to half of what Arkansas represents, okay. Each elected director from Mississippi represents 53 members, right? And, Mr. Chairman, you told me each elected director from Texas represents, you said, 80?

CHAIRMAN KORSMO: Well, there are 401 members so that's 80.

DIRECTOR MENDELOWITZ: Okay, so basically, we have a situation here where we've got the elected director from Arkansas representing a very large number of members compared to all the other states, right?

MR. CROWLEY: Bear in mind those directorships are allocated in these--in the case with one-per-state, it's statutory one-per-state.

DIRECTOR MENDELOWITZ: No, no, I understand that.

MR. CROWLEY: And that the 142 members in Arkansas hold--

DIRECTOR MENDELOWITZ: No, I'm not asking a question about capital stock. I asked you the basis on which the statute and the regulation gives us guidance on how to allocate a discretionary seat for an elective director on the board of directors.

MR. CROWLEY: And I gave you the answer.

DIRECTOR MENDELOWITZ: You told me there is no guidance whatsoever, it's totally discretionary.

MR. CROWLEY: Correct.

DIRECTOR MENDELOWITZ: So, I'm trying to establish, you know, over-representation, under-

representation, based on membership, that's all. So, currently, Arkansas has 142 members for each elected director and Texas has about 80 members for each elected director. Okay. Now, the Dallas Bank asked us to assign the discretionary elected member, if we choose to approve it, to the State of Texas. So what would happen to the average number of members represented by each director from Texas if we did this?

MS. SWEENEY: It would be about one to seven again.

MR. CROWLEY: Sixty-seven.

DIRECTOR MENDELOWITZ: Okay, so Texas would go from about 80 down to 67, right? And that's basically in the same range of all the other states, except for Arkansas, which would still remain at 142, right? Okay. That was my technical question for the staff.

CHAIRMAN KORSMO: I'm glad we have that answered. I should mention that those of us from states like North Dakota are particularly sensitive to these kinds of issues. Montana is probably the better example, which has something like 830,000 citizens, but one member in the House of Representatives and there are

congressional districts in the nation that, for one reason or another, I think the average now is 600--or is it 570,000 or something like that. So, you know, so the average congressional district, at least in the eyes of Montanans, is over-represented in that point. Anyway, Director O'Neill?

DIRECTOR O'NEILL: No. Can I now--

CHAIRMAN KORSMO: Is this a question or--

DIRECTOR O'NEILL: --can I make--

CHAIRMAN KORSMO: Do you have any more questions for the staff?

DIRECTOR O'NEILL: Can I make a motion--

CHAIRMAN KORSMO: Well, wait let's see if--let's make sure--do we have any more questions for the staff? Hearing none, now let me call on Director O'Neill.

DIRECTOR O'NEILL: Can I move, as it is in the Board Book, that the State of Texas gets one more elected director as it is stated in the Board Book?

CHAIRMAN KORSMO: As requested by the Federal Home Loan Bank?

DIRECTOR O'NEILL: Yes.

CHAIRMAN KORSMO: I don't mean to put words in your mouth, but--

DIRECTOR O'NEILL: As requested by the Federal Home Loan Bank.

CHAIRMAN KORSMO: Thank you. We now have a motion on the table. Is there any--finally, we have a motion on the table--after only 40 minutes, we have a motion on the table. The Chair is feeling like the discussion's getting away from him. Is there any discussion of the motion? Dr. Mendelowitz?

DIRECTOR MENDELOWITZ: Mr. Chairman, you and I, I think, have the same concerns with respect to the interests and protecting the interests of small institutions who are members of the Federal Home Loan Bank System. We've had this discussion before. I know that we both believe that the services provided to small members are the most legitimate and defensible in terms of the context of what it is appropriate for government to do when it intervenes in capital markets. And I raised the question with the staff over the representation of directors because what I've been grappling with, with respect to this request--I realize this request sounds

like a plain vanilla request. But what I've been grappling with respect to this request is my ever-present concern over protecting the interests of small members in the System and protecting their access to the benefits of the System.

The small members have far less clout in the System than the small number of very large members. And I'm always concerned that the greater clout and power that a handful of big players have will skew the distribution of benefits of the System to the big players at the expense of the small community institutions who I think are the most legitimate reason why this System exists.

Now, the required members, the nondiscretionary membership, is allocated on the basis of capital. And the bigger the institution, the more capital. So that the allocation of required elected members really is skewed very heavily toward the small number of large players in the System because they have so much more capital. And the issue I'd like to put on the table for discussion is, when it comes to the allocation of discretionary members, Mr. Chairman, how should we weigh the interests of small community institutions against large institutions in an

effort to try to protect the interests of our small members? Namely, is the fact that Arkansas has a large number of small members, and has only one elected director under the mandatory system, based on capital. So that each director from Texas represents 142, you know, small members in essence, whereas in Texas each elected director already represents half as many institutions as the director from Arkansas.

CHAIRMAN KORSMO: Two-thirds.

DIRECTOR MENDELOWITZ: What?

CHAIRMAN KORSMO: Two-thirds.

DIRECTOR MENDELOWITZ: Two-thirds. Should we, in fact, or actually, more, like, well, maybe whatever--whatever--round numbers, a ratio that the number of members the elected directors in Texas represent is considerably smaller now than Arkansas. Should we, in fact, allocate this elected director to Texas because under the existing mandatory rules, they have more capital and, therefore, they're entitled to it? Or should we, in fact, allocate this elected director to Arkansas in an effort to try to bring balance to the system and protect the interests of small community institutions?

I'm putting that on the table for discussion. I haven't fully resolved in my own mind where I'm going to come out and I really look forward to being informed by the discussion of my colleagues on the Board.

CHAIRMAN KORSMO: Before I call on Director O'Neill, I think it's important to remind everybody that, frankly, I asked Director Mendelowitz to raise this issue at this meeting in the wake of our discussion about this whole question--or, excuse me, in the wake of our briefing on this particular issue. We certainly did not discuss it at the briefing. But because it would be appropriate to discuss this policy aspect of this question at a Board meeting.

That having been said, well, first, I didn't anticipate we'd go 45 minutes on this, but that's fine, I mean this is the appropriate forum for us to have this discussion.

I think one of the things we should keep in mind in dealing with this issue--two things, actually: one that Director Weicher has already raised to us in pointing out the statutory issue we're confronting here with this particular request; and, second, keeping in mind that

we're in a situation now where we're dealing with an issue that might constitute changing rules in midstream by virtue of the fact that we already adopted at some previous meeting an allocation of directorships among the states in this district and, indeed, in all the districts that involved not just the mandatory elected directors whose allocation is based on capital stock, but we also set a standard for the allocation within those particular bank districts among the states of the discretionary directors.

I think the reason this discussion is important--and I'm grateful to my colleague for raising it -- he has put on the table an issue that we clearly have to keep in mind when we deal with the issue of apportioning directorships for the next election cycle, particularly, obviously, because these are the only ones with which we have discretion, those discretionary directorships that we consider. Obviously in the case of a bank that has 10 directors and only eight are the required, last year, we made a decision on where to assign two discretionary directorships. I think what I hear Allan suggesting is we may not have considered all the relevant factors when we

made that decision. And we should be clear that when we make this decision in the next cycle that we keep these kinds of factors in mind.

I would also suggest from my colleagues that well in advance of us having to deal with that issue, given the fact the discussion on the distribution of mandatory members is based on the capital situation on December 31 of this year, it won't take place till sometime after the first of the year. But that having been said, I think we want to be very careful when we make the decision in the next cycle about how, indeed, we distribute those discretionary directorships that already exist or may exist in the future for those five banks where the discretionary board seats exist.

Director O'Neill?

DIRECTOR O'NEILL: I applaud you, Allan, for giving us a sense of the different ratios for each of the states. But I guess what I come back to is we have discretion in some areas; in some areas, we don't. So, for seven of the banks, we never get involved in elected directors.

CHAIRMAN KORSMO: The allocation is a strict formula.

DIRECTOR O'NEILL: Yeah, because there are not five states, and if there are not five states, we don't have any discretion. For me, as you all know, we have some battles that we always wage over appointed directors. But for us to get so involved in the minutia of elected directors, to me, defeats the whole purpose of the devolution which said that this is for the states to decide, I mean, for the districts, the 12 banks and the districts to decide the way things go. So, I know that this is very, very simplistic. But for me Dallas said that it wanted an extra seat and they said that they wanted it in Texas. So, I think that they should be the ones that make the decisions, not us. So the reason that I'm going to vote in favor of this motion is because this is what Dallas says that it wants. And if we debate endlessly in these five, only five districts that we have the discretion, it seems like we would be reversing the devolution that was finished in Gramm-Leach-Bliley. For what's that worth.

CHAIRMAN KORSMO: Is there any other discussion?
Director Leichter?

DIRECTOR LEICHTER: Yeah, I just want to say, I'm going to support this resolution, but I think that Director Mendelowitz raised an important issue and I have to disagree with you, Tim, that this devolution certainly doesn't resolve this issue. I mean, if there was the devolution as you saw it, then the Texas or the Dallas Board wouldn't have to come to us and ask us for permission, discretionary action by this Board. And I think what Dr. Mendelowitz is suggesting that we have some standards. And one of the standards might well be the degree of representation of financial institutions. I think that's appropriate and I think we might even ask the staff if they would maybe make some recommendations to us. But I think it's an important policy question and raises some very fundamental issues as to the purpose of the system, what we exist for, and what our justification is. So I think it's appropriate to spend some time in trying to come up with some coherent standards.

DIRECTOR MENDELOWITZ: If John wants to go, I'm happy to let him go first.

DIRECTOR WEICHER: No, I think we've had enough discussion. From my standpoint, I've had enough discussion, before and after the motion.

CHAIRMAN KORSMO: Director Mendelowitz?

DIRECTOR MENDELOWITZ: I have to say, Tim, that I appreciate your comment, but you made it more difficult for me to vote for the resolution. I certainly would not want this meeting to close and leave anyone with the impression that I vote for things because the banks ask for them. I think that, you know, as the arm's-length regulator of the System, it's our job as a Board, collectively, to make judgments about those areas within our purview and make those judgments within the scope of our authority and responsibilities. As such, as Director Leichter pointed out, the allocation of the discretionary elected directors is a responsibility that rests with the Board or the Finance Board. It is not something that was delegated to the individual banks and, therefore, it is not something that, in fact, that should fall into the issue of delegation down to the banks.

With that said, I think we've raised a number of, I think, really important policy issues here. One is

what is the appropriate size of the board of directors of a Home Loan Bank. And this is an important issue because the statute sets the minimum size and it sets a maximum size, but we have discretion between the minimum and the maximum. And I believe there is a tradeoff on which I really have no information about. And that tradeoff is the more people you add to the board of directors, the more costs you impose on the operations of the Home Loan Bank System. Each additional director adds the cost paid to the director for meetings, travel costs, all these other things, and they can be quite substantial.

On the other hand, each additional director may, in fact, strengthen the quality of corporate governance and I don't know the relationship between the size of the board of directors and the quality of corporate governance.

Now, we do have an examination coming up on the part of our examination staff which is a systemwide, single-issue audit of the quality and effectiveness and best practices of corporate governance of the System. And so, I would like to task the staff when they undertake that examination to include in the audit program, or the

examination program, an effort to try to understand the link between the size of a board of directors and the quality of corporate governance so we can factor that into our discussions about whether we want to make the boards larger with discretionary directors or smaller.

So, if we can do that, I think that will inform our future discussion on whether to add discretionary directors.

CHAIRMAN KORSMO: I think that's an excellent point. I can't believe these words are coming out of my mouth, but I'm less concerned about the cost of adding individual directors than I am, I think, the flip side of your other point about that, whether having more actually improves corporate governance. I know that there is a point at which it makes more sense--I mean, too many cooks spoil the pot, in a certain sense. So, I think you're absolutely right on point, however, that this is an important aspect that should be addressed as we look at the whole question of Board governance.

DIRECTOR MENDELOWITZ: And I look forward to being informed by the staff's examination. The second issue is where do we allocate the requested spot, and I

have to say I found your arguments persuasive as to why we should, in fact, act directly on the request for an additional elected member rather than consider the option at this point of reducing the number of appointed directors. Your arguments were persuasive. I'm willing to go on and deal with that issue directly on the merits of the case. And because of the arithmetic, we really don't have much of an option there. I think, in fact, the arithmetic drives us, in my view, to approve an additional director.

So, that leaves, finally, the issue of where that elected director goes. As long as we view this allocation as an allocation for one year and one year only, I am not that troubled by complying with the request from Dallas. As long as we make clear to Dallas that this is not a permanent increase in the representation of the Texas Banks on the board of directors of the Dallas Bank. And secondly, if we, as a Board, give policy direction to the staff to examine the full range of issues and report back to us so we can make a determination as a policy matter the basis on which we're going to allocate in the future discretionary directorships, I would be prepared

to--not enthusiastically--but I would be prepared to vote for this resolution.

CHAIRMAN KORSMO: I think both of your second items are a given in the sense that--and this was why we thought it was important for us to have this discussion on the record today--is that we are now, as a Board, more engaged on this whole distribution question than I think we were when we made the decision last year, for whatever reason. So I think we can take as a given both of those points.

Director O'Neill? And then I think I'll call for the vote.

DIRECTOR O'NEILL: Your last point about it only being one year is a given because every year the staff does an allocation--gives us a sense of, based on the stock, who--which shifting has to happen based on the stock allocation. So as far as the elected directors, it's always only a one-year judgment. And next year, we'll have a different judgment. So that--

DIRECTOR MENDELOWITZ: But, Tim, one of the concerns I have is that historically, we de facto have used the capital allocation--

CHAIRMAN KORSMO: That is correct.

DIRECTOR MENDELOWITZ: --as a basis for allocating discretionary directorships and I am putting on the table, with the Chairman's support and encouragement, the fact that we have to examine the basis on which we allocate the discretionary directorships and I would submit, you know, a major concern and criteria that we should apply is, you know, how does the allocation of elective directorships affect the representations and interest of small community institutions.

CHAIRMAN KORSMO: I think at this point I will exercise my discretion as the Chair and call the question. The question is on the motion to approve the request of the Federal Home Loan Bank of Dallas to add an additional elective director for the State of Texas for the year--for the calendar year 2003. The secretary will please call the roll.

MS. BAKER: On the motion before the Board, Director Leichter?

DIRECTOR LEICHTER: Yes.

MS. BAKER: Director O'Neill?

DIRECTOR O'NEILL: Aye.

MS. BAKER: Director Mendelowitz?

DIRECTOR MENDELOWITZ: Yes.

MS. BAKER: Director Weicher?

DIRECTOR WEICHER: Aye.

MS. BAKER: Chairman Korsmo?

CHAIRMAN KORSMO: Yes. The motion is carried.

The request from the Federal Home Loan Bank of Dallas for the addition of an elective director from the State of Texas for the calendar year 2003 is approved.

And let me say, again, how much I appreciate us having this discussion today. I think this was the proper forum for this discussion to take place. I think it does provide guidance to the staff as to what we want to consider when we deal with this issue next year and appreciate very much, Pat and Neil, your hard work on dealing with this question. Thank you very much.

The final item on our agenda, Item No. 4-- before I bring it up, let me first apologize for an error. The agenda for today had originally listed an item concerning the board of directors for the Office of Finance. It should have listed two appointments to the Financing Corporation Board. With our Finance Board,

Office of Finance, and Financing Corporation, unfortunately communication sometimes breaks down. It's entirely my fault and I apologize. This was listed as tentative because I thought it wise to consider whether we should avoid overlap in the President's serving on the Office of Finance, board of directors, the REFCORP board of directors and the FICO board of directors. In this case, we can easily do so, but I do recommend that my colleagues consider this as a policy question. And we may want to have a discussion on that point.

I don't know that there's any staff input on this. I think the recommendation at this point is that Al DelliBovi of the Federal Home Loan Bank of New York and Chuck Thiemann of the Federal Home Loan Bank of Cincinnati be appointed to the FICO Board. I will announce that, in my discretion as Chairman, I'm authorized to designate one of the two members of the board as Chair and it is my judgment or I am announcing that assuming both Mr. DelliBovi and Mr. Thiemann are appointed, that it is my intention to designate Mr. DelliBovi as Chair of this body. With that, if we could have a motion, perhaps we should have a discussion and let me open the floor to

discussion about the recommendation, to the extent that we can, avoid having overlapping directorships among the 12 presidents. Director O'Neil?

DIRECTOR O'NEILL: In the past we have made sure that there's no overlap between FICO and REFCORP because those are two sets of bonds, one in '87, one in '89 so there might be some problem. So we always have made it clear that there couldn't be any overlap between FICO and REFCORP.

My view is that, more than either of those, the most work is with the Office of Finance, so my view would be why don't we make it so that there will be no overlap on any of the three and that way we will spread the work among the bank presidents. I would say that it would mean that there would be six people that serve one of them and six people that don't. The problem is that although FICO and Office of Finance are one-year appointments, REFCORP is a three-year appointment so it's not perfect symmetry. But, in general, it would be that six people would be on one of the three boards and six weren't and then it would switch. And I just think that makes it better for the

workload among the 12 bank presidents. That's, I guess, my view on it.

CHAIRMAN KORSMO: I appreciate those comments. Is there any other discussion of this question as a policy item about the rotation? I'm assuming that silence indicates that we have a consensus developed that this is the appropriate policy. Director Mendelowitz?

DIRECTOR MENDELOWITZ: In deference to the fact that John has a day job.

CHAIRMAN KORSMO: Thank you. So we will, by adopting this particular appointment motion, let's assume, at least until we make a different determination, that our practice will be that we will avoid overlap on service on the three Boards to the extent that that's possible. As I said I can't see any reason why we can't avoid that.

With that, I would entertain a motion to approve the appointment of Al DelliBovi and Chuck Thiemann as the directors of the FICO board for--the term is one year; is that correct? Thank you. Director Mendelowitz?

DIRECTOR MENDELOWITZ: I so move.

CHAIRMAN KORSMO: We have a motion. Is there any discussion of the motion? Seeing no discussion the

question is on the appointment of the Financing Corporation directors. The secretary will please call the roll.

MS. BAKER: On the motion before the Board, Director Leichter?

DIRECTOR LEICHTER: Yes.

MS. BAKER: Director O'Neill?

DIRECTOR O'NEILL: Aye.

MS. BAKER: Director Mendelowitz?

DIRECTOR MENDELOWITZ: Aye.

MS. BAKER: Director Weicher?

DIRECTOR WEICHER: Aye.

MS. BAKER: Chairman Korsmo?

CHAIRMAN KORSMO: Yes. The motion is carried. Al DelliBovi and Chuck Thiemann are hereby appointed to serve as the directors of the Financing Corporation for the next year. And as I indicated earlier, it is my intention, then, to name Mr. DelliBovi as the Chairman of that body.

Is there any other business to come before the Board? Hearing none, thank you very much. I think this

has been an important discussion. We've dealt with some serious issues, and I appreciate the comments today.

And with that, this meeting is adjourned thank you.

[Whereupon, at 11:30 a.m., the meeting was adjourned.]

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