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# Federal Home Loan Banks

**Primary Credit Analyst:**
Gaurav A Parikh, CFA, New York + 1 (212) 438 1131; gaurav.parikh@spglobal.com

**Secondary Contact:**
Stephen F Lynch, CFA, New York + 1 (212) 438 1494; stephen.lynch@spglobal.com

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# Federal Home Loan Banks

## Credit Highlights

| |
|---|
| None |

### Overview

| Key strengths | Key risks |
|---|---|
| Government-related entity (GRE) with an almost certain likelihood of extraordinary government support | Concentrated exposure to the U.S. mortgage market |
| Important to the implementation of U.S. government housing policy | Uncertainty regarding the impact of potential regulatory and legislative reforms |
| Important funding source for the U.S. banking system | Earnings vary based on advance demand and interest rates, though profitability is not a priority for Federal Home Loan Banks |
| Very strong loan asset quality and super-lien position vis-à-vis depository institutions that has historically prevented losses on advances | Growing exposure to nondepository financial institutions |

***We view the FHLB System as one of the most important U.S. GREs.*** In our opinion, the FHLBs' exceptionally favorable funding advantages are likely to continue as long as their policy role remains critical, and their link integral, to the U.S. government. Moreover, based on the history of ample funding for the FHLB System during periods of market stress in early 2020 and 2008, we believe access to funding is unlikely to be problematic even in stress scenarios.

***In our view, the FHLB System enjoy unusual advantages conveyed by the related legal framework.*** These advantages include lien priority over other creditors (without perfected and priority liens) in the event an insured depository member to which the system had loans outstanding fails. We also believe the Federal Housing Finance Agency (FHFA), the FHLBs' regulator, has clear and robust processes and procedures that enable effective governance, monitoring, and control of the FHLB System. These include administrative capacity and mechanisms for timely responses to any financial distress the system might encounter.

***The system primarily relies on short-term funding in response to member demands.*** Given the generally match-funded approach to issuance, as well as the overcollateralization of advances to members, we believe the tenor of the system's funding remains manageable. The FHLBs' principal investments are GSE (government-sponsored enterprise) mortgage-backed securities, federal funds sold, interest-bearing deposits, reverse repurchase agreements, and municipal and Treasury securities.

**Outlook**

S&P Global Ratings' outlook on the FHLB System debt ratings is stable, in line with the stable outlook on the U.S. sovereign credit rating. We expect the likelihood of extraordinary government support for the FHLB System, if needed, to remain almost certain for at least the next two years. If we changed our rating or outlook on the U.S., we would reflect that change in our ratings and outlook on the FHLB System's debt.

In the long term, the FHLB System faces uncertainty related to potential legislative changes associated with the broader reform of U.S. housing finance policies. If initiatives were to gain momentum and target substantial changes to the FHLB System, such that the role of the FHLB System in housing finance and as a liquidity provider for the U.S. banking system were diminished, we could lower our ratings on the system's debt. To date, however, such initiatives have neither succeeded in gathering substantial political momentum nor targeted the FHLB System.

## Rationale

The FHLBs are GSEs, federally chartered but privately capitalized, and independently managed. The FHLBs, together with the Office of Finance (a joint office of the FHLBs), make up the FHLB System. The FHLB System consists of the 11 FHLBs. We assign stand-alone credit profiles (SACPs) to each of the FHLBs but not to the system as a whole. Because the system issues consolidated debt obligations on behalf of its component FHLBs, and in light of their joint and several liability for these obligations, we have issue ratings on the system's debt.

The issuer credit ratings on the FHLBs are one notch higher than their 'aa' SACPs because, in our view, the likelihood of the government providing extraordinary support to them, if needed, is very high.

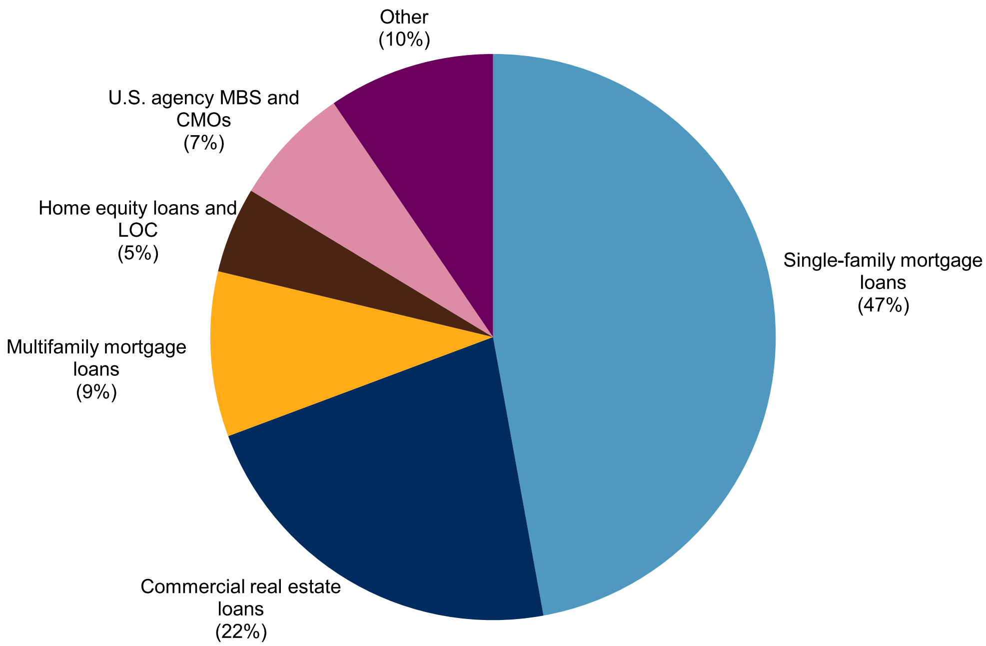
We view the FHLBs' business positions as strong, reflecting their established market positions in their districts, recurring business volumes, and public policy role, which we believe offset some of the risks associated with their lack of business diversity. The FHLBs also acquire mortgage assets from their members--providing them liquidity. Through these programs, the FHLBs share credit risk with their members and housing associates and manage the interest rate and prepayment risks.

We view the FHLBs' capitalization as very strong based on their member-capitalized co-op structure and low-risk collateralized lending business. As of March 31, 2022, the regulatory capital-to-assets ratio at each of the banks exceeded the FHFA 4.0% minimum requirement. The bulk of the FHLBs' assets are advances to members, which have a relatively low risk weight in our methodology because all of the exposure is to financial institutions. As a result, we view their capital, on a risk-adjusted basis, as stronger than it might otherwise appear. We expect their S&P Global Ratings risk-adjusted capital ratios, based on our measure, to remain above 15% over at least the next two years.

Another factor supporting our ratings is that none of the FHLBs has ever suffered a loss on a collateralized advance to a member (reflecting both the lien priority and substantial collateral held against advances). Although we believe some of the collateral could be under strain because of the current economic headwinds, we believe the amount of collateral, at approximately $2.3 trillion--or more than four times outstanding advances and other credit of $512 billion--as of March 31, 2022, offsets the potential for losses.

**Chart 1**

**Federal Home Loan Banks--Percentage Of Collateral Securing Advances**
As of March 31, 2022




Source: S&P Global Ratings.


In May 2022, the U.S. Senate confirmed Sandra Thompson as director of the FHFA. We continue to monitor the outcome of Federal Home Loan Banks' Mission Implementation Act bill that was put forward by Senator Catherine Cortez Masto (D-Nev.) in May 2021. The proposed bill includes an increase in the annual percentage set aside for Affordable Housing Program obligations to 30% of net income, from 10% currently. As part of the subsequent Congressional budget reconciliation process, a legislative proposal is under consideration for the FHLBs to set aside 15% of net income for their affordable housing program. If passed, this could weigh on FHLBs' earnings because of the associated increase in expenses.

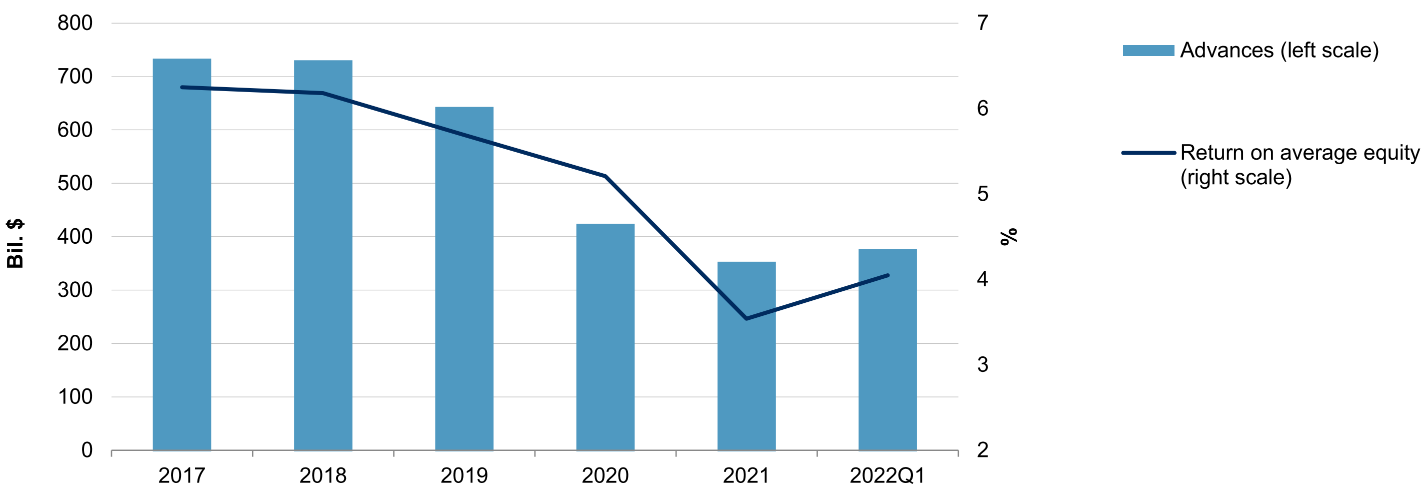
On March 21, 2022, the SEC issued a proposed rule on climate-related disclosures that would require registrants, including the FHLBs to expand the breadth, specificity, and rigor of climate-related disclosures in their periodic reports. Compliance would be phased in, with the FHLBs becoming subject to certain disclosure requirements in their annual reports for fiscal year 2024 and additional disclosures in 2025. If finalized as proposed, we expect the proposal will lead to increased operational costs.

We expect earnings to rise this year as member demand for advances will increase while liquidity in the financial markets normalizes and deposit balances decline. As such, we do not anticipate consolidation in the system over the next 12-24 months. In 2015, FHLB Seattle merged with FHLB Des Moines--the only consolidation of the FHLB System in its 90-plus-year history.

As of March 31, 2022, total principal amount advanced increased to $377 billion versus $349 billion at year-end 2021. The top 10 borrowers accounted for about 28% of advances, or $105 billion, and the top member was 4.3%, or $16.2 billion.

**Chart 2**

**Federal Home Loan Banks--Advances And Profitability**
Advances have grown but remain lower than pre-COVID-19 levels




Source: S&P Global Ratings.


## GRE Analysis: Critical Public-Policy Role And Integral Link To The Government

We view the FHLB System as one of the most important U.S. GREs. In our opinion, promoting homeownership is a central and long-standing U.S. policy, evidenced by the tax deductibility of mortgage interest and the activities of the U.S. Department of Housing and Urban Development. Such policy has, arguably, contributed to past U.S. housing market excesses. However, we do not expect this essential policy orientation to substantially change, given its widespread political appeal and the importance of consumption to U.S. economic growth (and homeownership to consumption, through wealth effects).

We think the FHLB System's critical public policy role to U.S. housing finance was clear in the U.S. mortgage crisis of

2008, during which advances (loans to client owner members) outstanding peaked at $1 trillion. The COVID-19 pandemic further illustrated the FHLB System's importance to the U.S. banking sector in times of uncertainty and economic dislocation. At the onset of the pandemic in 2020, advances rose to $806.9 billion, a 25.8% increase from year-end 2019, as member companies shored up liquidity to manage the stress. Advances then declined in the subsequent quarters owing to elevated levels of liquidity in markets due to actions taken by the Federal Reserve and the CARES Act and increased deposit balances at member institutions. As of March 31, 2022, advances increased to $377 billion from $349 billion at year-end 2021 but were lower than pre-COVID-19 levels ($422.6 billion in 2020 and $642 billion in 2019). As liquidity normalizes from historical high and the Fed continues to tighten the monetary policy to fight high inflation, we expect member demand for advances will remain high this year.

We expect net interest income to rise in 2022, driven by increased member demand for advances and positive correlation to rising interest rates. As of March 31, 2022, the total principal advance amount was $377 billion, of which commercial banks made up 35%, versus 39.7% same time last year, while insurance companies (excluding captive insurance companies) grew to 34% from 30.6% for the same period.

Although the government does not guarantee the FHLB System's obligations, the system's status as a U.S. GSE provides several advantages. FHLB securities are eligible to be used for collateral that the U.S. Federal Reserve banks are required to hold against currency they put into circulation. The FHLB System is also exempt from almost all corporate taxation, and the securities it issues are exempt from state and local income tax. The U.S. legal framework also gives the FHLB System lien priority over other creditors (including depositors) in the event of the failure of an insured depository member with outstanding loans. Reinforcing these links to the government, the FHFA oversees all strategic decisions the system makes, and it closely monitors the system's financial condition.

We view the GSE Credit Facility (GSECF), temporarily established by the U.S. Treasury Department in 2008, as a clear indicator of the government's willingness and ability to provide extraordinary support to the FHLB System in times of stress. The GSECF proactively offered government loan liquidity to the FHLB System (along with Fannie Mae and Freddie Mac), if needed, asking for just the system's own advances as collateral.

Despite the absence of a government guarantee, a close association between the system and the government is well entrenched in the minds of investors and other financial market participants, in our view. This association, together with a substantial amount of system securities outstanding ($699 billion as of March 31, 2022), could mean that substantial financial distress for the system could harm the U.S. government's reputation, increasing the government's incentive to support its GSEs. Supporting this belief, FHLB consolidated obligations continue to price at a narrow spread over U.S. Treasuries, affording the FHLBs and their member institutions low funding costs despite the substantial volume outstanding.

In our rating analysis, we differentiate between the aggregate FHLB System and the individual FHLBs. The individual FHLBs' role is very important, and their link to the government is very strong. Because the 11 FHLBs have joint and several liability for the senior unsecured debt obligations that the FHLB's Office of Finance issues, we think weakness in a single FHLB could affect investors' perception of the strength of the FHLB System as a whole. On the other hand, we believe each FHLB is less important, from a policy perspective, than the FHLB System as a whole. As a result, our assessment of both the role and the link of each individual FHLB is one degree weaker than our assessment for the system as a whole.

Because profit maximization is not a priority and each district has somewhat unique needs, we do not anticipate consolidation in the system over the next 12-24 months.

## Profile And Ownership: A Cooperative Owned By Its Member Institutions

Each FHLB is owned by its member financial institutions. The member institutions are primarily commercial and savings banks, though they have expanded to include credit unions, insurance companies, and community development financial institutions (CDFIs). The membership mix as of March 31, 2022, was 61.6% commercial banks, 16.4% credit unions, 12.7% savings institutions, 8.2% insurance companies, and 1.1% CDFIs.

A member institution must purchase capital to belong to an FHLB. The member institution's stock requirement is generally based on its use of FHLB products, subject to a minimum requirement. In return, the member institution may borrow on a secured basis at typically attractive rates from its FHLB. Member institutions may also receive dividends on their shares in the FHLB, which helps lower their total transaction funding costs. Additionally, the system provides support for affordable housing and community investment programs.

FHLBs provide members with a reliable source of funding for housing finance, community lending, and asset-liability management, as well as liquidity for members' short-term needs. This funding is in the form of long-term and short-term secured loans called "advances." These advances are primarily collateralized by residential mortgage loans and commercial real estate loans, as well as government and agency securities. Community financial institutions may also pledge small-business, small-farm, small-agribusiness, and community development loans as collateral for advances.

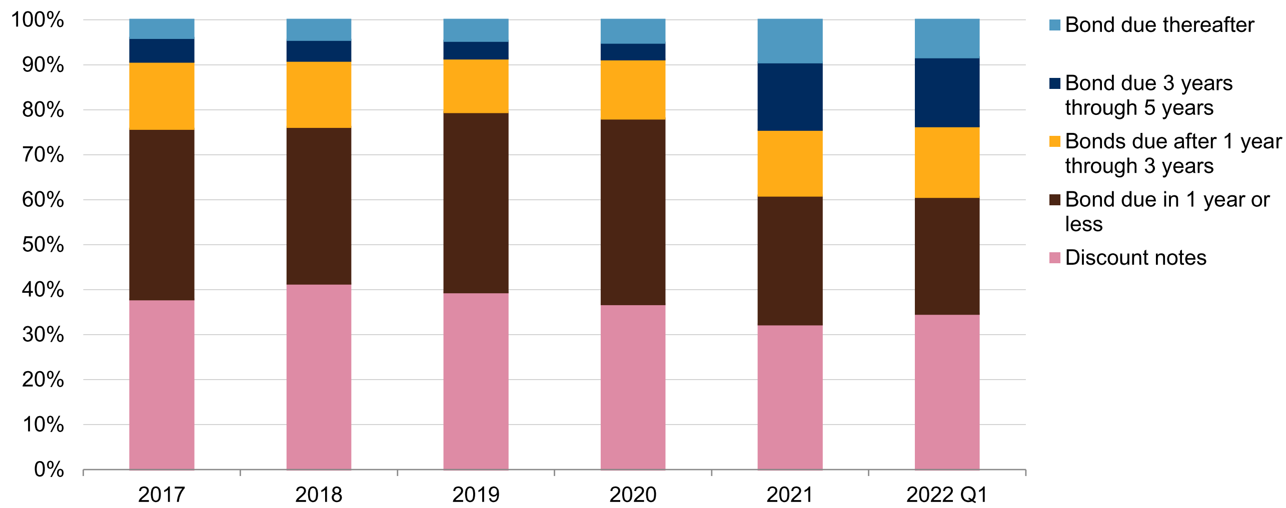
In addition to advances, FHLBs extend letters of credit to members--totaling $148 billion as of March 31, 2022. Members typically use letters of credit to secure public unit deposits, and the letters of credit would be converted to an advance in the rare event of a draw.

Although privately owned, the system is run as a cooperative for its member-owners. The system places more emphasis on retaining the capacity to quickly increase liquidity provisions, when needed, than on maximizing current profits. We believe the FHFA's close oversight reinforces this strategy.

We believe the system's transition from LIBOR-based funding toward funding based on the secured overnight financing rate (SOFR) could be smoother than for other issuers, given the system's larger percentage of short-term debt. The FHLBs have recently been moving toward floating-rate notes (FRN) to address address investor preference in a rising interest rate environment, with the majority of issuance linked to SOFR since 2020. $550 billion in SOFR-indexed FRNs have been issued since inception as part of the FHLBs' transition away from LIBOR. SOFR-indexed FRN maturities have ranged from three months to 6.5 years, with the largest concentration in maturities of two years or less. As of March 31, 2022, total consolidated obligations totaled $699.5 billion, of which total short-term funding (with a remaining maturity of less than one year) was 61%, a decline of about 9% from year ago.

**Chart 3**

**Federal Home Loan Banks--Consolidated Obligations By Contractual Maturity**




Source: S&P Global Ratings.



## Related Criteria

- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- Criteria | Governments | Sovereigns: Sovereign Rating Methodology, Dec. 18, 2017
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Financial Institutions | General: Issue Credit Rating Methodology For Nonbank Financial Services Companies, Dec. 9, 2014
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

| Ratings Detail (As Of August 1, 2022)* | |
|---|---|
| **Federal Home Loan Banks** | |
| Senior Unsecured | AA+ |
| Senior Unsecured | AA+/A-1+ |
| Senior Unsecured | AA+/Stable |
| Short-Term Debt | A-1+ |
| Short-Term Debt | AA+/Stable |

| Ratings Detail (As Of August 1, 2022)*(cont.) | |
|---|---|
| **Sovereign Rating** | |
| United States | AA+/Stable/A-1+ |
| **Related Entities** | |
| **Federal Home Loan Bank of Atlanta** | |
| Issuer Credit Rating | AA+/Stable/A-1+ |
| **Federal Home Loan Bank of Boston** | |
| Issuer Credit Rating | AA+/Stable/A-1+ |
| **Federal Home Loan Bank of Chicago** | |
| Issuer Credit Rating | AA+/Stable/A-1+ |
| **Federal Home Loan Bank of Cincinnati** | |
| Issuer Credit Rating | AA+/Stable/A-1+ |
| **Federal Home Loan Bank of Dallas** | |
| Issuer Credit Rating | AA+/Stable/A-1+ |
| **Federal Home Loan Bank of Des Moines** | |
| Issuer Credit Rating | AA+/Stable/A-1+ |
| **Federal Home Loan Bank of Indianapolis** | |
| Issuer Credit Rating | AA+/Stable/A-1+ |
| **Federal Home Loan Bank of New York** | |
| Issuer Credit Rating | AA+/Stable/A-1+ |
| **Federal Home Loan Bank of Pittsburgh** | |
| Issuer Credit Rating | AA+/Stable/A-1+ |
| **Federal Home Loan Bank of San Francisco** | |
| Issuer Credit Rating | AA+/Stable/A-1+ |
| **Federal Home Loan Bank of Topeka** | |
| Issuer Credit Rating | AA+/Stable/A-1+ |

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.