

ISSUER COMMENT

Merger of Seattle and Des Moines Federal Home Loan Banks Is Credit Positive

From [Credit Outlook](#)

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On Sunday, we expected the [Federal Home Loan Bank of Des Moines](#) (Aaa stable) and the [Federal Home Loan Bank of Seattle](#) (Aaa stable) to complete their merger. Post-merger, FHLBank Des Moines will be the continuing bank. The merger is credit positive for FHLBank Des Moines and the Federal Home Loan Banks System, a member-owned national cooperative of 11 regional banks post-merger that each provide a stable source of funding to member financial institutions (primarily banks).

We expect the merger to allow FHLBank Des Moines to take advantage of business opportunities in FHLBank Seattle's former jurisdiction that were unrealized because regulatory oversight of FHLBank Seattle limited its activities leading up to the merger. Regulatory oversight also restricted FHLBank Seattle's ability to repurchase capital stock from its members, which has resulted in a large balance of mandatorily redeemable capital stock (MRCS) that is past contractual redemption dates. A significant amount of these outstanding shares of regulatory-restricted MRCS were redeemed pre-merger, a positive development for FHLBank Seattle member banks looking to participate with its FHLBank free of regulatory restriction.

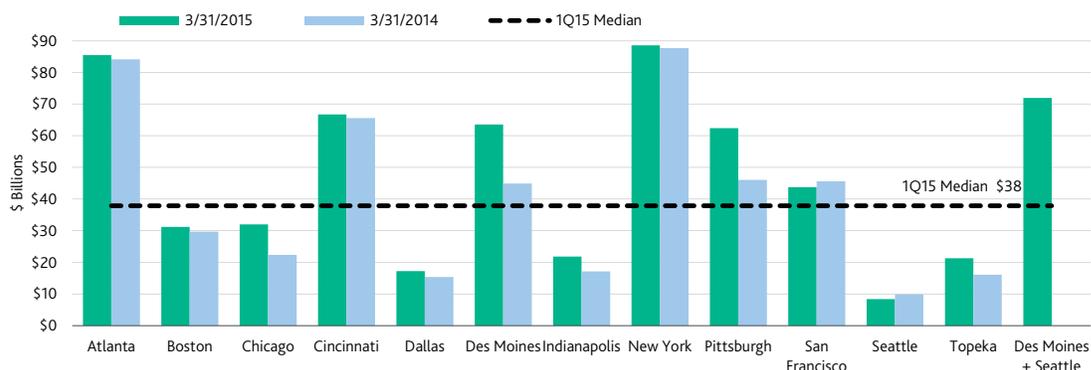
Post-merger, FHLBank Seattle members will have access to an FHLBank without restrictions, which should increase mortgage advances. The advance business is the core of an FHLBank franchise and is key to its financial health because it is a very low risk portfolio whose revenue covers the FHLBank's costs. The FHLBanks System issues debt, for which all FHLBanks are jointly and severally liable. All FHLBanks have similar business models: each offers member financial institutions advances, manages an investment portfolio and many purchase mortgage loans from member financial institutions, although the mix of these three elements varies by region.

Exhibit 1 summarizes outstanding advance balances for all of the FHLBanks as of 31 March 2015, and then combines FHLBank Des Moines and FHLBank Seattle for illustrative purposes. Combined, the Des Moines and Seattle will have the third-largest advance portfolio in the system, a stronger position than either had on a standalone basis.

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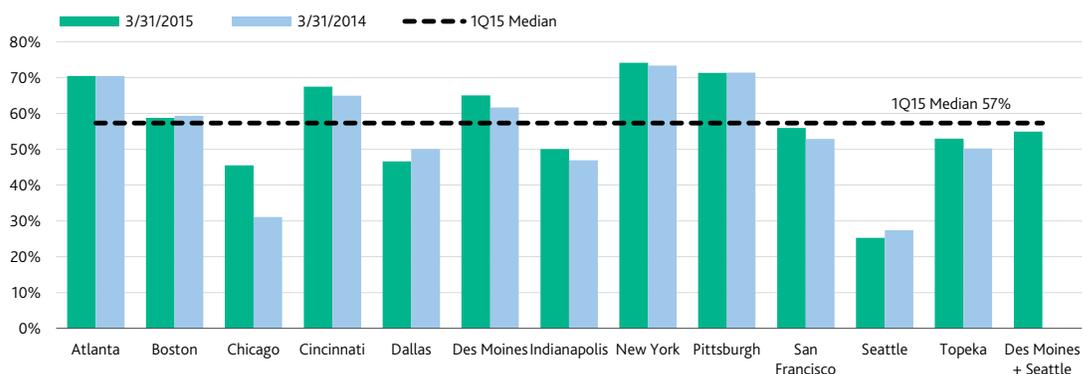
EXHIBIT 1
Federal Home Loan Banks Total Advances



Source: Quarterly earnings releases

Exhibit 2 shows advances as a percentage of total assets for all FHLBanks as of 31 March 2015, and then combines Des Moines and Seattle for illustrative purposes. Pre-merger, FHLBank Seattle had the lowest advances-to-assets ratio. On a pro forma basis, the combined Des Moines and Seattle FHLBank ratio of advances to total assets is very close to the median for all FHLBanks.

EXHIBIT 2
Federal Home Loan Banks Advances/Total Assets



Source: Quarterly earnings releases

Among the FHLBanks, Seattle had one of the largest exposures to private-label residential mortgage-backed securities (RMBS), with balances close to 5% of total assets during 2014. During the first quarter of 2015, FHLBank Seattle sold its private-label RMBS and reinvested the proceeds in higher quality government sponsored enterprise RMBS in preparation for the merger. The sale of the private-label RMBS eliminates future volatility from these securities and improves the overall quality of assets being merged into FHLBank Des Moines.

We expect continued alignment of the regional FHLBanks' business models and operations over the next couple of years, with consolidation a natural part of that alignment.

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