

Announcement: Moody's: FHLBanks facing GAAP pressures on OTTI losses in 2009

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New York, January 08, 2009 -- The Federal Home Loan Banks (FHLBanks) are currently facing the potential for substantial accounting impairments on their \$76.2 billion private-label MBS securities portfolio, Moody's Investors Service says in a recent report. Under a worst-case scenario, only four of 12 FHLBanks' capital would remain above regulatory minimums, but the rating agency states that this situation is unlikely. Nevertheless, the report suggests that the amount of loss "could be material to the banks' capital bases."

The FHLBanks were created to provide member institutions with a stable source of funding, mainly by supplying cash advances in exchange for collateral. Since the beginning of the credit crisis, the FHLBanks' role has become increasingly important, Moody's notes, because they have been a vital source of reliable liquidity to their members and, thus, to the US banking system.

Based on then-current market prices in 3Q08, the banks' total private-label MBS portfolio was valued at \$62.7 billion, thus representing a \$13.5 billion unrealized loss. In the short term, US GAAP accounting rules may require the FHLBanks to account for securities in their portfolio as 'other than temporary impairments,' or OTTI, says Senior Vice President Brian Harris, the author of the report.

"If these unrealized losses are deemed OTTI," he states, "the FHLBanks' capital levels would be significantly affected -- an issue that is likely to become far more evident during the next two quarters."

"The impact could have important ramifications -- both in terms of more limited, more expensive access to the capital markets and of heightened regulatory supervision due to the breach of regulatory capital minimums," the analyst points out.

Should the regulator believe that the OTTI losses of any individual FHLBank will crystallize into realized losses, its actions could be severe, including conservatorship or a forced merger into a healthy FHLBank. "On balance," Mr. Harris concludes, "the regulatory response to OTTI will probably focus on capital preservation because we believe that the ultimate economic losses will be less than OTTI, possibly by a material amount."

Moody's ratings assume a very high degree of government support. "Therefore," the analyst explains, "declines in capital and the potential regulatory and financial affects could result in reductions of the FHLBanks' Baseline Credit Assessment (BCA -- the stand-alone ratings of the entities), but the FHLBanks' Aaa senior debt rating and Prime-1 short-term debt rating are likely to remain unchanged."

The analyst concludes that the importance of the FHLBanks' lending activities is so significant that the regulators would be unlikely to reduce individual banks' lending activities even if they were to incur substantial OTTI charges.

The report is titled "Rating Implications on the Federal Home Loan Banks from Other-than-Temporary Impairments."

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