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Federal Housing Finance Agency
Division of Federal Home Loan Bank Regulation

To:	Federal Home Loan Bank Presidents Directors of Internal Audit
From:	Stephen M. Cross Deputy Director Division of Federal Home Loan Bank Regulation
Subject:	Strategic Plans

Introduction and Background

This bulletin sets forth the principles that the Division of Federal Home Loan Bank Regulation will use in evaluating the strategic plans of the Federal Home Loan Banks (FHLBanks). In addition, this bulletin re-emphasizes the requirements of Section 917.5 that an FHLBank's strategic plan establish quantitative performance goals for FHLBank products related to multifamily housing, small business, small farm, and small agri-business lending and report annually to the FHFA on its performance in achieving those goals.

Strategic planning is a firm's process of defining its future strategy, or direction, and making decisions on allocating its resources to pursue this strategy. The strategic plan reflects the choices that the board of directors has made concerning the future direction of the FHLBank, resource allocation, and risk tolerances. It is the result of a process that engages management, staff, and the board of directors, and should be a clear statement of the direction that the board of directors wants the FHLBank to take. Strategic planning is not a once-a-year document; rather, it is a continual process that evaluates successes and failures within the operational and financial environment facing the FHLBank.

In its most fundamental form, strategic planning consists of: (a) an analysis of the current financial and operational condition of a firm and an assessment of its current competitive and financial environment including the risks inherent in the environment – a "beginning state," (b) a projected financial and operational goal or "future state" that the firm seeks to achieve within a defined timeframe, and (c) the process by which the firm plans to reach its financial and operational goals through the allocation of its capital and human resources including consideration of the operational and market risks inherent in the process – an "interim assessment." A strategic plan may include a mission/vision statement, a "strengths, weaknesses, opportunities, and threats" (SWOT) analysis, and various financial scenario analyses.

The key benefits of a strong strategic planning process include: (a) defining realistic operational and financial goals consistent with a firm's mission over a specified timeframe, (b) communicating those goals and objectives to a firm's senior management, board of directors, and employees, (c) ensuring that the firm uses its capital and human resources efficiently and effectively on the key priorities established in the plan, and (d) providing a base from which to benchmark progress and to establish a mechanism for informed change when needed.

FHLBanks are government-sponsored, for-profit, financial institutions collectively owned by their members. Because many members expect the repurchase of excess stock at par value, an FHLBank needs to protect the par value of that stock by holding risks to very low levels. Low levels of risk usually mean reduced returns and limit the portfolio choices of an FHLBank compared with fully private entities.

Since FHLBanks are cooperatives and face limited equity or debt market discipline, an FHLBank's strategic plan may need to be more comprehensive in certain aspects such as financial projections and benchmarking than those typically prepared by public companies. The plan should be consistent with the board's risk tolerances, which should be low and focus on providing liquidity to members. A strategic plan can assist in (a) assessing a FHLBank's proposed future financial return relative to its risks, (b) assuring the FHLBank is using its capital and human resources efficiently, and (c) benchmarking the financial progress of a FHLBank relative to plan.

As government-sponsored financial cooperatives and pursuant to Section 1265 (formerly Section 940), Core Mission Activities, and Section 917.5, FHLBanks must take three actions concerning the strategic planning process. First, each FHLBank must adopt a strategic plan, which enumerates operating goals and objectives and discusses how the FHLBank will address credit needs and market opportunities. The plan must specify how the FHLBank will notify members of relevant programs and initiatives. Furthermore, the plan must establish certain quantitative performance goals, describe new business activities, and be supported by appropriate and timely research and analysis. Second, each FHLBank must review and monitor strategic plans. Third, each FHLBank must provide an annual report to the FHFA that analyzes and describes the FHLBank's performance in achieving the quantitative performance goals for FHLBank products related to multifamily, small business, small farm, and small agri-business lending.

Guidance

In assessing an FHLBank's strategic plan, the staff of the Division of FHLBank Regulation will look for the following:

- **Extent to which the strategic plan is a self-contained, stand-alone document.** A strategic plan is more useful if it contains all the qualitative and quantitative information necessary to assess the reasonableness of the plan without the need to consult other documents.

- **Assessment of current financial condition and risk level.** In assessing the current financial condition and risk level, the strategic plan should present in condensed form a balance sheet, income statement, and key financial and risk ratios. The level of detail in these statements should reflect the business model of the FHLBank and the particular risks it faces. These statements should tie to published GAAP financials or should easily be reconciled to GAAP financials. Average balances for a current balance sheet are useful as a supplement to the strategic plan, but are not sufficient as the sole presentation of the current financial condition of the FHLBank.

- **Projected future-state financial condition and risk level.** The strategic plan should clearly define realistic financial and operational goals and broad risk limits that are consistent with the FHLBank's mission. The strategic plan should include a condensed future-state balance sheet and income statement, and key financial and risk ratios.

  To develop a well thought out strategic plan, it is essential that the future state not be determined or driven by financial model assumptions, such as growth rates from the beginning balance sheet. Instead, it is the clearly defined, well-articulated financial goals of the future state that should drive the operations of the FHLBank, and, therefore, the model assumptions.

- **Projected interim assessments of financial condition and risk levels.** The strategic plan should provide sufficient financial detail to allow an FHLBank's senior management and board of directors to benchmark the financial progress of an FHLBank relative to the strategic plan, and, if necessary, establish a mechanism for adaptation**.** For benchmarking, the FHLBank ought to do assessments and variance reporting on a quarterly basis. The strategic plan should include a condensed balance sheet and income statement, and key financial and risk ratios to allow an interim assessment of the strategic plan.

- **Scenario analysis.** A strategic plan should provide alternative scenarios and risk assessments to allow an informed reader sufficient information to assess the likely future state in alternative financial scenarios in addition to the base-line future state. Depending on the circumstances of the FHLBank, these scenarios need not be limited to just alternative interest rates and differing business/membership levels. The FHLBank should prepare as many scenarios as appropriate to its circumstances. However in all cases, each scenario analysis should be robust and supported by sufficient evidence.

- **Narrative, key assumptions, and risk assessment.** The narrative should allow an informed reader to understand and follow the key aspects of the plan, assess whether the strategic plan is realistic, whether it is consistent with an FHLBank's mission, and whether it ensures appropriate management of risk levels. The plan should document key financial assumptions including the current and projected interest-rate environment.

When projected financial assumptions are at significant variance from historic rates, the document should provide enough narrative to allow a reader to assess their reasonableness. The discussion of the economic and business environment should provide sufficient context for the reader to assess all key assumptions. Finally, the document should explain any new business activities or initiatives contemplated in the strategic plan and document and support key assumptions.

- **Compliance with the requirements of Section 917.5.** Section 917.5 imposes substantive requirements on an FHLBank's strategic planning process. An FHLBank should fully address all of the requirements of this Section in its strategic plan. Further, commencing with the 2011 examination cycle, in assessing these plans, the FHFA's examiner will :

  - Review an FHLBank's policies and practices to assure that the FHLBanks are serving their Community Financial Institution members' need for advances, and that the FHLBanks can substantiate their collateral acceptance, discount, and risk management practices;
  - Evaluate the existence and appropriateness of quantitative performance goals for products related to agricultural and small business financing, including the use of alternative and appropriate collateral; and
  - Monitor an FHLBank's outreach and Community Financial Institution collateral needs assessments efforts for safety and soundness and mission fulfillment purposes.

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