

Federal Home Loan Bank System
Lending and Collateral Q&A
December 4, 2008

Note> Each answer in this document is written as if it were a stand-alone response. Therefore, some information may be repeated.

1. What is an advance and how do advances work?

The FHLBanks make loans, called “advances,” almost exclusively to their members¹ on the security of mortgages and other collateral pledged by the borrowing member. Advances are the largest category of assets of the FHLBanks on a combined basis, representing 70.8 percent of total assets at September 30, 2008 and 68.8 percent of total assets at December 31, 2007. Advances are secured by mortgages held in member portfolios and other eligible collateral pledged by members. Due to market, size or other limitations, lenders may originate loans that they want to hold in portfolio or are unable to sell in the secondary mortgage market. FHLBank advances can serve as a funding source for a variety of conforming and nonconforming mortgages. FHLBank advances support important and diverse housing markets, including those focused on low- and moderate-income households and rural areas. For those members that choose to sell or securitize their mortgages, FHLBank advances can provide interim short-term funding.

Each FHLBank develops its program of advances to meet the particular needs of its members. The FHLBanks offer a wide array of fixed- and variable-rate advances, with maturities ranging from one day to 30 years. The FHLBanks offer both standard and customized advance structures.

2. Who can borrow from the FHLBanks?

As a cooperative, each FHLBank conducts its advance business almost entirely with its members. Membership is limited to regulated depository institutions, insurance companies engaged in housing finance and community development financial institutions. Members include commercial banks, thrifts, credit unions and insurance companies that meet membership criteria and have applied for and been approved as a member.

FHLBank advances are made to members of all sizes, but provide a much needed funding alternative to smaller community lenders that generally lack diverse funding sources. Smaller community lenders very often do not have access to many of the funding alternatives available to larger financial entities, including repurchase agreements and commercial paper. The FHLBanks give these lenders access to wholesale funding at competitive prices.

3. How do FHLBanks assess and mitigate the credit risk of advances?

Each FHLBank is an independent entity with its own policies and procedures in place to assess and mitigate the credit risk from advances. While each FHLBank evaluates credit risk emanating from its members’ financial condition, all advances are secured by eligible collateral. Management of each FHLBank believes that adequate policies and procedures are in place to effectively manage that FHLBank’s respective credit risk from advances.

Each FHLBank manages its credit exposure to advances using an integrated approach that provides for the ongoing review of the financial condition of its member borrowers coupled with a conservative collateral

¹ The FHLBanks also make advances to eligible housing associates. Advances to housing associates represent approximately 0.02 percent of total advances.

policy. Each FHLBank establishes lending policies and procedures to limit its risk of loss while balancing its members' needs for a reliable source of funding.

The FHLBanks regularly and actively monitor the financial condition and performance of all borrowers. In addition to having access to quarterly call reports and other financial data for members, as reported to their primary regulator, the FHLBanks have access to federal supervisory examination information regarding the safety and soundness of operations within member depository institutions. FHLBanks require insurance companies to provide copies of audited financial reports that are filed with state regulators, and may have access to their supervisory examinations and/or comprehensive statutory financial data, as well as independent ratings. FHLBanks may also require supplemental information as necessary to determine the financial condition of members. Based on the evaluation of financial trends and condition of a member institution, the FHLBank may take additional steps to protect its security interest in collateral pledged and impose borrowing limitations (e.g., term, product type, amount) to reduce credit exposure to a member experiencing financial decline. The financial condition of a member will generally also have a bearing on the frequency and degree of collateral reviews, the level of required overcollateralization to secure advances and the level of haircuts assigned to pledged assets.

The FHLBanks protect against credit risk on advances by collateralizing all advances. The FHLBank Act requires that FHLBanks obtain and maintain security interests from their members in acceptable collateral sufficient to secure all advances at all times that the advance is outstanding to protect against losses. The FHLBank Act also allows the FHLBanks to accept as eligible collateral for advances only certain United States government or government agency securities, residential mortgage loans and securities backed by such, cash, deposits in the FHLBank and other real estate-related assets².

Collateral arrangements will vary with member credit quality, borrowing capacity and collateral availability as well as the FHLBank's overall credit exposure to the member. An FHLBank establishes each member's borrowing capacity by determining the amount it will lend against each collateral type. Members are also required to fully collateralize the face amount of any letters of credit issued for their benefit by an FHLBank. Each FHLBank can call for additional or substitute collateral during the life of an advance to protect its security interest. An FHLBank would require a borrower to substitute qualified collateral or to pay down advances if necessary to maintain sufficient qualified collateral to cover outstanding advances. Substitution generally occurs if the borrower does not have sufficient excess collateral pledged to support outstanding credit exposure. The call for additional collateral can include requesting ineligible collateral to secure advances if an FHLBank believes that it needs the collateral in order to protect itself. However, such ineligible collateral cannot serve as the basis for issuing or renewing an advance for a member.

During 2008, as in prior years, the FHLBanks had rights to collateral (either loans or securities) on a member-by-member basis with a value in excess of outstanding advances. Members provide collateral reporting information to the FHLBanks at least quarterly; collateral reporting frequency depends on the relative size of the borrowing relationship, the financial condition of the borrowing member or housing associate, and the type of collateral pledged. Collateral "haircuts" may also be differentiated in accordance with the frequency of updates.

² The FHLBank Act permits members that qualify as Community Financial Institutions (CFIs) to pledge certain CFI-specific collateral. CFI collateral includes small-business, small-farm, and small-agribusiness loans. To the extent that the expanded eligible collateral for CFIs generally includes higher risk loans, as compared to marketable securities and single-family loans, it results in the potential for an increase in the credit risk to the FHLBanks. The potential increased credit risk from CFI collateral is mitigated by the FHLBanks that accept this collateral through higher haircuts (lower lending values) on such collateral. Advances to CFIs secured with expanded eligible collateral represent approximately 1.3% of total advances.

The FHLBanks continue to evaluate and make changes to their collateral guidelines when reviewing their borrowers' financial condition in response to continuing deterioration in the housing and mortgage markets. For example, some FHLBanks decreased the maximum borrowing limits on certain types of mortgage loan collateral, increased certain secondary market discounts, and/or added new secondary market discounts for loans with high-risk characteristics and for loans with deficiencies in either their servicing and/or underlying documentation. These changes further mitigate the credit risk of advances.

In summary, the FHLBanks limit their risk of loss on advances by:

- securing borrowings with sufficient acceptable collateral,
- having the ability to demand additional collateral, or substitute collateral, during the life of an advance,
- monitoring the creditworthiness and financial condition of borrowers, and
- performing collateral reviews and valuation procedures.
- In addition, the FHLBank Act:
 - gives the FHLBanks the authority to protect their security position with respect to advances, including requiring the posting of additional collateral, and
 - grants the FHLBanks a priority over the claims and rights of any party, including any receiver, conservator, trustee or similar lien creditor³.

In the 76-year history of the FHLBanks, no FHLBank has ever experienced a credit loss on an advance. The management of each FHLBank believes it has policies and procedures in place to manage its credit risk on advances effectively. Based upon the sufficiency of the collateral held as security for its advances, management's credit analysis and the repayment history of each FHLBank's advances, each FHLBank's management believes that an allowance for credit losses on its advances was unnecessary as of the date of their last published financial statements. This position is supported by the independent external auditor's examination and annual unqualified audit opinion of each FHLBank's financial position, including a determination that no loss reserves are necessary.

4. What types of collateral are acceptable for advances? Who determines “acceptable” collateral types and who sets and monitors the haircuts as a function of collateral? What are the requirements/characteristics of assets that may be pledged?

The FHLBanks are required by the FHLBank Act and Federal Housing Finance Agency regulation to obtain a security interest in sufficient collateral on advances to protect against losses. Only certain types of asset classes are deemed to be eligible collateral for advances, but each FHLBank has the latitude within the statutory/regulatory guidance to determine what specific types of collateral it will accept and the lending value that it will assign to these specific types of collateral. The approval of a new collateral type typically involves risk management assessment and recommendation and may require approval from the Federal Housing Finance Agency as a new business activity. As a general rule, an FHLBank's Board of Directors or their designees approve the acceptable collateral types within FHLBank Act regulations and the policies

³ An exception exists for the claims and rights of a party that would be entitled to priority under otherwise applicable law and is an actual *bona fide* purchaser for value of such collateral or is an actual secured party whose security interest in such collateral is perfected in accordance with applicable state law.

established by the Federal Housing Finance Agency. Management evaluates and monitors members' collateral to ensure that it complies with the FHLBank's policies and procedures.

Collateral eligible under statute/regulation to secure new or renewed advances to all members includes:

- one-to-four family and multifamily mortgage loans (no more than 90 days delinquent) and securities representing such mortgages;
- securities issued, insured or guaranteed by the U.S. government or any U.S. government agency (for example, mortgage-backed securities issued or guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae);
- cash or deposits in the FHLBank;
- certain other collateral that is real estate-related, provided that the collateral has a readily ascertainable value and that the FHLBank can perfect a security interest in it; and
- certain qualifying securities representing undivided equity interests in eligible advances collateral.

Residential mortgage loans are the principal form of collateral for advances. As a matter of course and through multiple means, the FHLBanks perfect the security interests in collateral granted to them by their borrowers. In addition, the FHLBanks must take any steps necessary to ensure that their security interests in all collateral pledged by non-depository institutions for an advance are as secure as their security interests in collateral pledged by depository institutions. This applies to collateral pledged by insurance companies and housing associates to secure advances.

Under the FHLBank Act, an FHLBank has a statutory lien on that FHLBank's capital stock held by its members, which serves as further collateral for the indebtedness of these members to the FHLBank. The Act also gives FHLBanks the authority to protect their security position with respect to advances, including requiring posting of additional collateral, whether or not such additional collateral was eligible to originate or renew an advance. In order to borrow from its FHLBank, a member must pledge collateral in the form of a blanket lien or by specific identification, or deliver such collateral to the FHLBank or its agent (acceptable third party). Under the FHLBank Act, a security interest granted to an FHLBank by a member is entitled to a priority over the claims and rights of any party (including any receiver, conservator, trustee or similar lien creditor), except the claims and rights of a party that would be entitled to priority under otherwise applicable law and is an actual *bona fide* purchaser for value of such collateral or is an actual secured party whose security interest in such collateral is perfected in accordance with applicable state law.

5. What are the acceptable methods of pledging collateral to the FHLBanks and how do these methods differ?

Based upon the financial condition of the member, most of the FHLBanks classify each member by the method of pledging collateral into one of three collateral categories: blanket-lien status, listing (specific) pledge status, or possession (delivery) status. In order to protect the quality of FHLBank consolidated obligations and members' stock investment in the FHLBanks, advances of funds, letters of credit, and other extensions of credit or credit services (collectively, "advances") are transacted only on a secured basis. Typically, each member is assigned a collateral status based on the individual FHLBank's determination of the member's current financial condition as well as other information obtained. Under the blanket-lien status, an individual FHLBank allows a member to retain possession of eligible collateral pledged to the FHLBank, provided the member executes a written security agreement and agrees to hold the collateral for the benefit of the FHLBank. Note, however, that the blanket pledge is typically accepted by the FHLBanks only for loan collateral; most securities collateral must be delivered to the FHLBank or an FHLBank-approved third-party

custodian and pledged to the benefit of the applicable FHLBank. Under listing (specific identification) collateral status, the member holds physical possession of specific collateral pledged to the FHLBank but the member provides listings of loans pledged to the FHLBank with detailed loan information such as loan amount, payments, maturity date, interest rate, loan-to-value, collateral type, FICO[®] scores, etc. From a member's perspective, the benefit of listing collateral in lieu of a blanket pledge security agreement is that, in some cases, the discount or haircut applicable to such collateral may be lower than that for unlisted (blanket lien) collateral. From an FHLBank's perspective, the benefit of listing collateral is that it provides more detailed loan information to arrive at a more precise valuation. For members in possession (delivery) collateral status, the FHLBank requires the member to place physical possession of eligible collateral with the FHLBank or a third-party custodian to secure sufficiently all outstanding obligations.

The least restrictive and the most widely used collateral arrangement by FHLBank members is the blanket-lien pledge status. Currently, the majority of members may borrow under the blanket-lien status. It is generally assigned to lower risk institutions pledging loan collateral. Under the blanket-lien status, a member borrower is not required to deliver loan level detail on pledged loans. Typically, the FHLBanks monitor eligible collateral under blanket status using regulatory financial reports, which most members submit quarterly, and/or periodic collateral "certification" documents/reports submitted to the FHLBanks by all significant borrowers. Each borrowing member must execute a blanket pledge security agreement that sets forth the necessary collateral requirements. The FHLBanks' blanket pledge security agreements typically cover the majority of the members' assets whether or not the FHLBank accepts the assets as eligible collateral, although the FHLBanks can only originate new advances or renew advances against certain eligible collateral categories. A blanket lien can cover one-to-four-family mortgages, multi-family mortgages, home equity lines of credit, second mortgages, agricultural or commercial mortgages, small business (commercial and industrial) and agri-business loans. The FHLBanks generally require securities collateral to be delivered to the FHLBank or to an FHLBank-approved third-party custodian.

The FHLBanks file UCC financing statements against members' assets pledged under the blanket pledge security agreements. Members are required to maintain at all times an amount of eligible collateral that satisfies the minimum collateral requirement established by the FHLBank for each member. All borrowing members in blanket-lien status must either: (a) submit to the FHLBank, on a periodic basis, with frequency depending upon the member's financial strength and condition, an audit opinion that confirms the member is maintaining sufficient amounts of eligible collateral in accordance with the FHLBank's policies (agreed-upon procedures or positive assurance); or (b) undergo a periodic on-site field review of pledged collateral performed by FHLBank staff or its agent. The FHLBanks may require their members to certify their collateral holdings on a periodic basis. Collateral verifications and on-site reviews can also be performed by the FHLBanks whenever it is determined necessary.

Members on blanket-lien status agree to inform their FHLBank within a designated time period of any event that materially reduces the principal amount of, or otherwise changes, collateral pledged to the FHLBank under the FHLBank's blanket pledge security agreement. In any event, the members update information relating to pledged collateral on a periodic basis, or as requested by their FHLBank.

6. Are there limits to the amount that an FHLBank will lend a member?

The FHLBanks generally establish an overall credit limit for each borrower, which caps the amount of credit availability to such borrower. This limit is designed to mitigate the FHLBanks' credit exposure to an individual borrower, while encouraging borrowers to diversify their funding sources. The credit limit is typically calculated by dividing the borrower's total credit obligations to the FHLBank by the borrower's total assets. A borrower's total credit limit with an FHLBank includes the face amount of outstanding letters of credit, the principal amount of outstanding advances, the total exposure of the FHLBank to the borrower under any derivative contract and credit enhancement obligation of the member on mortgage loans sold to the FHLBank (if any). The FHLBank determines the credit limit of a borrower by evaluating a wide variety

of factors, including, but not limited to, the borrower's overall creditworthiness and collateral management practices.

The FHLBanks impose borrowing limits on members within a maximum range of 35 to 55 percent of a member's total assets. Borrowing in excess of an FHLBank's maximum borrowing limit requires special approval of that FHLBank's board and/or management. To determine the maximum amount and term of the advances an FHLBank will lend to a member, an FHLBank may assess the member's creditworthiness and financial condition utilizing the quarterly report the member files with its regulators and other available information. An FHLBank may also evaluate the collateral pledged and conduct periodic collateral reviews to confirm the quality and quantity of collateral pledged. Most FHLBanks require delivery of all securities collateral to the FHLBank or through third-party safekeeping agents, but each FHLBank may also require delivery of loan collateral under certain conditions (for example, when a member's creditworthiness deteriorates).

Collateral arrangements will vary with member credit quality, collateral availability, collateral quality, results of periodic on-site reviews of collateral, and overall member credit exposure to the FHLBank and others. Each FHLBank member with outstanding advances is generally required to: (a) deliver a third-party collateral verification report based upon agreed-upon procedures or positive assurance attesting to the eligibility and sufficiency of the member's mortgage collateral; or (b) undergo an on-site field review of pledged collateral performed by FHLBank staff or its agent. The identification of members for collateral verification/field reviews is based on the relative risk associated with each member's particular risk profile. The frequency of the collateral verification/field review is generally based on the financial health of the member, the amount of the member's advances (e.g., financially secure members with large amounts of advances might be on an annual frequency whereas financially secure members with a small amount of advances might be on a triennial frequency), the types of collateral pledged (e.g., members with borrowings covered entirely by delivered securities might be exempted), and/or the amount of collateral coverage (e.g., members borrowing a higher percentage of their assets and/or eligible collateral would generally represent a higher risk and therefore may be subject to this requirement more frequently). Typically, an FHLBank may require the delivery of collateral from any member at any time. An FHLBank's management may determine the borrowing capacity of a member based on the member's credit quality and eligible collateral pledged in accordance with the FHLBank's member products policy and applicable regulatory requirements.

Generally, a member's creditworthiness is determined and periodically assessed by an FHLBank using the member's financial information, regulatory examination and enforcement actions, and other public information. An FHLBank typically requires members to update periodically their collateral reporting information in order to establish the amount it will lend to each member. Lending values are established by each FHLBank setting forth the amount the FHLBank would lend against each collateral type that the FHLBank decides to accept. The FHLBanks generally use the periodic collateral field reviews to determine if additional haircuts are necessary for collateral reported by specific members.

An FHLBank may evaluate the type of collateral pledged by members and assign a lending value to the collateral based on a percentage of its fair value (typically securities collateral or delivered or specifically-identified loan collateral) or book value (typically loan collateral held by the member). The lending values assigned to the various types of eligible collateral generally include margins for: (a) estimated costs to sell or liquidate and (b) the risk of a decline in the value of the collateral due to market or credit volatility. The lending values applied to the various collateral types are discussed in more detail in Question No. 7.

Other factors that an FHLBank may consider in determining a member's borrowing capacity include: (a) the pledging method for loans (for example, specific identification, blanket lien, or required delivery), (b) collateral verification/field review results, (c) the member's financial strength and condition, and (d) the concentration of collateral type by member. FHLBanks typically monitor and review each member's borrowing capacity and collateral requirements on a daily basis to determine that it adheres to the

FHLBank's collateral requirements as set forth in its member products policy for determining borrowing capacity.

During an FHLBank collateral field review of a borrowing member, an FHLBank may examine a statistical sample of each member's pledged loans. As discussed previously, a member's review frequency typically depends on factors including the risk profile of the member and the manner in which the collateral is pledged. The loan review validates the loan ownership and existence of the loan note, verifies whether the FHLBank has a perfected interest in the loans, determines that the loan qualifies under the FHLBank's collateral policies (e.g., loan type, current payment status, etc.) and validates that the critical legal documents exist and are accessible to the FHLBank. The loan review also may identify applicable secondary market discounts in order to assess salability and liquidation risk and lending value.

7. What are the haircuts on the various types of collateral for advances?

All member obligations to the FHLBanks are secured with eligible collateral discounted to protect the FHLBanks from default in adverse circumstances. Collateral discounts, or haircuts, used in determining lending values of the collateral are calculated to estimate that the lending value of collateral securing each member's obligations exceeds the amount the member may borrow from the FHLBanks. That is, collateral is discounted to the point where its lending value will exceed the amount that may be owed to the FHLBank if any member defaults in all but the worst outcomes. As covered in Question No. 6, FHLBank haircuts used in establishing lending values typically include margins for: (a) estimated costs to sell or liquidate and (b) the risk of a decline in the value of the collateral due to market or credit volatility.

Generally, collateral discounts or lending values as a function of the acceptable collateral types are ultimately established by the FHLBanks' Boards of Directors and are subsequently monitored by collateral and/or credit risk management.

Lending value ranges for each collateral type depend on the credit and financial strength ratings assigned to the member, the method of pledging collateral, quality and performance of the collateral such as individual borrower payment history and debt service coverage ratios for mortgages, collateral liquidity, the results of any field reviews of that collateral to the extent they result in adjustments to loan eligibility or additional discounts due to credit administration issues, the level of subprime and nontraditional mortgage loans pledged and the quality of those loans, and the existence of any formal regulatory action against the member. Additional factors that affect collateral lending value ranges include, but are not limited to: collateral reporting frequency, member debt ratios and the type and quality of collateral documentation.

An FHLBank may adjust collateral lending values based upon individual loan portfolio performance and/or detailed file reviews that evaluate a sample of loans for each portfolio type pledged. When assigning collateral haircuts for a particular borrower, an FHLBank typically considers the member's overall financial condition, the date of the member's last field review, the amount of the FHLBank's credit exposure to the borrower, potential concerns regarding the borrower's credit quality, the borrower's ratio of advances-to-assets and the level of reliance on a particular collateral type. FHLBanks that accept subprime loans as collateral may adjust the collateral haircut based on various factors including the amount and composition of subprime collateral in the portfolio, the member's level of charge-offs and the number of loans on nonaccrual status. In any case, mortgage loan collateral must be performing loans with delinquencies not to exceed a maximum of 90 days.

Each FHLBank weights all of the above factors differently. The following collateral lending values have been combined for the blanket, listing and delivery methods of pledging collateral and range across the 12 FHLBanks as shown below. Collateral lending values are determined by subtracting the collateral haircut from 100 percent.

**Range of Collateral Lending
Values
at September 30, 2008**

Collateral Type

Single-family mortgage loans	45-91%(1)
FHA/VA loans	50-93%(2)
Multifamily mortgage loans	40-80%(3)
U.S. government/Treasury securities	80-99.5%(4)
U.S. agency securities (including MBS)	54-99%(5)
Non-agency MBS/CMOs	25-98%(6)
Other U.S. government-guaranteed mortgage loans	50-90%(7)
Community financial institution (CFI) collateral (e.g., small-business, small-farm, small-agribusiness loans)	15-67%(8)
Other real estate related collateral (e.g., commercial real estate, construction loans, home equity lines of credit)	25-80%(9)

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- (1) Most single-family mortgage loan collateral is discounted in the 61%-85% range.
 - (2) Most FHA/VA loan collateral is discounted in the 67%-93% range.
 - (3) Most multifamily mortgage loan collateral is discounted in the 50%-80% range.
 - (4) Most U.S. government/Treasury securities collateral is discounted in the 87%-99% range.
 - (5) Most U.S. agency securities collateral is discounted in the 87%-98% range.
 - (6) Most non-agency MBS/CMO collateral is discounted in the 75%-93% range, with the highest end of the range assigned to AAA-rated securities.
 - (7) Most other U.S. government-guaranteed mortgage loan collateral is discounted in the 50%-90% range.
 - (8) Most CFI collateral is discounted in the 22%-60% range.
 - (9) Most other real estate related collateral is discounted in the 40%-74% range.

Because some FHLBanks apply their lending values to the book value of the loan collateral, the collateral discounts or haircuts also take into consideration risks related to the lack of detailed loan data (for blanket lien pledges), payoffs occurring between reporting periods, and regional loan concentrations for a particular borrower. The discount applied to collateral, as well as the ability to pledge less liquid forms of collateral, may be adjusted for an individual borrower. Please note, however, that all FHLBanks compute the lending value of each member's collateral without consideration of the FHLBank capital stock owned by the member. The FHLBank capital stock serves as security above and beyond the lending value assigned to the member's collateral.

8. What types of collateral secure the FHLBanks' largest advance balances?

At September 30, 2008, 36 individual FHLBank members held advance balances of at least \$5 billion. In the aggregate, these advances represented approximately 57% of total FHLBank advances outstanding at September 30, 2008, with collateralization ratios (i.e., a member's eligible collateral divided by that member's advances outstanding) ranging from 1.25 to 3.27 (weighted-average collateralization ratio of 1.78). Eligible collateral values include (a) market values for private-label and agency securities and (b) the unpaid principal balance for all other collateral pledged by delivery, specific identification or blanket lien. At September 30, 2008, approximately 52% of these 36 individual FHLBank members' eligible collateral was pledged by specific identification, with approximately 39% pledged in the form of a blanket lien and approximately 9% pledged by delivery. The eligible collateral securing these 36 individual FHLBank members' advances was comprised of residential first mortgages (51%), home equity lines of credit/second mortgages (18%), private-label and government/agency securities (18%), commercial real estate (9%) and other collateral (4%).

9. How do the FHLBanks value collateral? What happens if the pledged collateral drops in value? Does the FHLBank have any recourse?

Typically, the FHLBanks establish collateral valuation methodologies for each collateral type and calculate the lending value of the pledged collateral to determine whether a borrower has satisfied its collateral maintenance requirement. Lending values for the various types of eligible collateral accepted by each FHLBank are adjusted on a periodic basis depending upon market conditions. To the extent the lending value for collateral is calculated using some type of estimated fair value (i.e., versus book value), the amounts used in determining lending values are updated by the FHLBanks on a periodic basis, with some updated as frequently as daily (e.g., securities collateral may be re-valued daily). The FHLBanks may also conduct periodic collateral field reviews to establish the amount they will lend against each collateral type for each member or to make additional adjustments to a borrower's pledged mortgage collateral, based on the results of an on-site review. This review may involve a qualitative assessment of risk factors that includes an examination of legal documentation and credit underwriting on mortgage collateral. This valuation process takes into account any risk factors the FHLBanks may consider in liquidating the collateral to obtain repayment of an advance in the event of a borrower's default. The types of risks addressed in the collateral valuation process typically include holding, resolution and disposition costs, as well as discounts applied by the secondary market to account for:

- Change in market value of the pledged loan or security due to current interest rates,
- Decline in underlying real estate values of the properties backing the loan or security,
- Credit underwriting of the assets, and
- Any documentation deficiencies.

The FHLBanks may utilize customized internal or external valuation models to value certain types of collateral. Third-party valuations may be obtained on a periodic basis, which can be as often as daily for securities collateral. Mortgage loan collateral for which a lending value is calculated could be priced using a combination of a vendor pricing model and the results of discounts from the on-site review of the collateral as well as discounted cash flow analysis. No loan is given a lending value in excess of the outstanding principal balance. Securities delivered to the FHLBanks or a third-party for the benefit of the FHLBank as collateral for advances are generally held in separate collateral safekeeping accounts and are marked-to-market using independent sources such as Bloomberg, Interactive Data or the FHLBanks' third-party safekeeping agents. Subsequently, mark-to-market prices on securities are updated daily or weekly.

10. What is the policy and practice for the subprime and nontraditional loans? What is the collateral replacement rate for mortgages pledged as collateral and whole loans purchased?

Most of the FHLBanks do not strictly prohibit the pledging of subprime loans as collateral for advances. However, some of the FHLBanks do not accept any loans as collateral with subprime or nontraditional characteristics. Those FHLBanks that accept subprime loans as eligible collateral may require members to identify subprime types pledged which may result in haircuts being established at higher levels to discount sufficiently this collateral type. In addition, higher haircuts could be applied to portfolios pledged by certain higher risk members. Subprime product is further identified through on-site collateral reviews and FICO score reporting. Some FHLBanks perform due diligence reviews, order exam reports and perform onsite collateral verifications on members that are repeatedly identified as having high-risk collateral. Members are responsible for collateral pledged, regardless of whether they originated or purchased the residential mortgages. In all cases, mortgage loan collateral must be performing loans with delinquencies not to exceed a maximum of 90 days. The majority of the FHLBanks' collateral policies are more conservative and consider mortgage loans to be eligible collateral only if the delinquencies do not exceed 30 to 60 days.

Furthermore, the FHLBanks promote responsible and anti-predatory lending by its members. Therefore, any mortgage loan pledged would have to comply with the FHLBanks' anti-predatory lending policies that require all loans pledged to the FHLBanks as collateral to comply with all applicable federal, state, and local laws. The FHLBanks typically receive qualified collateral reports and/or updates from the borrowing members on at least a quarterly basis in order to confirm that the pledged loan collateral conforms to the FHLBank's requirements. The FHLBanks use a risk-based concept to evaluate collateral and establish appropriate discounts or haircuts using this concept. The FHLBanks might identify certain types of single-family residential mortgage collateral that may present increased credit risks. Accordingly, an individual FHLBank would choose to monitor the volume of subprime mortgage loans and nontraditional residential mortgage loans pledged by its members to secure advances and other credit obligations. If the FHLBank determines that the level of subprime or nontraditional residential mortgage loans pledged by a member indicates a potentially heightened risk, the FHLBank may perform an extended credit review of the member which may result in the FHLBank imposing restrictions designed to mitigate the FHLBank's credit risk exposure.

11. What are the standard practices an FHLBank would have in place to monitor the financial condition of a member?

The FHLBanks regularly and actively monitor the financial condition and performance of all borrowers. In addition to having access to quarterly call reports and other financial data for members, as reported to their primary regulator, the FHLBanks have access to federal supervisory examination information regarding the safety and soundness of operations within member depository institutions. FHLBanks require insurance companies to provide copies of audited financial reports that are filed with state regulators, and may have access to their supervisory examinations and/or comprehensive statutory financial data, as well as independent ratings. FHLBanks may also require supplemental information as necessary to determine the financial condition of members. Based on the evaluation of financial trends and condition of a member institution, the FHLBank may take additional steps to protect its security interest in collateral pledged and impose borrowing limitations (e.g., term, product type, amount) to reduce credit exposure to a member experiencing financial decline. The financial condition of a member will generally also have a bearing on the frequency and degree of collateral reviews, the level of required overcollateralization to secure advances and the level of haircuts assigned to pledged assets.

12. Under what circumstances would an FHLBank take possession of collateral? What happens if a member fails? If a member fails, are the FHLBanks prepared to manage collateral in the event the receiver of the failed institution does not pay off the advance?

An FHLBank would typically take physical possession because of the deteriorating financial condition of a member, but there could be other situations such as regulatory actions by a member's primary regulator that would indicate inadequate controls or other conditions that would cause an FHLBank to take physical possession of collateral. Historically, when an insured depository institution member has failed, the FHLBanks have been repaid in full because the value of the collateral, including any FHLBank stock owned by the member, has far exceeded the outstanding advances and other credit obligations to the FHLBank. However, every FHLBank has a collateral liquidation plan in place in case the FHLBank would have to liquidate the collateral to satisfy the failed member's outstanding advances and other credit obligations to the FHLBank.

From the beginning of 1981 to the middle of 1992, which included the savings and loan crisis, there were 1,260 Federal Savings and Loan Insurance Corporation (FSLIC)-insured institution failures⁴, resulting in the insolvency of the FSLIC. While the majority of these institutions had outstanding FHLBank advances, the FHLBanks never incurred a credit loss on an advance due to the collateralization policies stated above and as

⁴ Information obtained from the Congressional Budget Office (<http://www.cbo.gov>).

the result of the FHLBanks' preferential rights over other secured creditors, even in receivership or conservatorship, as further explained in the last paragraph of Question No. 4. As part of the Competitive Equality Banking Act of 1987, and as reaffirmed by the Financial Institutions Recovery, Reform and Enforcement Act of 1989, the U.S. Congress established the priority of FHLBank secured interests to encourage the FHLBanks to continue lending to insolvent thrifts and enable the FSLIC to conserve its cash resources.

From January 1, 2008 through December 4, 2008, 23 institutions with deposits insured by the Federal Deposit Insurance Corporation (FDIC) have failed⁵; 22 of these institutions were FHLBank members. These institutions have either paid off their FHLBank advances or their FHLBank advances have been assumed by another FDIC-insured entity. The FHLBanks have not incurred any credit losses during this period as a result of these failures.

For example, the FDIC and the Office of Thrift Supervision facilitated the sale of the banking operations of Washington Mutual, Inc. – Washington Mutual Bank, Henderson, NV and Washington Mutual Bank, FSB, Park City UT to JPMorgan Chase. As a result, the FHLBanks' outstanding advances to the Washington Mutual Banks were assumed by JPMorgan Chase.

As for IndyMac Bank, the FHLBank of San Francisco's outstanding advances to IndyMac Bank have been assumed by IndyMac Federal Bank, a non-member operated by the FDIC. Because the estimated fair value of the collateral posted by IndyMac Federal Bank exceeds the carrying amount of the advances outstanding, and the FHLBank of San Francisco expects to collect all amounts due according to the contractual terms of the advances, no allowance for loan losses on the advances outstanding to IndyMac Federal Bank, FSB, was deemed necessary by the FHLBank of San Francisco's management.

12. Are the FHLBanks holding any collateralized debt obligations (CDOs) as collateral and if so, how are they being valued?

CDOs are not considered an eligible collateral asset class by any of the FHLBanks. However, it is possible that one or more of the FHLBanks have CDOs pledged as collateral through the blanket-lien pledge (i.e., pledged under the blanket lien pledge although not considered eligible collateral for purposes of originating or renewing an advance). In general, the FHLBanks require that all securities collateral be rated single-A or higher in order to qualify as eligible collateral to originate or renew an advance. Because all securities collateral typically must be delivered to the FHLBanks, the FHLBank would not originate or renew advances without acceptable eligible collateral. In addition, securities held as collateral are subject to substitution if downgraded below an acceptable level (typically, below a single-A rating).

Statements contained in this release may be “forward-looking statements.” By their nature, these forward-looking statements, including those regarding the operations of the FHLBanks and their lending and collateral policies, are subject to risks and uncertainties related to the business of the FHLBanks and the general business environment, all of which are difficult to predict and many of which are beyond the control of the FHLBanks. These risks and uncertainties could cause actual results to differ materially from those expressed or implied in forward-looking statements or could affect the extent to which a particular objective, projection, estimate, or prediction is realized. Such risks and uncertainties include the following: changes in interest rates, housing prices, employment rates and the general economy; the size and volatility of the residential mortgage market; demand for FHLBank advances; volatility of market prices, rates, and indices or other factors, including natural disasters, that could affect the value of investments or collateral held by the FHLBanks as security; political events, including legislative, regulatory, judicial or other developments that affect the FHLBanks, their members, counterparties and/or investors in the consolidated obligations of the FHLBanks; competitive forces, including other sources of funding available to FHLBank members, and

⁵ Information obtained from the FDIC (<http://www.fdic.gov/bank/individual/failed/banklist.html>).

the ability to attract and retain skilled individuals; the pace of technological change and the ability to develop and support technology and information systems; changes in investor demand for consolidated obligations and/or the terms of interest-rate exchange agreements and similar agreements; the application of accounting rules, such as SFAS 133; and the ability to introduce new FHLBank products and services and successfully manage the risks associated with those products and services. Investors are encouraged to consider these and other risks and uncertainties that are discussed in periodic combined financial reports posted on the Office of Finance website, www.fhlb-of.com, and in reports filed by each FHLBank with the Securities and Exchange Commission.