Issuer Comment: FHLBanks' 2nd Quarter 2010 Earnings Commentary

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Moody's Investors Service said that the Federal Home Loan Bank System's (FHLBank System) second quarter 2010 results did not hold any ratings implications. The FHLBank System reported net income of $326 million for the second quarter of 2010, which included credit-related other-than-temporary impairments (OTTI) of $495 million. Second quarter 2010 net income of $326 million declined substantially from the $1,123 million of net income reported in the second quarter of 2009. However, the results in the second quarter of 2010 were comparable to the $325 million in net income reported in the first quarter of 2010.

Two FHLBanks (Pittsburgh and Indianapolis) reported net losses of $68 million and $13 million, respectively primarily due to increased OTTI charges. Credit-related OTTI has been a significant drag on the FHLBanks' earnings and Moody's views potential credit-related OTTI as the most significant risk to future earnings.

The FHLBanks have mitigated the risk by building excess capital so that the FHLBank could meet its minimum capital requirements even if their private-label MBS securities are written down further. retention. For example, the FHLBanks of San Francisco and Atlanta owned $19.0 billion and $11.5 billion of private-label mortgage-backed securities (MBS), respectively, as of March 31, 2010 and Moody's estimated that each has $8.0 billion and $3.7 billion, respectively, as of June 30, 2010. Of the FHLBanks with material exposures to private-label MBS, all of them have a "cushion" of excess capital that could buffer further deterioration in these portfolios. This cushion is their excess capital as a percentage of their private-label MBS amortized value. For nearly all of the FHLBanks with material exposures to private-label MBS, this cushion is greater than 20% of this portfolio's value. For the FHLBanks of Topeka and Chicago, their excess capital as a percentage of private-label MBS (based on amortized cost) is somewhat lower at 15.3% and 11.5%, respectively. This means that a FHLBank's private-label MBS could be written down by the amount of its cushion and it would still maintain its required minimum capital. Furthermore, the ratios do not incorporate the capital benefits of future earnings or actions that these FHLBanks could take, such as shrinking their balance sheets.

The FHLBank System's balance sheets continue to shrink to below pre-credit crisis levels. Advances totaled $540 billion as of June 30, 2010, compared with $631 billion at year-end 2009. The decline in advances has been partially offset by increases to the FHLBank System's investment portfolio, which had grown to $309 billion as of the second quarter2010, up from $284 billion as of year-end 2009. The increase in investments is primarily attributed to an increase in short-term investments, Agency MBS and other U.S. obligations. The increase in the FHLBank investment portfolio was facilitated by the temporary change in their investment portfolio limit to six times capital from three times capital by its regulator, the Federal Housing Finance Agency. However, the six-time capital limit expired on March 31, 2010 and is likely to result in the FHLBank System's balance sheet shrinking at a faster pace.

GAAP capital levels remained largely unchanged at $43.2 billion as of June 30, 2010 compared with $42.8 billion at year-end 2009. Moody's expects the FHLBanks' to report very strong regulatory ratios as capital increased during the second quarter 2010 while assets declined by 7.7% compared with year-end 2009.

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