

2015 Annual Stress Test Disclosure – FHLB Seattle

**Results of the Federal Housing Finance Agency
Supervisory Severely Adverse Scenario**

As Required by the Dodd-Frank
Wall Street Reform and Consumer Protection Act

July 23, 2015

AGENDA

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Stress Test Background

- The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) requires certain financial companies with total consolidated assets of more than \$10 billion, and which are regulated by a primary Federal financial regulatory agency, to conduct annual stress tests to determine whether the companies have the capital necessary to absorb losses as a result of adverse economic conditions.
- In September 2013, Federal Housing Finance Agency (FHFA), regulator of the Federal Home Loan Banks (FHLBanks), implemented annual stress testing rules for the FHLBanks as required by the Dodd-Frank Act.
- In accordance with these rules, and because the Federal Home Loan Bank of Seattle (FHLB Seattle) no longer exists as a separate legal entity, the Federal Home Loan Bank of Des Moines (FHLB Des Moines) is publicly disclosing the results of the FHLB Seattle stress test in this document.

Disclosure on the Merger of FHLB Seattle and FHLB Des Moines

- The merger of the two FHLBanks became effective May 31, 2015.
- The two FHLBanks were separate legal entities on September 30, 2014, the as of date for the stress test. As per FHFA requirements, the stress test for FHLB Seattle was conducted on a stand-alone basis, without incorporating the impact of the merger with FHLB Des Moines.
- Under the severely adverse scenario, significant losses were projected for FHLB Seattle driven primarily by two legacy portfolios: first, exposure to Private Label Mortgage Backed Securities (PLMBS) led to \$126MM in other-than-temporary impairment (OTTI) credit losses and a \$865MM reduction in Other Comprehensive Income under the global market shock; and second, unsecured money market term investment (longer than one day to maturity) with a single counterparty assumed to fail instantaneously led to a projected counterparty default loss of \$354MM.
- In preparation for its merger with FHLB Des Moines, FHLB Seattle eliminated exposure in each of the two portfolios that were the primary drivers of loss as measured in this stress test. FHLB Des Moines does not currently have material exposure in either PLMBS or term money market positions. **As a result, the capital adequacy of the combined Bank under the severely adverse scenario should not be materially affected by the balance sheet of FHLB Seattle.**

Executive Summary (cont.)

Stress Test Requirements

- FHFA provided inputs and key assumptions for the severely adverse scenario.
- Results are projected over the nine-quarter period from the fourth quarter of 2014 to the fourth quarter of 2016, starting with actual balances as of September 30, 2014.
- The stress test results under the FHFA severely adverse scenario, as disclosed in this document or otherwise, should not be viewed as forecasts of expected or likely outcomes of future results. Rather, these modeled projections are based solely on the FHFA's severely adverse scenario and other specific required assumptions.

Stress Test Results

- Although significant reductions in the risk profile of the Federal Home Loan Bank of Seattle were made after the date of this stress test and prior to its merger with the Federal Home Loan Bank of Des Moines, these stress test results still demonstrate the capital adequacy of the Federal Home Loan Bank of Seattle under the FHFA's severely adverse economic conditions as of December 31, 2016.
 - Regulatory capital ratio (which is permanent capital divided by total assets) at December 31, 2016, is 7.66%, exceeding the minimum regulatory requirement of 4.00%.
 - Regulatory leverage capital ratio (which is permanent capital multiplied by 1.5 divided by total assets) at December 31, 2016, is 11.35%, exceeding the minimum regulatory requirement of 5.00%.
 - Total GAAP Capital at December 31, 2016, is \$4 million.

Stress Test Components

Stress Test Components

Net interest income + other non-interest income, net

- Net interest income (expense), operating expenses and other non-interest income (expense)

(Provision) benefit for credit losses on mortgage loans

- Provisions for credit losses related to mortgage loans held for portfolio

OTTI credit losses

- Other-than-temporary impairment (OTTI) credit losses for investment securities

Mark-to-market gains (losses)

- Mark-to-market gains (losses) related to changes in fair value of derivatives, trading securities and other gains (losses) on assets and liabilities held at fair value

Global market shocks

- Instantaneous global shocks of interest rates, volatility, agency mortgage-backed securities (MBS) option-adjusted spreads (OAS) and non-agency MBS prices applied to trading securities, available-for-sale (AFS) securities, and held-to-maturity (HTM) securities that are deemed to have OTTI losses in the stress test scenario. Global shocks applied to AFS and OTTI HTM securities are included in other comprehensive income (loss).

Counterparty default losses

- Instantaneous and unexpected default of largest counterparty across secured and unsecured lending, repurchase/reverse repurchase agreements and derivatives exposures

Severely Adverse Scenario Results & Assumption

Severely Adverse Scenario Results

FHLBank Dodd-Frank Stress Test Template - SEVERELY ADVERSE (Disclosure to the Public)

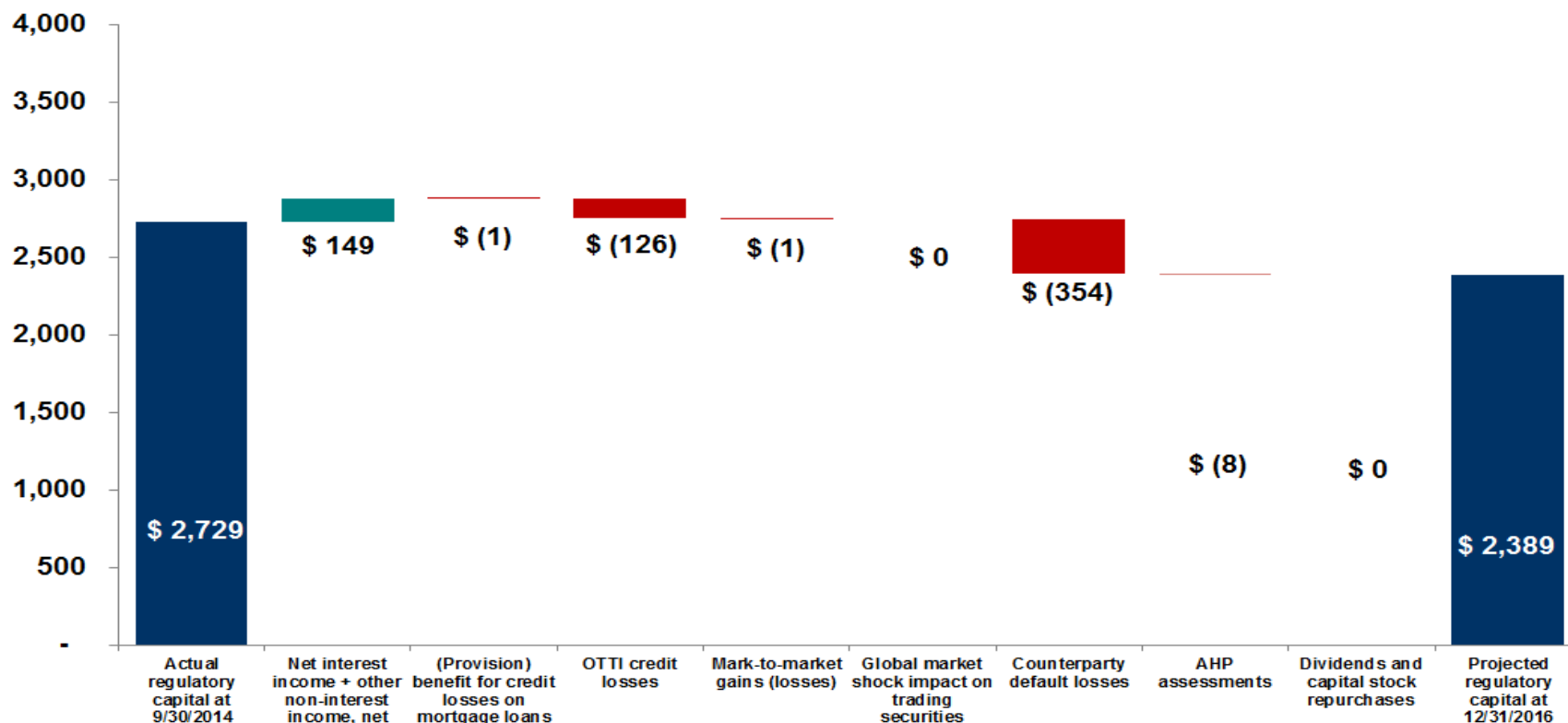
	Cumulative Projected Financial Metrics (Q4 2014- Q4 2016)
1 Net interest income + other non-interest income, net	149
2 (Provision) benefit for credit losses on mortgage loans	(1)
3 OTTI credit losses	(126)
4 Mark-to-market gains (losses)	(1)
5 Global market shock impact on trading securities	-
6 Counterparty default losses	(354)
7 AHP assessments	(8)
8 Net income (loss)	(341)
9 Other comprehensive income (loss)	(865)
10 Total comprehensive income (loss)	(1,206)
11 Total capital (GAAP) - starting	1,210
12 Total capital (GAAP) - ending	4
13 Regulatory capital ratio - starting	7.79%
14 Regulatory capital ratio - ending	7.66%

These projections represent hypothetical internal estimates based on applying rules and conditions set forth in the FHFA's Severely Adverse Scenario. These estimates are not forecasts of FHLB Seattle expected results. Any distribution of dividends remains subject to approval by the FHLB Des Moines Board of Directors as part of the combined Bank post-merger.

Severely Adverse Results – Regulatory Capital Analysis

- Regulatory capital, which is defined as the sum of capital stock, retained earnings and mandatorily redeemable capital stock, decreases from \$2.7 billion at 9/30/2014 to \$2.4 billion at 12/31/2016.
- All results shown below are modeled projections, except for actual regulatory capital at 9/30/2014.

(\$ in millions)

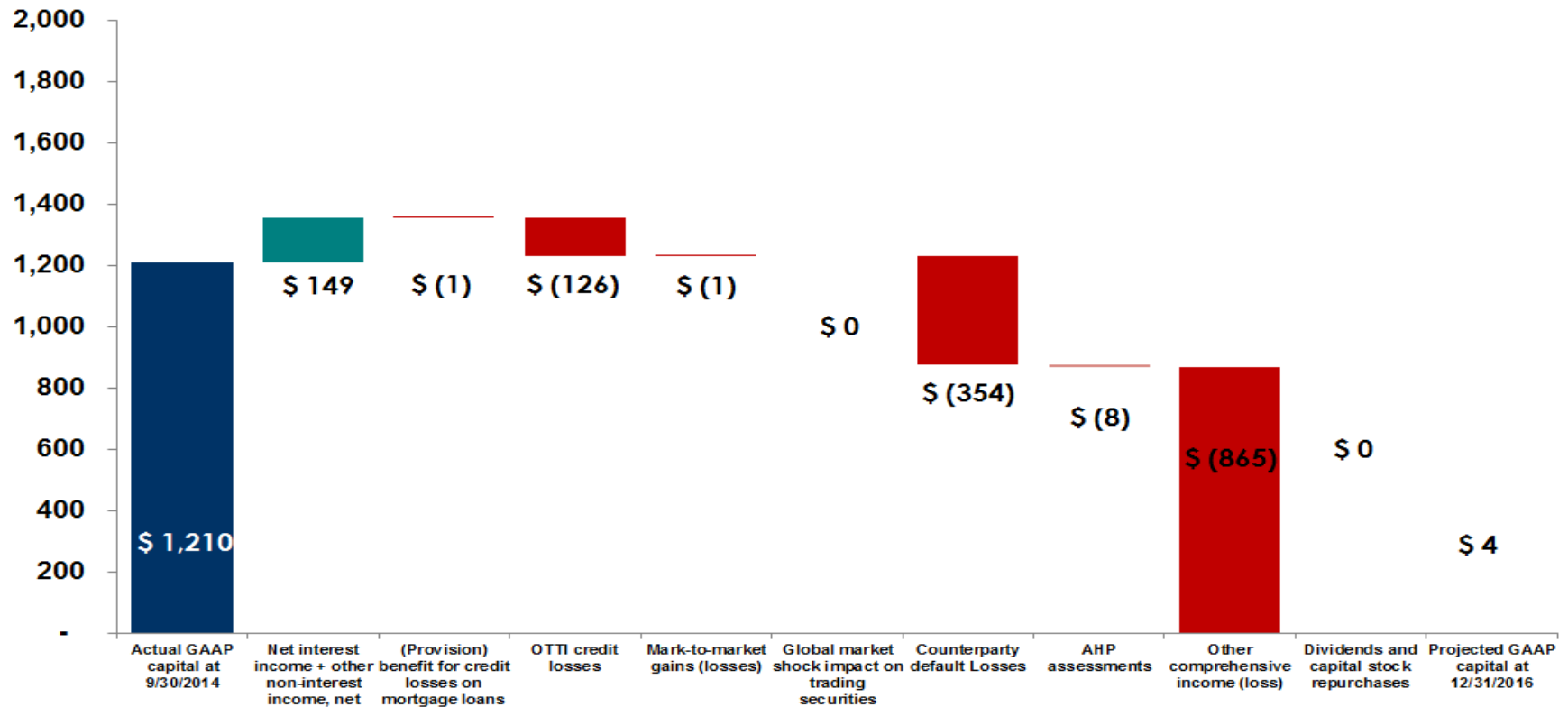


These projections represent hypothetical internal estimates based on applying rules and conditions set forth in the FHFA's Severely Adverse Scenario. These estimates are not forecasts of FHLB Seattle expected results. Any distribution of dividends remains subject to approval by the FHLB Des Moines Board of Directors as part of the combined Bank post-merger.

Severely Adverse Results – Total GAAP Capital Analysis

- Total GAAP capital, which is defined as the sum of capital stock, retained earnings and accumulated other comprehensive income (loss), decreases from \$1.2 billion at 9/30/2014 to \$4.2 million at 12/31/2016.
- All results shown below are modeled projections, except for actual Total GAAP Capital at 9/30/2014.

(\$ in millions)



These projections represent hypothetical internal estimates based on applying rules and conditions set forth in the FHFA's Severely Adverse Scenario. These estimates are not forecasts of FHLB Seattle expected results. Any distribution of dividends remains subject to approval by the FHLB Des Moines Board of Directors as part of the combined Bank post-merger.

Severely Adverse Scenario Key Assumptions Provided by FHFA

Macroeconomic Variables	
Residential House Prices (<i>Peak to trough decline with no recovery over the planned horizon</i>)	-25%
Commercial Real Estate Prices (<i>Peak to trough decline with no recovery over the planned horizon</i>)	-35%
Real Gross Domestic Product (<i>Annual GDP growth rate</i>)	-3.7% (2015),+2.1% (2016)
Unemployment Rate (<i>Peak</i>)	10.1% (Q2 2016)
Interest Rate Variables	
30-yr Mortgage Rate (<i>Average over the plan horizon</i>)	4.7%
10-yr Treasury Rate (<i>Average over the plan horizon</i>)	1.4%
Global Market Shock	
Instantaneous price shocks on non-agency securities	-14.2% to -79.6%
Instantaneous option-adjusted spread (OAS) shocks on: Agency debt/debenture	+20bps

Component Methodologies

Component Methodologies

Net interest income + other non-interest income, net

Description	<ul style="list-style-type: none"> • Reflects projections of net interest income (expense), operational expenses and other non-interest income (expense) over the nine-quarter period • Material risks covered include interest-rate risk, operational risk and business risk
Methodologies	<ul style="list-style-type: none"> • Estimates net interest income by projecting portfolio balances, funding mix and spreads using the macroeconomic variables provided by the FHFA and management assumptions • Non-interest income and expense estimated by management • Estimates operational risk losses based on the Bank’s historical operational loss experience and relevant external data consistent with supervisory expectations

(Provision) benefit for credit losses on mortgage loans

Description	<ul style="list-style-type: none"> • Reflects credit loss provisions related to estimated losses on mortgage loans held for portfolio. • Captures mortgage credit risk
Methodologies	<ul style="list-style-type: none"> • Loan loss reserves forecasted by projecting the population of loans 90+ days delinquent or in foreclosure, and corresponding loss severity over the nine-quarter period. Specifically: <ul style="list-style-type: none"> – Forecasts the amortized balances for the affected population under the FHFA-provided macroeconomic scenario – Forecasts loss severity based on the stressed HPI curves – Combines the projected amortized balances and loss severities to compute projected losses

OTTI credit losses

Description	<ul style="list-style-type: none"> • Reflects credit-related OTTI losses for non-agency investment securities • Material risks covered include credit risk associated with the investment portfolio
Methodologies	<ul style="list-style-type: none"> • Estimates OTTI of non-agency MBS, by projecting cash flow shortfalls. Incorporates FHFA provided and internal assumptions for: <ul style="list-style-type: none"> – Housing prices, interest rates, mortgage rates and monoline insurer performance • Estimates credit losses on Housing Finance Agency securities, incorporating historical default and recovery rates as related to the Severely Adverse scenario

Component Methodologies (cont.)

Mark-to-market gains (losses)

Description

- Reflects mark-to-market gains (losses) from changes in fair value of derivatives, trading securities and assets and liabilities held at fair value due to changes in interest rates
- Material risk covered includes interest rate risk

Methodologies

- Applies FHFA-specified interest rates and internal interest rate assumptions through the use of valuation models to estimate changes in fair value of derivatives, trading securities and assets and liabilities held at fair value

Global market shocks

Description

- The Global market shock is an instantaneous decline in market value of trading securities, AFS securities and those HTM securities that are deemed to have OTTI losses. The instantaneous losses and corresponding reduction of capital are taken in the first quarter of the testing horizon without any future recoveries during the nine-quarter planning horizon. This shock is treated as an add-on to the macroeconomic and financial market environment specified in the stress test. Global shocks applied to AFS and OTTI HTM securities are included in other comprehensive income (loss).

Methodologies

- Applies FHFA-specified shocks, taken in the first quarter of the forecast horizon, to trading securities, AFS securities, and also used to calculate the non-credit component of OTTI associated with HTM securities:
 - Non-Agency Securitized Products: Relative Market Value Shock
 - Municipals: Spread Widening
 - Agencies: OAS Widening

Counterparty default losses

Description

- Reflects instantaneous and unexpected default of largest counterparty net exposure
- Material risks covered include unsecured and secured lending, repurchase/reverse repurchase agreements and derivative exposures, but exclude advances and overnight positions

Methodologies

- Estimates credit loss arising from largest counterparty net stressed exposure by applying global market shock to non-cash securities/collateral held or received and derivatives positions including non cash collateral exchanged
- Incorporates FHFA-provided and management assumptions for:
 - Interest rates
 - Credit spreads
 - Recovery rates

Key Risks Considered

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Market Risk

- The risk to earnings or capital arising from changes in the market value of mortgage loans, investment securities or other financial instruments due to changes in the level, volatility or correlations among financial market rates or prices, including interest rates. Specifically, market risk to the FHLBank includes the risk that the market value, or estimated fair value, of the FHLBank's portfolio will decline as a result of changes in interest rates and/or changes in spreads.

Credit Risk

- The risk to earnings or capital arising from the default, inability or unwillingness of a borrower, obligor or counterparty to meet the terms of any financial obligation with the FHLBank or otherwise perform as agreed. Specifically, credit risk to the FHLBank as it pertained to the stress test includes the risk of loss due to defaults on principal and interest payments on advances, MBS and other investments, interest-rate exchange agreements, mortgage loans and unsecured extensions of credit. Based on the FHLBank's collateral management practices and further analysis of existing and supplemental collateral support, the FHLBank projected no credit losses on advances. This is consistent with the history of the FHLBank System which has never experienced a loss on a member advance, even through highly stressful economic environments.

Operational Risk

- The risk of loss resulting from inadequate or failed processes, systems, human factors or external events. Operational risk is inherent in the FHLBank's business activities and can manifest itself in various ways, including accounting or operational errors, business interruptions, fraud and technology failures. This definition includes legal risk, which is the risk of loss arising from defective transactions, litigation or claims made, or the failure to adequately protect company-owned assets.

Business Risk

- The risk of an adverse effect on the FHLBank's profitability resulting from external factors that may occur in both the short and long term. Business risk includes the impact of regulatory risk. Declines in business may affect the FHLBank's capital levels by reducing its activity-based capital stock balance and slowing the pace at which the FHLBank can build retained earnings. Additionally, the reduction in capital levels will limit the FHLBank's ability to purchase additional investments, thereby further limiting potential income and growth.

Questions.

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