

RESEARCH

Research Update:

Federal Home Loan Bank of Des Moines 'AAA/A-1+' Ratings Off CreditWatch; Outlook Negative

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Rationale

On Sept. 21, 2006, Standard & Poor's Rating Services removed its 'AAA/A-1+' counterparty credit rating on the Federal Home Loan Bank of Des Moines (FHLB-Des Moines) from CreditWatch with negative implications where it had been placed on April 26, 2006. The outlook is negative.

The negative outlook reflects our concerns about several senior management changes at FHLB-Des Moines, as well as the interest rate exposure it is facing with sizable holdings of prime, fixed-rate, long-dated mortgage loans purchased through the Mortgage Partnership Finance (MPF) Program. Nevertheless, we do not believe these concerns warrant a downgrade at this time.

The ratings on FHLB-Des Moines reflect the bank's outstanding asset quality, strong balance sheet liquidity, conservative risk management, and sufficient risk-adjusted capital levels. The bank's credit risk profile reflects the advantageous funding position it derives from its government-sponsored enterprise (GSE) status. The FHLB-Des Moines is a member of the FHLB system, which is one of the housing GSEs in the U.S. The bank's business is primarily funded with low-cost consolidated obligation bonds issued by the Office of Finance on behalf of the bank.

Since 1999 the bank has participated in the MPF program, which involves holding long-term, fixed-rate whole mortgage loans on its balance sheet. The amount generated on FHLB-Des Moines' balance sheet under this program has grown rapidly over the years, and accounts for about 29% of total assets. This program adds incremental operational, credit, and most of all interest rate risk. This change in business mix and the degree of hedging required to facilitate this growth of MPF loans has negatively affected creditworthiness. With the large proportion of MPF loans, we will continue to monitor the MPF program and hedging strategies closely.

The bank has to date done a good job managing its interest rate risks, although profitability is still affected by rate changes. Interest rates coming off their historic lows starting in mid-2004 has allowed the bank to improve profitability and lessened concern about FAS 133-related earnings volatility. Since the passage of FIRREA, the bank's capital-generating ability has been restrained by the tax on earnings to fund the Affordable Housing Program and the Resolution Funding Corp. (REFCORP) obligations. In 2001, REFCORP became a percentage of earnings instead of a set deduction from

equity. Earnings continue to benefit from access to low-cost funding and good control of operating expenses.

Outlook

The negative outlook on the FHLB-Des Moines reflects the changing business mix that includes a large exposure to MPF loans on the balance sheet and the multiple senior management changes during the past nine months. The growth in MPF loans at the bank has increased its exposure to interest rate risk and placed higher demands on risk management to manage these portfolios in a rising or volatile interest rate environment.

Ratings List

Ratings Affirmed;	CreditWatch/Outlook	Action;	Ratings Withdrawn
		To	From
Federal Home Loan Bank of Des Moines			
Counterparty Credit Rating		AAA/Negative/A-1+	AAA/Watch
Neg/A-1+			

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