The FMP provides a framework within which the Federal Home Loan Banks (Banks) may implement their financial management strategies in a prudent and responsible manner. The FMP includes a series of guidelines relating to the investment, funding, and hedging practices of the Banks, as well as to the management of credit, interest rate, and liquidity risks. Adhering to the guidelines promotes the Banks’ ability to accomplish their housing finance and community development missions while generating sufficient income to meet their various financial obligations. The FMP has evolved from a series of policies and guidelines initially adopted by the Finance Board’s predecessor agency, the Federal Home Loan Bank Board (FHLBB). The FHLBB had adopted guidelines comparable to the FMP in the 1970s and revised them a number of times thereafter. The Finance Board adopted the FMP in 1991, consolidating in one document the previous policies on funds management, hedging, and interest rate swaps, and adding new guidelines on management of unsecured credit and interest rate risks.

In recent years, the financial markets and the Banks’ participation in those markets have evolved considerably. Moreover, Congress has altered the statutory provisions governing the Federal Home Loan Bank System (System), principally through the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Public Law 101–73, 103 Stat. 415 (August 9, 1989). As a consequence of such financial and legislative changes, the FHLBB and Finance Board periodically revised their financial policies and guidelines so that the Banks could continue to manage their finances prudently, profitably, and in furtherance of their mission. In undertaking such revisions to the FMP and its predecessor policies, the FHLBB and Finance Board in the past accepted informal comments from the Banks as part of that process. In some instances, staff of the Banks submitted proposals for consideration by the agency, and in other instances staff of the Banks and the agency worked together to analyze the existing policies and to suggest ways in which they could be revised to reflect the changing environment in which the Banks operate. Such informal processes and collaborative efforts reflected the dual regulatory and managerial responsibilities exercised by the FHLBB and the Finance Board.

More recently, however, the nature of the relationship between the Finance Board and the System has changed, both as a result of the changes brought about by FIRREA and of the process of devolution undertaken by the Finance Board. As a result of the Finance Board’s determination to devolve to the Banks those managerial responsibilities that are not vested by statute in the Finance Board, the agency has assumed a more predominantly regulatory role with respect to the Banks. The Finance Board intends to concentrate its efforts on its regulatory role, overseeing the safety and soundness of the Banks and ensuring that they adhere to their housing finance and community development missions. In light of the changes in its role and its relationship with the Banks, the Finance Board has determined that it would be appropriate to issue the FMP as a statement of agency policy and to solicit comments on the FMP from the public at large.

II. Statement of Policy

The Finance Board last revised and reissued the entire FMP in July 1996, following which Banks and other parties raised several interpretive questions. In the version of the FMP that is being published today the Finance Board is proposing to resolve three interpretive questions, to incorporate into the FMP two other matters that the Finance Board has addressed previously by separate resolutions, and to make three additional changes that the Finance Board deems appropriate. The publication of the FMP as a proposed policy statement shall not suspend the effectiveness of the version of the FMP approved by the Finance Board on July 3, 1996 pursuant to Resolution No. 96–45, nor the separate revisions approved on December 6, 1996 by Resolution No. 96–90 (relating to inflation-indexed consolidated obligations) or on January 14, 1997 by Resolution No. 97–05.
(relating to branch and agency offices). The Finance Board intends to consider the comments received before adopting this proposed revision to the FMP, including the six new revisions described below, in final form.

Branch and Agency Offices

As part of the July 1996 revisions to the FMP, the Finance Board revised the definition of "eligible financial institution" to exclude the U.S. branch and agency offices of foreign commercial banks. Resolution No. 96-45 (July 3, 1996). In January 1997, the Finance Board reinstated those branch and agency offices as "eligible financial institutions," provided that the foreign commercial bank has at least $250 million in Tier I (or tangible) capital, can be designated as at least a Level III counterparty under the FMP, and has a country risk rating of not lower than AA from Thomson Bankwatch. Resolution No. 97-05 (January 14, 1997). The Finance Board has incorporated the changes from Resolution No. 97-05 into the proposed version of the FMP, although as noted above, the changes made by that resolution continue in effect.

Alternative Funding Sources

On an annual basis, the Finance Board approves the authority of the Office of Finance Board (OF Board) to approve the issuance of System consolidated obligations (COs). The Banks' authority to participate in such debt issuances is addressed by section IV. of the FMP. As part of the Finance Board's approval of the Office of Finance 1997 Debt Issuance Authorization, the Finance Board made three changes to the FMP to allow the Banks to participate in the debt issues the OF Board is authorized to approve. Resolution No. 96-90 (December 6, 1996). Those changes made by Resolution 96-90 remain in effect and are included in the version of the FMP published today.

The Banks may participate in COs for which the coupon or principal may vary based upon the movement of an eligible financial index. The first change to the FMP revised the definition of a financial index to include an index that is sanctioned by a national government and serves as an aggregate measure of inflation, including those indices derived from aggregate measures of economic performance and prices. This amendment permitted the Banks to participate in the issuance of inflation-indexed COs.

Debt issues that are tied to a financial index pertaining to a foreign country or that are denominated in a foreign currency are subject to minimum sovereign risk rating requirements. The second change to the FMP permitted the use of sovereign risk ratings from Moody's or Standard & Poor's for countries not rated by Thomson Bankwatch (Thomson). All three rating agencies focus on the assessment of political and economic risk and their ratings generally tend to be well correlated.

The third change to the FMP increased the minimum sovereign risk rating required from Thomson for index and currency eligibility from A- to AA- in order to conform the FMP to the practice of the OF. If a country is not rated by Thomson, a Sovereign Risk Rating for long-term bonds or deposits from Moody's of not lower than Aa3 or a Sovereign Risk Rating for Foreign Currency from Standard & Poor's of not lower than AA- may be used.

Obligations Guaranteed by the United States

The investment guidelines of the FMP list the types of assets that are authorized investments pursuant to Sections 11(g), 11(h), or 16(a) of the Federal Home Loan Bank Act, 12 U.S.C. 1431(g), (h), 1436(a). One such type is any marketable obligation issued or guaranteed by the United States. A question has been raised whether this provision encompasses obligations for which the principal may be guaranteed by the United States, but the interest may not be guaranteed or may be guaranteed only in part.

The version of the FMP approved in 1991 provided that only the direct obligations of the United States were authorized investments. In 1993, the Finance Board broadened the provision to include obligations guaranteed by the United States. The inclusion of obligations guaranteed by the United States recognizes that the full faith and credit of the United States is not limited to obligations issued by the United States Treasury, and that there is no difference in an instrument's credit risk where the full faith and credit of the United States is guaranteed through a guaranty, rather than directly. The Finance Board is proposing to revise Section II.B.6. of the Investment Guidelines to clarify that it includes only those instruments that possess the same credit risk as a direct obligation of the United States, meaning that the guaranty must extend to both the principal and interest due on the obligation.

Unsecured Credit Guidelines

The July 3, 1996 revisions to the FMP made separate changes to the Hedge Transactions Guidelines and to the Unsecured Credit Guidelines, which have prompted a question about the inter-relationship of those provisions. Footnote 6 of the hedging guidelines was revised to include among the eligible counterparties certain entities with a Moody's rating of at least Baa or a Standard & Poor's rating of at least BBB, but only if transactions with those parties result in no unsecured credit exposure for the Bank. The Finance Board also revised Section VI.B. of the Unsecured Credit Guidelines to exclude from the definition of "unsecured extensions of credit" certain off-balance sheet extensions of credit that are subject to a specified type of net cross-collateral agreement. A question has been raised as to whether the two provisions could be read together to allow some level of unsecured credit exposure to triple-B rated counterparties, subject to the required net cross-collateral requirement.

In making those revisions to the FMP the Finance Board intended that they be applied independently of each other, and that transactions with triple-B rated counterparties not result in any unsecured credit exposure to the Banks. The Finance Board is proposing to revise Section VI.B. of the Unsecured Credit Guidelines to state expressly that the only off-balance sheet extensions of credit subject to a net collateral exchange agreement that may be deemed not to be unsecured extensions of credit are those made to institutions that meet the requirements for at least a Level III counterparty, as defined within the Unsecured Credit Guidelines.

Counterparty Downgrade

The Unsecured Credit Guidelines provide that when a rating agency places a Bank's counterparty on creditwatch for a potential downgrade the Bank should treat the counterparty as if a downgrade actually has occurred. The Finance Board is proposing to revise Section VI.C.2.f. of the Unsecured Credit Guidelines to clarify that for purposes of determining the remaining available credit line for on-balance sheet investment purposes, the Bank shall assume that the agency has assigned to the counterparty a rating at the next lower notch, for example, a downgrade from A-1 to A-2, A-1 to A-2, or AA2 to AA3. The Finance Board expects that a Bank would assume a larger downgrade than the minimum required by the FMP, if warranted by the circumstances, and would take the appropriate steps.
Interest Rate Risk Guidelines: Exclusion of FIRREA Cash Flows and Other Amendments

Internal models employed by the Banks to calculate their duration of equity have become increasingly sophisticated, and have effectively supplanted reliance on the Finance Board's internal model for calculating duration of equity. The models currently used by the Banks have the capacity to discount cash flows associated with various assets and liabilities at rates appropriate to the instrument. For these reasons, the Finance Board is proposing to modify Sections VII.B.1. and 3. of the Interest Rate Risk Guidelines to: (1) Exclude specific reference to the CO cost curve as an appropriate uniform discounting methodology, and (2) Provide that calculations should be performed by the Banks employing calculation methods and assumptions that reasonably capture the interest rate risks inherent in their on-and-off balance sheet activities.

In addition, the Finance Board is proposing to revise Section VII.B.4. to exclude the REFCorp and AHP cash flows from Bank duration of equity calculations. The System pays $300 million annually for interest on the REFCorp bonds, with each Bank's portion determined by a two-part formula. Initially, each Bank pays 20 percent of its net income (first round). If the aggregate of those payments yields less than $300 million, each Bank pays an additional amount based on its share of System advances to institutions insured by the Savings Association Insurance Fund (second round). The annual AHP payment is the greater of 100 million or 10 percent of System net income.

When the FMP's interest rate risk guidelines were first implemented in 1991, the REFCorp and AHP payments were not included in the cash flows used to calculate each Bank's duration of equity. Subsequently, some of the Banks concluded that it was appropriate to include the REFCorp and/or AHP cash flows when calculating duration of equity and measuring interest rate risk. They assumed that their shares of the System's obligations could be considered fixed liabilities represented by fixed annual payments or cash outflows, and should be explicitly included in their asset/liability management. When the FMP was revised in 1993, the Finance Board required that each Bank report its cash flows and calculate its duration of equity both with and without the projected cash flows which represent the Bank's share of the System's REFCorp and AHP obligations. The Finance Board, in Decision Memorandum No. 94-DM-48 dated November 10, 1994, indicated that when measuring individual Bank compliance with the FMP's interest rate risk limits, it would take into consideration the Bank's determination to include or exclude the FIRREA cash flows in its interest rate risk management strategies.

With the growth in System income since 1993, however, an increasing share of the total REFCorp payment is generated by the first round of the formula. In 1996, the amount of the obligation generated by the second round represented only eight percent of the total REFCorp payment. By comparison, in 1995, 1994 and 1993 the second round share represented 17, 30, and 40 percent of the total, respectively. In 1996, each Bank's contribution to the AHP represented 10 percent of its income.

As System income increases, the percentage of income each Bank pays to REFCorp and AHP will converge to the System average. To the extent that the REFCorp and AHP obligations represent a fixed percentage of each Bank's income, they are, in effect, a tax, which ordinarily is not considered when estimating a Bank's duration and market value of equity. Because the percentage paid by each Bank is currently very close to the System average (no Bank paid more than 1.1 percent more or less than the System average in 1996), the Finance Board considers it appropriate to treat the payment as if it were a tax and is proposing to exclude the REFCorp and AHP cash flows from Bank duration of equity calculations. Any Bank that exceeds the duration limits as a result of this change will be expected to develop a plan for returning to compliance.

Housing and Community Development Investments

The Finance Board has encouraged the Banks to submit proposals to engage in pilot programs for new mission-related activities. The Finance Board has determined that the pilot program structure is the most effective way to encourage the Banks and their members to test the viability and benefits of any new activities in a controlled manner that limits the risks to a Bank and to the System. As part of the July 1996 revisions to the FMP, the Finance Board established a detailed set of criteria under which to evaluate any such proposals. The Finance Board has employed those criteria most recently in approving pilot programs proposed by the New York, Atlanta, and Chicago Banks, respectively.

The FMP criteria provide that any such new investments to support housing and community development must: (1) Ensure the appropriate levels of expertise and controls necessary to manage risk and preserve the triple-A rating; (2) Ensure that the Bank's involvement assists in providing financing that may not otherwise be available or may be available only on less attractive terms; and (3) Ensure that the investment promotes, or does not detract from, the cooperative nature of the System. Prior to entering into such an investment, a Bank must provide a complete description of the contemplated investment activity, including a comprehensive analysis of how the above criteria are fulfilled, and must obtain from the Finance Board written confirmation that the criteria have been satisfied.

These criteria follow closely the criteria recommended by the General Accounting Office (GAO) for the consideration of new products and services for the Banks. GAO Report No. 94-38, at pages 97-99. The GAO developed six criteria for evaluating proposals for new products and services, which it viewed as necessary to maintain the safety and soundness and missions of the System. Those criteria are: (1) Avoiding competition with members; (2) Possessing the expertise to conduct the new activities profitably; (3) Conforming to the housing finance, affordable housing, and community development missions; (4) Addressing a need that others are not adequately meeting; (5) Pricing the product to provide an adequate rate of return; and (6) Maintaining the System's triple-A rating. The Finance Board believes that the FMP criteria are consistent with those developed by GAO and establish a prudent analytical framework within which to evaluate proposals from the Banks.

The text of the proposed FMP follows:

Federal Housing Finance Board Statement of Policy

Financial Management Policy for the Federal Home Loan Bank System

I. Policy Objective

The Federal Housing Finance Board (Finance Board) Financial Management Policy (FMP) for the Federal Home Loan Bank System has been established to provide a framework within which the Federal Home Loan Banks (Banks) are allowed to implement prudent and responsible financial management strategies that assist them in accomplishing their mission, and in
generating income sufficient to meet their financial obligations, in a safe, sound, and profitable manner. The specific objectives of each section of the FMP are listed below.

A. Investment Guidelines

1. Establish policy with respect to the use of funds not required for the Banks’ advances programs or operating requirements.
2. Specify permissible investment assets.
3. Establish eligibility requirements and limitations for investment counterparties.
4. Establish requirements with respect to the characteristics of permissible investments.
5. Establish limits for permissible investment assets.

B. Liquidity Guidelines

1. Implement the provisions of the Federal Home Loan Bank Act (Act), as amended, with respect to required deposit reserves.
2. Establish additional liquidity requirements.
3. Specify the types and characteristics of investment assets which may be used to satisfy the reserve and liquidity requirements.

C. Funding Guidelines

1. Identify authorized funding sources.
2. Prescribe the conditions under which the Banks may enter into non-U.S. dollar denominated and other non-standard financing arrangements.
3. Establish individual Bank leverage limits.

D. Hedge Transaction Guidelines

1. Define authorized hedging transactions and counterparties.
2. Establish requirements and limitations for authorized hedging transactions.
3. Establish a framework for the valuation and collateralization of interest rate swap and option transactions.
4. Establish standards for hedge documentation.

E. Unsecured Credit Guidelines

1. Establish minimum standards for counterparties receiving extensions of unsecured credit.
2. Establish limits on the amount of unsecured credit a Bank may extend.
3. Establish a method for measuring unsecured credit risk.

F. Interest Rate Risk Guidelines

1. Establish limits on the aggregate interest rate risk a Bank may incur.
2. Establish a method for measuring interest rate risk.

G. Implementation Guidelines

1. Define the responsibilities of a Bank’s board of directors, management, and internal audit staff.
2. Define the responsibilities of the Federal Housing Finance Board.

II. Investment Guidelines

A. Purpose

To establish policy on the use of funds not required for credit programs or operations, to explicitly permit the purchase of mission-related and liquid assets, and to provide a safe and sound mechanism for generating income during periods of reduced credit demand to ensure that financial commitments can be met and that dividends can be maintained at levels sufficient to attract and retain members. Each Bank will be responsible for determining the extent to which its investment authority will be used to augment income from advances, consistent with Finance Board regulations and policies.

B. Permissible Investments

To the extent to which they are specifically authorized under Sections II(g), II(h) or 16(a) of the Act, or to the extent a Bank has determined that they are securities in which fiduciary or trust funds may invest under the laws of the state in which the Bank is located, the following investments are permitted:

1. Overnight and term funds, that on the settlement date have a remaining term to maturity not exceeding 9 months, placed with eligible financial institutions.1
2. Overnight and term resale agreements, that on the settlement date have a remaining term to maturity not exceeding 9 months, with eligible counterparties, using for collateral securities which are eligible investments under this section, and Federal Housing Administration (FHA) and Veterans’ Administration (VA) mortgages.2
3. U.S. dollar deposits, that on the settlement date have a remaining term to maturity not exceeding 9 months, placed with eligible financial institutions.
4. Commercial paper, bank notes, and thrift notes traded in U.S. financial markets and rated both P±1 by Moody’s and A–1 by Standard & Poor’s, that on the settlement date have a remaining term to maturity not exceeding 9 months.3
5. Bankers’ acceptances, drawn on and accepted by eligible financial institutions, that on the settlement date have a remaining term to maturity not exceeding 9 months.
6. Marketable obligations issued or guaranteed as to both principal and interest by the United States.
7. Marketable direct obligations of U.S. Government Sponsored Agencies and Instrumentalities for which the credit of such institutions is pledged for repayment of both principal and interest.
8. Securities representing an interest in pools of mortgages (MBS) issued, guaranteed or fully insured by the Government National Mortgage Association (GNMA), the Federal Home Loan Mortgage Corporation (FHLMC), or the Federal National Mortgage Association (FNMA), or Collateralized Mortgage Obligations (CMOs), including Real Estate Mortgage Investment Conduits (REMICs), backed by such securities.
9. Other MBS, CMOs, and REMICs rated Aaa by Moody’s or AAA by Standard & Poor’s.
10. Asset-backed securities collateralized by manufactured housing loans or home equity loans and rated Aaa by Moody’s or AAA by Standard & Poor’s.
11. Marketable direct obligations of state or local government units or agencies, rated at least Aa by Moody’s or AA by Standard & Poor’s, where the purchase of such obligations by a FHLBank provides to the issuer the customized terms, necessary liquidity, or favorable pricing required to generate needed funding for housing or community development.
12. Other investments that support housing and community development, provided that prior to entering into such investments, the Bank:
   a. ensures the appropriate levels of expertise, establishes policies, procedures, and controls, and provides for any reserves required to effectively limit and manage risk exposure and preserve the Bank’s and the System’s triple-A rating;
   b. ensures that its involvement in such investment activity assists in providing housing and community development financing that is not generally available, or that is available at lower levels or under less attractive terms;
   c. ensures that such investment activity promotes (or at the very least, does not detract from) the cooperative nature of the System;
   d. provides a complete description of the contemplated investment activity (including a comprehensive analysis of how the above three requirements are fulfilled) to the Finance Board; and
   e. receives written confirmation from the Finance Board, prior to entering into such investments, that the above...
investment eligibility standards and requirements have been satisfied.

C. Limitations on Authorized Investments

1. Investments in other than U.S. Dollar denominated securities are prohibited.

2. A Bank may enter into agreements to purchase MBS, CMOs, REMICs, and eligible asset-backed securities so long as such purchases will not cause the aggregate book value of such securities held by the Bank to exceed 300 percent of the Bank’s capital. A Bank may not increase its holdings of such securities in any one calendar quarter by more than 50 percent of its total capital at the beginning of that quarter.4

3. The purchase of Interest Only or Principal Only stripped MBS, CMOs, REMICs, and eligible asset-backed securities is prohibited.

4. The purchase of residual interest or interest accrual classes of MBS, CMOs, REMICs, and eligible asset-backed securities is prohibited.

5. The purchase of fixed rate MBS, CMOs, REMICs, and eligible asset-backed securities, or floating rate MBS, CMOs, REMICs, and eligible asset-backed securities that on the trade date are at rates equal to their contractual cap, with average lives that vary more than six years under an assumed instantaneous interest rate change of 300 basis points, is prohibited.

III. Liquidity Guidelines

A. Purpose

To implement statutory requirements and to ensure each Bank’s ability to meet potential funding needs arising from credit demands, deposit withdrawals, and debt redemptions without incurring material losses.

B. Statutory Deposit Reserve Requirements

Each Bank is required to maintain an amount equal to the total deposits received from its members invested in:

1. Obligations of the United States.

2. Deposits in banks or trust companies (as defined in Finance Board regulation) which are eligible financial institutions.

3. Advances that mature in 5 years or less to members.

C. Additional Liquidity Requirements

1. Each Bank is required to maintain a daily average liquidity level each month in an amount not less than:

   a. 20 percent of the sum of its daily average demand and overnight deposits and other overnight borrowings during the month, plus

   b. 10 percent of the sum of its daily average term deposits, Consolidated Obligations (COs) and other borrowings that mature within one year.

2. Eligible Investments: The following investments, to the extent permitted under subsection II.B, are eligible for compliance with subsection III.C.1 liquidity requirements:

   a. Overnight funds and overnight deposits, as otherwise described in subsection II.B.1.

   b. Resale agreements, which mature in 31 days or less, as otherwise described in subsection II.B.2.

   c. Negotiable certificates of deposit, bankers’ acceptances, commercial paper, bank notes, and thrift notes as described in subsections II.B.3, 4, and 5.

   d. Marketable obligations of the United States as described in subsection II.B.6 which mature in 36 months or less.

   e. Marketable direct obligations of U.S. Government Sponsored Agencies and Instrumentalities as described in subsection II.B.7 which mature in 36 months or less.

   f. Cash and collected balances held at Federal Reserve Banks and eligible financial institutions, net of member pass-throughs.

3. Limitation: A security that has been pledged under a repurchase agreement cannot be used to satisfy liquidity requirements.

IV. Funding Guidelines

A. Purpose

To establish parameters for the use of alternative funding sources and structures in order that each Bank may fund its activities in a prudent, cost effective manner.

B. Bank Specific Liabilities

1. Deposits: A Bank may accept deposits from members, from any institution for which it is providing correspondent services, from another Federal Home Loan Bank, and from other instrumentalities of the United States, subject to provisions of the Act and the Finance Board’s regulatory and policy requirements.

2. Federal Funds: A Bank may purchase federal funds from any financial institution that participates in the federal funds market.

3. Repurchase Agreements: Repurchase agreements requiring the delivery of collateral by a Bank are permitted with any Federal Reserve Bank, U.S. Government Sponsored Agencies and Instrumentalities, primary dealers recognized by the Federal Reserve Bank of New York, eligible financial institutions, and states and municipalities with a Moody’s Investment Grade rating of 1 or 2. Repurchase agreements not requiring the delivery of collateral by the Bank may be entered into with any supplier of funds.

C. Consolidated Obligations

A Bank may participate in COs, so long as entering into such transactions will not cause the Bank’s total COs and unsecured liabilities, as defined in Section 910.0 of the Finance Board’s regulations (but excluding interBank loans), to exceed 70 times the Bank’s total capital. Each Bank shall make every effort to manage its liabilities and capital to ensure compliance with the 20:1 leverage limit.

1. A Bank may participate in the following types of standard debt issues:

   a. Debt with a fixed rate and fixed maturity, in either coupon or discount form.

   b. Debt with a fixed maturity whose coupon rate may vary in predetermined increments or based upon the movement of U.S. Treasury securities, U.S. Dollar LIBOR, the 11th District Cost of Funds Index, or FHLBank COs.

   c. Debt whose principal may be called or redeemed in whole or in part at the discretion of the investor, or based upon the movement of U.S. Treasury securities, U.S. Dollar LIBOR, the 11th District Cost of Funds Index, or FHLBank COs.

   d. Debt whose principal amortizes according to a predetermined schedule.

   e. Debt with a coupon rate that may change from fixed to floating, or vice versa, at the discretion of the Bank, according to a predetermined schedule, or based upon the movement of one or more financial indices.

2. A Bank may also participate in non-standard debt issues, some examples of which are:

   a. Debt whose coupon may vary based upon the movement of an eligible financial index (other than those identified in subsection C.1.b. above).5

   b. Debt whose principal is subject to redemption in whole or in part, based upon the movement of one or more eligible financial indices (other than those identified in subsection C.1.c. above).

   c. Debt whose principal balance may increase based upon the movement of one or more eligible financial indices.

   d. Debt whose coupon may vary based upon the movement of two or more eligible financial indices, including transactions which multiply the effect of rate changes.

   e. Debt denominated in a currency other than U.S. Dollars, including the European Currency Unit (ECU), whose
exchange rate risk relative to the U.S. Dollar can be effectively hedged.

3. If a Bank participates in a debt issue other than the standard transactions described in subsection C.1 above, the Bank will be required to enter into a contemporaneous hedging arrangement that allows the interest rate and/or basis risk to be passed through to the hedge counterparty, unless the Bank is able to document that the debt will: (a) Be used to fund mirror-image assets in an amount equal to the debt; or (b) offset or reduce interest rate or basis risk in the Bank’s portfolio, or otherwise assist the Bank in achieving its risk management objectives. If a Bank participates in debt denominated in a currency other than U.S. Dollars, the currency exchange risk must be hedged.

4. An FHLBank shall not directly place consolidated obligations with another FHLBank.

V. Hedge Transaction Guidelines

A. Purpose

To allow the implementation of hedging programs that control the interest rate and basis risk which arises in the ordinary course of business.

B. Permitted Instruments and Strategies

Long and short positions in the cash, forward, futures, and option markets (including caps and floors), and the purchase and sale of interest rate exchange agreements (swaps) are permitted if they assist a Bank in achieving its interest rate and/or basis risk management objectives. Hedging strategies must be explicitly stated at the time of execution and adequate documentation must be maintained during the life of the hedge. A Bank may also enter into interest rate swaps and options with a member to facilitate the member’s asset/liability management strategies. Speculative use of hedging instruments is prohibited.

C. Hedging With Interest Rate Swaps and Options (Including Caps and Floors)

1. All swaps entered into by a Bank shall be governed by the FMP.

2. Unsecured credit exposure resulting from interest rate swaps and options (as defined in subsection VI.B.) is governed by the FMP’s Unsecured Credit Guidelines.

3. Collateral Requirements: A Bank shall require collateral for interest rate swaps and options from those counterparties (or guarantors) that, on the trade date of the transaction, do not qualify for unsecured extensions of credit, and for risk exposure that, on the trade date of the transaction, exceeds the limits for unsecured extensions of credit established in the FMP. (Each Bank’s board of directors may identify a level of exposure it deems material before a collateral call will be required, either at the initiation, or throughout the life, of a hedge agreement. If a Bank chooses to identify a minimum collateral call level, that level or the method for calculating it must be included in the Bank’s policy, as required in subsection VIII.A.1.f. of the FMP.)

a. The dollar amount of collateral shall be determined by the Bank commensurate with the risk undertaken and shall be maintained in accordance with the requirements of the Bank’s agreement with the counterparty.

b. Collateral required during the life of the transaction shall be no less than the market value of the swap, as determined by the Bank, plus net accrued interest due to the Bank, unless the transaction is subject to a net collateral exchange agreement as described in subsection VI.B.

c. For option transactions in which the Bank is a potential receiver of payments, a minimum initial collateral maintenance level must be established that is no less than the market value of the contract, plus amounts due to the Bank under the contract.

d. Collateral agreements entered into by a Bank that are not required by the FMP will not be subject to FMP collateral requirements.

4. A Bank may enter into an unsecured interest rate swap or option agreement with a counterparty that does not meet the minimum credit standards as long as the transaction results in a net reduction of credit risk arising from previously existing swap or option agreements with that counterparty, and a master agreement executed by the Bank and the counterparty provides for such netting.

5. A Bank may, for hedging purposes, enter into interest rate swap agreements in which the notional principal balance amortizes based upon the prepayment experience of a specified group of MBS or the behavior of an interest rate index (Indexed Principal Swaps), or swap agreements which may be terminated or extended at the option of the Bank or its counterparty (swaptions).

a. Interest rate swaps that amortize according to the behavior of Interest Only or Principal Only stripped MBS/CMOs/REMICs are prohibited.

b. Interest rate swaps that amortize according to the behavior of residual interest or interest accrual classes of CMOs or REMICs are prohibited.

c. Indexed principal swaps that have average lives that vary by more than six years under an assumed instantaneous change in interest rates of 300 basis points are prohibited, unless they are entered into in conjunction with the issuance of COs or the purchase of permissible investments in which the interest rate risk is passed through to the investor or counterparty.

6. In addition to interest rate caps and floors, a Bank may take long and short hedge positions in any options contract provided that:

a. The underlying instrument is an investment or a futures contract permissible under this policy.

b. The hedge is constructed such that the price volatility of the option position is consistent with the price volatility of the cash instrument being hedged or with the option component of that instrument.

c. The option contract is traded on an organized exchange regulated by the Commodity Futures Trading Commission or the Securities and Exchange Commission; or through a recognized securities dealer which reports its position regularly to the Federal Reserve Bank of New York.

7. Documentation:

a. Market value determinations and subsequent collateral adjustments should be made, at a minimum, on a monthly basis.

b. Failure of a counterparty to meet a collateral call will result in an early termination event.

c. Early termination pricing and methodology shall be detailed in all interest rate swap and option contracts in which a Bank is involved as principal. This methodology must reflect a reasonable estimate of the market value of the swap or option at termination. Standard International Swap and Derivatives Association, Inc. language relative to early termination pricing/methodology may be used to satisfy this requirement.

d. The transfer of an agreement or contract by a counterparty shall be made only with the consent of the Bank.

e. Transactions with a single counterparty shall be governed by a single master agreement when practicable.

8. Non-U.S. Dollar denominated swaps are authorized only to convert matching non-U.S. Dollar denominated debt to U.S. Dollar denominated debt, or to offset another non-U.S. Dollar denominated swap.
D. Hedging in the Financial Futures Markets:

1. Long and short positions in financial futures may be used for hedging purposes provided that:
   a. The underlying instrument is an investment or other transaction permissible under this policy.
   b. The price of the futures contract has a high correlation with the price of the cash instrument being hedged.
   c. The futures contract is traded on an organized exchange regulated by the Commodity Futures Trading Commission.
2. If delivery of the underlying security will cause a Bank to exceed any investment limitation of the FMP, the Bank must close out its position prior to taking delivery.
3. Any Bank with a position which exceeds 5 percent of the open interest in any specific futures contract month shall report that position to the investment desks of the other Banks and to the Managing Director of the Finance Board within one business day of the initiation of the position. Notification shall also be given when such a position declines below 5 percent.

E. Hedging in the Cash or Forward Markets

1. The purchase or sale of cash market securities for either regular (cash) or forward delivery is permitted, provided that:
   a. Only securities that are permissible investments under this policy are used.
   b. The price of the cash or forward instrument has a high correlation with the price of the instrument being hedged.
   c. Any security purchased in the cash market for hedging purposes is subject to the investment limits of the FMP.
2. Short positions in instruments authorized in the FMP, the purchase of securities under resale agreements, and the borrowing of securities in connection with short sales is authorized for hedging purposes.

VI. Unsecured Credit Guidelines

A. Purpose

To set prudent limits on unsecured credit risk arising from authorized investment and hedging strategies.

B. Scope

All on- and off-balance sheet extensions of credit, in which the value of collateral pledged to the Bank by a counterparty is less than the credit the Bank has extended to that counterparty. Off-balance sheet extensions of credit to institutions that are at least Level III counterparties (as defined in section VI.C.2), which are subject to a net collateral exchange agreement having prudent limits on the maximum allowable levels of unsecured credit exposure as approved by the Bank's board of directors, shall not be considered unsecured extensions of credit. (Inter-Bank loans, obligations of an FHLBank, and obligations of, or guaranteed by, the United States are not subject to the requirements of this section.)

C. Eligibility for Unsecured Extensions of Credit

1. The amount of unsecured credit that may be extended to individual counterparties shall be commensurate with the counterparty's credit quality. A counterparty's credit quality shall be determined by credit ratings of the counterparty's debt, debt securities, or deposits.

2. Acceptable Credit Ratings: A Bank may extend unsecured credit to counterparties assigned the following credit ratings at the transaction trade date:

<table>
<thead>
<tr>
<th>Thomson Bankwatch</th>
<th>IBCA</th>
<th>Moody's</th>
<th>Standard &amp; Poor's</th>
<th>IDC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Level I</td>
<td>A/B</td>
<td>A</td>
<td>P-1 Aaa</td>
<td>A–1 AA</td>
</tr>
<tr>
<td>Level II</td>
<td>B/C</td>
<td>B</td>
<td>A Aaa</td>
<td>AA 165–190</td>
</tr>
<tr>
<td>Level III</td>
<td>C</td>
<td>C</td>
<td>A</td>
<td>A 140–164</td>
</tr>
</tbody>
</table>

a. With respect to investments in instruments other than commercial paper, bank notes and thrift notes, Thomson Bankwatch shall be the primary short-term rater; i.e., a short-term rating from Moody's, Standard & Poor's, IBCA or IDC may only be used if the counterparty is not rated by Thomson. For investments other than commercial paper, bank notes, or thrift notes, an A– 1 or P–1 rating from Standard & Poor's or Moody's may only be used to determine allowable levels of unsecured credit exposure when it is a stand-alone rating and not the result of credit enhancement of a counterparty's commercial paper issue. For long-term investments, only ratings from Moody's and Standard & Poor's may be used. The use of short- or long-term credit ratings shall be appropriate to the term of the transaction; i.e., short-term ratings for transactions with a maturity equal to 1 year or less; long-term ratings for transactions with a maturity greater than 1 year.

b. Single-A and double-A ratings from Moody's and Standard & Poor's shall be interpreted to include the full range of the generic rating category (e.g., single-A will include A–1 and A3).

c. Rating downgrades of counterparties shall not require the liquidation of existing positions.

d. A Bank will have discretion to choose the rating it will use if the rating agencies disagree on either a counterparty's long or its short-term credit rating.

e. In the event of a split rating (i.e., a counterparty falling into different FMP unsecured credit levels based on its short- and long-term ratings), the higher of the two ratings will dictate the total amount of unsecured credit the Bank may extend to the counterparty; however, the lower of the two ratings will limit the allowable credit exposure to the counterparty for transactions with maturities governed by that rating.

f. When a counterparty is placed on creditwatch for potential downgrade by a rating agency, the Bank shall: (1) For purposes of determining the remaining available credit line for on-balance sheet investment purchases assume a rating from that agency at the next lower notch, e.g., a downgrade from A–1 to A–2 or from AA2 to AA3; or (2) for off-balance sheet transactions, take action deemed appropriate by the Bank, taking into account contractual agreements in force with the counterparty.

3. Limitations on Unsecured Credit Extensions

a. Unsecured extensions of credit to a single U.S. Government Sponsored Agency or Instrumentality shall not exceed 100 percent of a Bank's capital.

b. Unsecured extensions of credit to a single Level I counterparty shall not exceed 30 percent of a Bank's capital.
B. Interest Rate Risk Limitation

1. Each Bank is required to maintain the duration of its equity, under an assumed 200 basis point change in interest rates, within a range of +7 years to -7 years.

2. Each Bank is required to maintain its duration of equity, under an assumed 200 basis point change in interest rates, within a range of +7 years to -7 years.

3. Duration of equity calculations shall be performed by each Bank at intervals prescribed by the Finance Board. Each Bank shall employ calculation methods and assumptions that reasonably capture the interest rate risks inherent in its on- and off-balance sheet activities.

4. Each Bank is required to report its cash flows and calculate its duration and market value of equity without projected cash flows which represent the Bank's share of the System's REFCorp and AHP obligations.

VIII. Implementation Guidelines

A. The Board of Directors of Each Bank Shall

1. Adopt and forward to the Finance Board a financial management policy consistent with the FMP within 90 calendar days of the effective date of the FMP. The Bank's policy will address:
   a. the role of the investment portfolio in fulfilling the Bank's public purpose, maintaining liquidity, and generating earnings;
   b. explicit limits (in percent) on changes in net market value (in addition to limits on changes in net market value implicit in the duration limits set forth in subsection VII.B.) resulting from interest rate risk and convexity;
   c. how the investment strategy addresses the mark to market accounting requirements of SFAS 115;
   d. the cash flow implications of the FIRREA obligations and their impact on the Bank's measurement and control of interest rate risk;
   e. a commitment to attain and maintain a stand-alone triple-A rating on short-term deposits or other unsecured long-term liabilities;
   f. any maximum threshold and minimum collateral call levels approved by the Bank's board for off-balance sheet transactions and the methods by which such levels are determined; and
   g. the maximum allowable level of term (i.e., one year or greater), unsecured credit exposure arising from on-balance sheet transactions.

2. Review and approve, prior to implementation, any significant changes in financial strategies undertaken by Bank management.

3. To the extent that the Bank enters into investment transactions not explicitly permitted under Sections III(g), III(h), or 16(a) of the Act, ensure that such investments are securities in which fiduciary and trust funds may invest under the laws of the state in which the Bank is located.

4. Identify the tolerable risk limits for mortgage-backed and asset-backed security investments, including the amount of capital (market value) the Bank is willing to expose under a 200 basis point movement in interest rates.

5. Evaluate modeling and management expertise available to measure and control the credit, interest rate, basis, and other risks involved in financing and investment arrangements entered into by the Bank.

6. Establish policies that promote diversity in the Bank's funding sources and investments.

7. Authorize specific individuals to develop financial strategies and to execute financial transactions governed by the FMP. (Duties and responsibilities shall be appropriately divided so that no one individual has sole responsibility for any two of the following functions: trading; funds and security transfer; and portfolio accounting)

8. Approve the opening of any unsecured checking or settlement accounts with counterparties that do not meet the credit standards established in the FMP. Decide whether to maintain any existing unsecured checking or settlement accounts with counterparties that have been downgraded below credit standards established in the FMP. Justification for such approvals shall be available to Finance Board examiners for review. (Unsecured checking or settlement accounts with counterparties that do not meet the credit standards of the FMP but that are covered by deposit insurance or are otherwise guaranteed are exempt from this requirement).

9. Approve a list of brokers, reporting dealers, and futures commission merchants with whom the Bank may purchase and sell securities and contracts.

B. Management of Each Bank Shall

1. Establish internal control systems to ensure compliance with the FMP.

2. Submit a monthly report to its board of directors and to the Finance Board regarding the activities governed by the FMP. At a minimum, the report shall cover the areas of investments, liquidity, funding, hedging, unsecured credit risk, and interest rate risk. It will also discuss compliance with the limitations in the FMP and the Bank's internal policies. Any exceptions to the FMP shall be highlighted and explained.
in the compliance report submitted to the Finance Board; such report shall be in a format defined by the Finance Board.

3. Provide periodic data, as requested by the Finance Board, to facilitate its oversight of FMP compliance.

4. Establish one or more securities safekeeping agents and notify the Finance Board accordingly. (Authorized agents include Federal Reserve Banks, Federal Home Loan Banks, and other eligible financial institutions domiciled in the U.S.)

5. Account for financial transactions executed under the FMP in accordance with Generally Accepted Accounting Principles.

C. The Internal Auditor of Each Bank Shall Establish Internal Auditing Programs That Test for Compliance with the FMP

D. The Federal Housing Finance Board Shall

1. Monitor each Bank's compliance with the FMP.

2. Interpret any questions related to the FMP.

3. Consider requests for exceptions to the FMP.

E. This Most Recently Amended Version of the FMP Shall

1. Become effective on

2. Amend and replace the Financial Management Policy dated July 3, 1996. Financial transactions and contracts that were authorized for, and entered into by, the Banks under these and any preceding policies, and that remain outstanding on the effective date of the FMP, are grandfathered for purposes of compliance with the amended policy guidelines.

Footnotes

1. The term “eligible financial institutions” includes:
   a. Federal Home Loan Banks;
   b. FDIC-insured financial institutions, including U.S. subsidiaries of foreign commercial banks, whose most recently published financial statements exhibit at least $100 million of Tier I (or tangible) capital if the institution is a member of the investing FHLBank or at least $250 million of tangible capital for all other FDIC-insured institutions, and which have been rated at least a level III institution as defined in subsection VI.C. of the FMP.
   c. U.S. branch or agency offices of foreign commercial banks, provided that the most recently published financial statements of the foreign commercial bank exhibit at least $250 million of Tier I (or tangible) capital and the foreign bank can be designated at least a Level III counterparty as defined under Section VI.C.2. and has a country risk rating of not lower than AA from Thomson Bankwatch.

2. Eligible counterparties for resale agreements include the Federal Reserve Bank of New York, primary dealers in government securities recognized by the Federal Reserve whose capital exceeds $250 million or whose obligations under such agreements are guaranteed by a U.S. Government agency if the capital exceeds $250 million, and U.S. Government Sponsored Enterprises for which the credit of such institution is pledged for repayment. The Bank for International Settlements (BIS) and the central banks of foreign countries with a Thomson Bankwatch country risk rating of at least double-A are considered eligible counterparties, provided the resales are collateralized solely by FHLBank System consolidated obligations. Resale agreements may be consummated using a designated custodian, provided the custodian is a domestic eligible financial institution and documentation is provided which evidences the Bank's security interest in the collateral held by the custodian.

3. Commercial paper, bank note, and thrift note issuers will be in the bank's banking, housing finance, or securities industries as determined by an FHLBank. Commercial paper, bank note, and thrift note issuers (or guarantors if applicable) must exhibit on their most recently published audited financial statements at least $100 million of tangible capital if the institution is a member of the investing FHLBank or at least $250 million of tangible capital for all other institutions. If the commercial paper, bank note, or thrift note issue receives its A-1/P-1 rating by virtue of a guarantee or other credit enhancement, the minimum tangible capital requirement and the maximum allowable unsecured credit exposure (as determined in subsection VI.C.) shall apply to the guarantor rather than to the issuer.

4. For purposes of determining compliance with the 300 percent of capital limit, investment levels will be measured as of the transaction trade date and capital levels will be based on the Bank's most recently available monthly financial statement. A Bank will not invest in securities solely to bring the level of its holdings into compliance with the limit. A Bank's dollar roll financing activity will not be included in calculating the Bank's position relative to the limit.

5. A “financial index” is defined as an index that pertains to: (1) Interest rates, (2) baskets of equities, (3) currencies, or (4) aggregate measures of inflation, sanctioned by a national government, including those derived from aggregate measures of economic performance and prices. In the event of debt tied to a basket of equities, the basket should include a sufficient number of equities to ensure that the movement of the index is not dictated by the performance of just one equity in the basket. To be considered “eligible,” an index must be publicly available and verifiable independent of underwriters or selling group members. For an index that pertains to a foreign country, that country must be assigned a Country Risk Rating no lower than AA – by Thomson Bankwatch. In the event a country is not rated by Thomson Bankwatch, Sovereign Risk Ratings from Moody’s or Standard & Poor’s may be used subject to the following requirements: a country must be assigned a Sovereign Risk Rating for long-term bonds or deposits from Moody’s of not lower than Aa3 or a Sovereign Risk Rating for Foreign Currency from Standard & Poor’s of not lower than AA-1. The European Currency Unit (ECU) shall be deemed an eligible index.

6. Eligible non-member counterparties for hedging transactions include:
   a. Eligible financial institutions;
   b. Foreign financial institutions rated at least a Level III institution, as defined in subsection VI.C. of the FMP, and domiciled in countries receiving a country risk rating of at least AA from Thomson Bankwatch;
   c. Domestic corporations or partnerships, foreign corporations, domestic subsidiaries of foreign corporations, international organizations, and foreign governments or their agencies, rated at least single-A by Moody’s or Standard & Poor’s, or rated Baa by Moody’s or BBB by Standard & Poor’s.

7. For purposes of the FMP, unsecured extensions of credit will be measured as follows:
   a. For on-balance sheet transactions, an amount equal to the sum of the book value of the item plus net payments due the Bank.
   b. For off-balance sheet transactions, an amount equal to the sum of the net market value of the agreement, as determined by the Bank, plus net payments due the Bank.
   c. Extensions of credit arising from off-balance sheet transactions with one counterparty may be netted provided the Bank and the counterparty have executed a master agreement that provides for such netting.

8. The effective maturity of interest rate exchange agreements may be considered the term from settlement to the date on which an FHLBank has the unilateral and unconditional option to terminate the agreement at its then current market value. For Indexed Principal Swaps, the effective maturity shall be the weighted average maturity using consensus prepayment speed estimates for current interest rate levels, unless an appropriate alternative methodology is applied.

Dated: March 5, 1997.

By the Board of Directors of the Federal Housing Finance Board.

Bruce A. Morrison, Chairperson.

[FN No. 97-6878 Filed 3-18-97; 8:45 am]

BILLING CODE 6725-01-U

FEDERAL MARITIME COMMISSION

Ocean Freight Forwarder License Applicants

Notice is hereby given that the following applicants have filed with the Federal Maritime Commission applications for licenses as ocean freight forwarders pursuant to section 19 of the