



**Federal Home Loan Bank System  
Discussion of the FHLBanks' Capital Structure and Regulatory Capital Requirements  
November 14, 2011**

The following Q&A summarizes the capital structure of the Federal Home Loan Banks (FHLBanks) and capital standards as required by the Gramm-Leach-Bliley Act of 1999 (GLB Act). The GLB Act required each FHLBank to adopt a new capital plan and convert to a new capital structure. As of September 30, 2011, all FHLBanks other than the FHLBank of Chicago had implemented their respective capital plans and converted to the GLB Act capital structure and minimum capital requirements discussed below. The FHLBank of Chicago's approved capital plan will be implemented on January 1, 2012. The new capital requirements are found in the Federal Home Loan Bank Act, as amended, and regulations issued by the Federal Housing Finance Board. On July 30, 2008, a new regulator, the Federal Housing Finance Agency (FHFA), was created to supervise the Federal Home Loan Banks and the other housing GSEs. On July 30, 2009, the FHFA released a final rule, effective August 4, 2009, that established criteria for capital classifications and critical capital levels for the FHLBanks. The final rule contained amendments to clarify certain provisions in the interim final rule that became effective on January 30, 2009.

**1) What capital structure does the GLB Act permit?**

The FHLBanks are permitted to offer two classes of stock to their members. Class A stock is redeemable by members at par six months after giving written notification to the FHLBank of intent to redeem shares. Class B stock is redeemable by members at par five years after giving written notification to the FHLBank of intent to redeem shares. In the past, FHLBanks have redeemed excess stock earlier than the statutory lockouts of six months for Class A stock and five years for Class B stock in response to member requests and for FHLBank balance sheet management purposes. Most FHLBanks only issue Class B stock.

**2) What are the capital stock purchase requirements for members of FHLBanks that have converted to a GLB Act capital structure?**

FHLBank capital is based on voluntary membership of regulated financial institutions. Members purchase stock in an FHLBank to meet (1) a basic membership requirement generally based on the amount of mortgage-related, collateral eligible to secure advances, or total assets owned by the member and (2) an activity requirement based on the member's outstanding advances, typically in the range of 4% to 5% of the member's outstanding advance amount and any other business activity as determined by the FHLBanks in their capital plans. Advances, the core business of the FHLBanks, are a self-capitalizing asset.

In addition, the FHLBanks may adjust minimum stock investment requirements to ensure that the FHLBanks remain in compliance with minimum capital requirements.

**3) How does an FHLBank pay dividends on its stock?**

An FHLBank may declare and pay dividends in either cash or capital stock, assuming the FHLBank is in compliance with FHFA regulations and other regulatory requirements.

**4) What regulatory capital requirements must the FHLBanks meet?**

Each FHLBank that has converted to a new capital structure is subject to three capital requirements under its capital plan and FHFA rules and regulations.



- a) Capital-to-Assets Ratio – The FHLBanks are required at all times to maintain a total regulatory capital-to-assets ratio of at least 4%.
- b) Leverage Capital Ratio – The FHLBanks are required to maintain a 5% minimum leverage ratio based on leverage capital, which is the sum of permanent capital, weighted by a 1.5 multiplier, plus all other regulatory capital.
- c) Risk-Based Capital – The FHLBanks must at all times maintain sufficient permanent capital that is at least equal to the sum of its credit risk, market risk and operations risk components. All components of risk-based capital are calculated in accordance with the rules and regulations of the FHFA.
  - (a) The credit risk component is determined by adding together the capital risk charges for assets, off-balance sheet items and derivatives contracts. These charges are based on, among other things, the credit risk percentages assigned to each item by the FHFA.
  - (b) The market risk component is the sum of: (1) the market value of its portfolio at risk from movements in interest rates, foreign exchange rates, commodity prices and equity prices that may occur during times of market stress; and (2) the amount by which the current market value of its total capital falls short of 85% of its book value.
  - (c) The operations risk component is equal to 30% of the combined credit and market risk components of the risk-based capital requirement.

**5) How is permanent capital defined?**

Permanent capital is defined as retained earnings and the amounts paid for Class B stock. Mandatorily redeemable capital stock is considered permanent capital for regulatory purposes.

**6) How is total regulatory capital defined?**

Regulatory capital is defined as the sum of permanent capital, the total amounts paid for Class A stock, any permitted general allowance for losses and any other amount from sources available to absorb losses that the FHFA has determined by regulation to be appropriate to include in determining total capital. Total regulatory capital also includes mandatorily redeemable capital stock.

**7) What happens if an FHLBank does not meet one or more of its capital requirements?**

Under FHFA regulations, any FHLBank that fails to meet its minimum capital requirement may not pay a dividend or redeem or repurchase capital stock.

An FHLBank may not redeem or repurchase any capital stock without approval of the FHFA if the FHFA or that FHLBank's Board of Directors determines that it has incurred, or is likely to incur, losses that result in, or are likely to result in, charges against the capital of the FHLBank while such charges are continuing or expected to continue.



**8) What actions can an FHLBank take to build capital?**

In order to preserve their financial strength and build capital positions, FHLBanks may reduce or suspend dividend payments and/or voluntary stock repurchases from members. Some FHLBanks have implemented one or more of these steps. Additional disclosures are available on each FHLBank website and/or FHLBank filings with the SEC.

In addition, the FHLBanks may adjust minimum stock investment requirements such as the membership- or activity-based requirements to ensure that the FHLBanks remain in compliance with minimum capital requirements.

**9) The FHFA published a final rule regarding capital classifications and critical capital levels for the FHLBanks effective as of August 4, 2009. What are the definitions and requirements of the new capital classifications?**

The FHFA, as required by the Housing and Economic Recovery Act of 2008, established criteria for each of the following capital classifications based on the amount and type of capital held by the FHLBanks:

- a) Adequately capitalized. An FHLBank will be considered adequately capitalized if the FHLBank has sufficient permanent and total capital to meet or exceed its risk-based and minimum capital requirements.
- b) Undercapitalized. An FHLBank will be considered undercapitalized if the FHLBank does not have sufficient permanent or total capital to meet one or more of its risk-based or minimum capital requirements, but such deficiency is not large enough to classify the FHLBank as significantly undercapitalized or critically undercapitalized.
- c) Significantly undercapitalized. An FHLBank will be considered significantly undercapitalized if the amount of permanent or total capital held by the FHLBank is less than 75% of any one of its risk-based or minimum capital requirements (e.g., less than a 3% capital-to-assets ratio), but such deficiency is not large enough to classify the FHLBank as critically undercapitalized.
- d) Critically undercapitalized. An FHLBank will be considered critically undercapitalized if the amount of total capital held by the FHLBank is less than or equal to the critical capital level. The interim final rule established the critical capital level for an FHLBank at an amount equal to 2% of the FHLBank's total assets.

The Director of the FHFA has discretion to reclassify an FHLBank's capital classification under certain circumstances generally related to safety and soundness concerns.

**10) What prompt corrective actions (PCAs) will occur if an FHLBank is classified as other than adequately capitalized?**

An FHLBank classified as undercapitalized must submit a capital restoration plan to the FHFA for approval, execute the approved plan, suspend dividend payments and excess stock redemptions or repurchases, and not permit growth of its average total assets in any calendar quarter beyond the average total assets of the



preceding quarter, unless otherwise approved by the FHFA. Additionally, the FHLBank may not acquire, directly or indirectly, an equity interest in any operating entity (other than as necessary to enforce a security interest granted to the FHLBank) nor engage in any new business activity, unless:

- The Director of the FHFA has approved the FHLBank's capital restoration plan, the FHLBank is implementing the capital restoration plan and the Director of the FHFA determines that proposed acquisition or activity will further achievement of the goals set forth in that plan; or
- The Director of the FHFA determines that the proposed acquisition or activity will be consistent with the safe and sound operation of the FHLBank and will further the FHLBank's compliance with its risk-based and minimum capital requirements in a reasonable period of time.

An FHLBank classified as significantly undercapitalized is subject to mandatory restrictions beyond those that apply to an undercapitalized FHLBank. The FHLBank may not pay a bonus to or increase compensation of its executive officers, without prior approval of the FHFA. The FHFA may also take discretionary actions with regard to a significantly undercapitalized FHLBank, including:

- limiting the increase or requiring a reduction in on- or off-balance sheet obligations of the FHLBank;
- limiting the increase or requiring a reduction in assets held;
- requiring capital and/or retained earnings to be increased;
- modifying, limiting, or terminating any activity of the FHLBank; and
- taking steps to improve the management at the FHLBank by ordering a new election for the FHLBank's board of directors, dismissing particular directors or executive officers who held office for more than 180 days prior to the date on which the FHLBank became undercapitalized, and ordering the FHLBank to hire qualified executive officers, subject to approval by the Director of the FHFA.

If an FHLBank is classified as critically undercapitalized, the FHFA may place an FHLBank in conservatorship or receivership. An FHLBank will be placed in mandatory receivership if (1) the assets of an FHLBank are less than its obligations during a 60-day period or (2) the FHLBank is not, and during a 60-day period has not, been paying its debts on a regular basis. Until such time the FHFA is appointed as conservator or receiver for a critically undercapitalized FHLBank, the FHLBank is subject to all mandatory restrictions and obligations applicable to a significantly undercapitalized FHLBank and will remain subject to any ongoing restrictions or obligations that the Director of the FHFA has imposed on the FHLBank, or any restrictions or obligations that are applicable to the FHLBank under the terms of an approved capital restoration plan.

#### **11) Why doesn't the FHLBank of Chicago have a risk-based capital requirement?**

To date, the FHLBank of Chicago has not implemented a new capital plan under the GLB Act. As of September 30, 2011, the FHLBank of Chicago remained in compliance with the minimum capital and leverage requirements as required by the FHFA. Until the FHLBank of Chicago implements its new capital plan on January 1, 2012, the capital requirements discussed above do not apply and the pre-GLB Act capital rules remain in effect.



Additional discussion of the FHLBanks' capital structure, regulatory capital requirements and capital classifications is available on [www.fhfb-of.com](http://www.fhfb-of.com), in individual FHLBank SEC filings on the SEC's EDGAR system, within the Third Quarter 2011 Combined Financial Report and in the FHFA's final rule relating to capital classifications as published in the Federal Register on August 4, 2009.

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