

FEDERAL HOUSING FINANCE BOARD

FINANCIAL MANAGEMENT POLICY
FOR THE FEDERAL HOME LOAN BANK SYSTEM

PREAMBLE

The Financial Management Policy for the Federal Home Loan Bank System is being established by the Federal Housing Finance Board to provide guidance to, and establish limits for, the Federal Home Loan Banks ("FHLBanks" or "Banks") in their development and implementation of financial programs and strategies. This Policy is designed to allow the FHLBanks to implement prudent financial management strategies to accomplish their housing finance mission in a safe, sound, and profitable manner.

The Financial Management Policy revises and consolidates the previous Funds Management, Hedging, and Interest Rate Swap Policies. Additionally, for the first time, it establishes System-wide requirements and limitations on transactions that expose the Banks to unsecured credit risk or interest rate risk. The Policy establishes guidelines for all non-advance financial activity, both on and off the asset side of each Bank's balance sheet. It also establishes parameters for each Bank's overall asset/liability management, including liquidity requirements and interest-rate risk limitations.

The Policy's investment guidelines identify eligible alternatives for the placement of funds not required for the Banks' credit programs. These alternative investments are intended to provide sufficient liquidity to fund maturing liabilities and to meet advances demand. In addition, the investment authority will enable the Banks to supplement interest income during periods of inadequate advance demand and assist the Banks in meeting their financial obligations.

The Policy's expansion of the Banks' investment authority in certain areas is not to be interpreted as a diminution of the Finance Board's emphasis on the Banks' housing finance mission, or the need for expansion and enhancement of the Banks' advances programs. Providing advances for the purpose of promoting housing finance remains the primary mission of the Bank System and should be the highest priority of the Federal Home Loan Banks. Accordingly, this Policy provides transitional investment authority. The provision for sunset of certain investment authorities directs the Banks toward advances as their dominant asset and the foundation of their operations.

Responsible implementation of the expanded investment authority is also emphasized in the Policy. To the extent a Bank's board of directors determines to utilize the authority granted, it must ensure that: 1) responsibility for implementation is delegated to technically competent staff; 2) adequate procedures and controls are developed for prudent management of the programs; and 3) ongoing reviews of the programs are conducted, with periodic reports of findings submitted to the board of directors.

The Finance Board will closely monitor the Banks' performance under the Financial Management Policy guidelines. Moreover, as indicated in the Policy, the Finance Board will rely upon the Banks' boards of directors, their management, and their internal auditors to participate in the development and oversight of the programs established under this Policy.

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I. POLICY OBJECTIVE

The objective of the Federal Housing Finance Board (Finance Board) Financial Management Policy for the Federal Home Loan Bank System is 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 housing finance mission in a safe, sound, and profitable manner. The specific objectives of each subsection of this policy are listed below.

A. Investment Guidelines:

1. Establish policy with respect to the use of funds not required for the Banks' credit programs or operating requirements.
2. Specify eligible investment assets.
3. Establish eligibility standards for issuers of authorized investment assets.
4. Establish requirements with respect to the characteristics of authorized investments.
5. Establish investment limits for eligible assets.

B. Liquidity and Reserve Guidelines:

1. Implement the provisions of the Federal Home Loan Bank Act, as amended, with respect to required reserves for particular instruments.
2. Establish additional liquidity requirements.
3. Specify the types and characteristics of investment assets which may be used to comply with required liquidity levels.
4. Authorize the use of short-term funding vehicles.

C. 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 eligibility standards for hedge documentation.
- D. Unsecured Credit Guidelines:
1. Establish minimum standards for counterparties receiving extensions of unsecured credit.
 2. Establish limits on the amount of unsecured credit that may be extended.
 3. Establish a method for measuring unsecured credit risk.
- E. Interest Rate Risk Guidelines:
1. Establish limits on the aggregate interest rate risk that may be incurred.
 2. Establish a method for measuring interest rate risk.
- F. Implementation Guidelines:
1. Define the responsibilities of each 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 and to provide a safe and sound mechanism to generate income during periods of inadequate credit demand to ensure that financial commitments can be met and that dividends can be maintained at levels sufficient to attract and retain members.
- B. Authorized Investments: The following investments are allowable for Bank portfolios.¹
1. Overnight and term fund placements, having maturities not exceeding six months, with eligible financial institutions.²

2. Overnight and term resale agreements, having maturities not exceeding six months, with eligible counterparties, using for collateral securities which are eligible investments under this section, and FHA and V.A. mortgages.
 3. Deposits, having a remaining term to maturity of not more than six months, issued by eligible financial institutions.
 4. Commercial paper, having a remaining term to maturity of not more than six months, issued by domestic financial companies rated P-1 by Moody's or A-1 by Standard and Poor's.
 5. Bankers' acceptances, having a remaining term to maturity of not more than six months, drawn on and accepted by eligible financial institutions.
 6. Marketable direct obligations of the United States.
 7. Marketable direct obligations of U.S. Government Sponsored Agencies and Instrumentalities for which the credit of such institution is pledged for repayment of both principal and interest.
 8. Securities representing an interest in pools of mortgages issued, guaranteed or fully insured by the Government National Mortgage Association (GNMA), Federal Home Loan Corporation (FHLMC), or Federal National Mortgage Association (FNMA).
 9. Collateralized Mortgage Obligations (CMOs), including Real Estate Mortgage Investment Conduits (REMICs), backed by mortgages securities issued, guaranteed or fully insured by GNMA, FNMA, or FHLMC.
 10. Non-federal agency mortgage-backed securities rated AAA by Moody's or AAA by Standard & Poor's.
- c. Limitations on Authorized Investments:
1. The total book value of mortgage-backed securities (II.B.8, II.B.9, and II.B.10) may not exceed 200 percent of a Bank's capital on the day such investments are made. However, no Bank may increase its holdings of mortgage-backed securities in any one calendar quarter by more than 50 percent of that Bank's capital at the beginning of the quarter.

2. The purchase of Interest Only or Principal Only stripped mortgage-backed securities is prohibited.
3. The purchase of residual interest or interest accrual classes of CMOs/REMICs is prohibited.
4. The purchase of mortgage-backed securities with average lives that vary more than six years under an assumed instantaneous interest rate change of 300 basis points from the estimated base case is prohibited.
5. Investments in other than U.S. dollar denominated securities are 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 Requirements:
 1. Deposit Reserves: Each Bank is required to maintain an amount equal to the total deposits received from its members invested in:
 - a. obligations of the united States,
 - b. deposits in (eligible) banks or trust companies,
 - c. advances to members that mature in 5 years or less as specified in Section 11(g) of the Federal Home Loan Bank Act.
 2. Legal Reserves: Each Bank is required to maintain an amount in cash and investments, above that required for deposit reserves (III.B.11, equal to the amount of Legal Reserves as prescribed in Section 16 of the Federal Home Loan Bank Act. All investments listed in III.C.2 and secured advances are eligible to meet this reserve requirement.

C. Additional Liquidity Requirements:

1. Each Bank is required to maintain an average liquidity level each month in an amount not less than the sum of:
 - a. 20 percent of the sum of its daily average demand and overnight deposits and other overnight borrowings, and
 - b. 10 percent of the sum of its daily average for term deposits, consolidated Obligations and other borrowings that mature within one year.
2. Eligible Investments: The following investments are eligible for compliance with subsection III.C.1 liquidity requirements:
 - a. Overnight funds and overnight deposits placed with eligible financial institutions.
 - b. Resale agreements, which mature in 31 days or less, as otherwise described in subsection II-B.2 of this Policy.
 - c. Negotiable certificates of deposit, Bankers' Acceptances and Commercial Paper as described in subsections II.B.3, 4, and 5 of this policy.
 - d. Marketable direct obligations of the United States (II.B.6) which mature in 36 months or less.
 - e. Marketable direct obligations of U.S. Government Sponsored Agencies and Instrumentalities which mature in 36 months or less as otherwise described in subsection II.B.7 of this Policy.
 - f. Cash and collected balances held at the Federal Reserve Bank and other 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.

D. Short Term Funding Authorization:

1. Federal Funds : A Bank may purchase federal funds from any financial institution that participates in the federal funds market.⁷
2. Repurchase Agreements: Repurchase agreements requiring the delivery of collateral by a Bank are permitted with the Federal Reserve Bank, U.S. Government Sponsored Agencies and Instrumentalities, Primary Dealers as recognized by the Federal Reserve Bank of New York, eligible financial institutions, and states and municipalities with a Moody's Investment Grade (MIG) Rating of 1 or 2. Repurchase agreements may be consummated with any supplier of funds in transactions not requiring the delivery of collateral by a Bank.

IV. HEDGE TRANSACTION GUIDELINES

- A. Purpose: To allow implementation of hedge programs that control the interest rate or basis risk which arises in the ordinary course of operation.
- B. Authorized 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 authorized if they reduce the interest rate or basis risk exposure to which the Federal Home Loan Banks are subjected in their normal course of business. Speculative use of instruments and transactions authorized for hedging purposes is not permitted. Hedging strategies utilizing approved instruments may be implemented so long as the specific objectives are explicitly stated at the time of execution, adequate documentation is maintained during the life of the hedge, and the hedge is designed to:
 1. Reduce the interest rate, basis, or option risk associated with consolidated bonds, discount notes and other liabilities: advances or commitments for advances; or investments.
 2. Enable a Bank to comply with the limitations established for interest rate risk in section VI of this Policy.

- C. Hedging With Interest Rate Exchange Agreements (Swaps) and Options (Including Caps and Floors):
1. If a Bank enters into any swap or option agreement that may require future payments to be made to the Bank, the counterparty (including any member counterparty) or its guarantor shall be a highly rated institution, or the obligation shall be adequately secured in accordance with the minimum collateralization requirements (subsection IV.C.6).
 2. 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.
 3. Unsecured risk exposure associated with interest rate swaps and options is governed by the Unsecured Credit Guidelines (section V of this Policy).
 4. 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 mortgage backed securities 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 mortgage backed securities 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 from the estimated base case are prohibited.
 - d. The aggregate notional principal amount of indexed principal swaps and swaptions shall not exceed 100 percent of a Bank's capital on the trade date of the transaction.

5. 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 either a security authorized for investment by this policy or a futures contract authorized by this policy.
 - b. The hedge is constructed in a manner such that the price volatility of the option position is consistent with the price volatility of the cash instrument being hedged or the option component of that instrument.
 - c. The option contract is traded on an organized exchange regulated by the Commodities 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.

6. Collateral Security: A Bank shall require collateral for interest rate swaps and options from those counterparties (or guarantors) that do not meet the definition of highly-rated institutions and for credit risk exposure that exceeds established limits on unsecured extensions of credit on the trade date of the transaction. The dollar amount of collateral shall be maintained in accordance with the requirements of the Bank's agreement with the counterparty and shall be determined by the Bank commensurate with the risk undertaken, but shall be no less than the following minimum levels:
 - a. For a fixed/floating swap or a floating/fixed swap, a minimum initial collateral maintenance level must be established that is no less than 0.5 percent of the notional amount. Collateral required during the life of the transaction will be no less than the market value of the swap, plus net accrued interest due to the Bank, plus 0.5 percent of the notional amount. The collateral required will be no less than zero (0) for all transactions with a counterparty governed by the same master contract. For floating/floating (basis) swaps, collateral must be maintained sufficient to compensate for the difference in the volatility of the indices.

- b. Each Bank may, at its discretion, waive collateral requirements for member swaps that are matched to collateralized advances, or offsetting swaps, as long as the matching advances, or offsetting swaps, are outstanding.
 - 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, plus 0.5 percent of the transaction amount.
7. Documentation:
- a. Market value determinations and subsequent collateral adjustments should be made, at a minimum, on a monthly basis.
 - b. Failure to meet a collateral call shall 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.
 - 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-dollar denominated debt to dollar denominated debt, or to offset another non-dollar denominated swap.
- D. Hedging in the Financial Futures Markets:
- 1. Long and short positions in financial futures may be used for hedging provided that:
 - a. The underlying instrument is an investment or transaction that is eligible 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 Commodities Futures Trading Commission.
 - 2. If delivery of the underlying security will place the Bank in a position of exceeding any investment limitation set by this Policy, the Bank must close out the 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 Finance Board within one business day of the initiation of the position. Notification shall also be provided 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 authorized under the Investment Guidelines section of 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 included in the investment limits of this Policy.
 - 2. Short positions in instruments authorized in this Policy, the purchase of securities under resale agreements, and the borrowing of securities in connection with short sales is authorized for hedging purposes.

V. UNSECURED CREDIT GUIDELINES

- A. Purpose: To set prudent limits on unsecured credit risk arising from authorized investment and hedging strategies.
- B. Scope: All extensions of credit by a Bank to the extent that the value of collateral in which a security interest is held by a Bank is less than the credit extended, whether arising from off balance sheet transactions, or from those recorded to the balance sheet.¹⁰
- C. Eligibility for Unsecured Extensions of Credit:
 - 1. The amount of unsecured credit that may be extended to individual counterparties shall decline with the counterparty's credit quality. Differences in credit quality shall be represented by credit ratings of a counterparty's debt, debt securities, or deposits.¹¹
 - 2. Acceptable Credit Ratings: Unsecured credit may be extended only to counterparties assigned the following credit ratings at the time of the transaction:

	Thomson Bankwatch	IBCA		Moody's		Standard & Poor's		IDC Short Term
		Short Term	Long Term	Short Term	Long Term	Short Term	Long Term	
Level I	A A/B	A A/B	AAA	P-1	Aaa	A-1	AAA	above 190
Level II	B B/C	B B/C	AA		Aa		AA	165-190
Level III	C	C	A		A		A	140-164

- a. Single A ratings for long-term credit by Moody's, Standard & Poor's, and IBCA shall be interpreted to include the full range of the generic rating category, including A- and A3.
- b. Rating downgrades of counterparties shall not require the liquidation of previously existing positions.
- c. The use of short or long term credit ratings for eligibility purposes shall be appropriate to the term of the transaction.

3. Acceptable Country Risk Rating: Unsecured credit may be extended only to foreign counterparties subject to minimum risk of political and economic instability as represented by a country risk rating of I by Thomson Bankwatch.
4. Limitations on Unsecured Credit Extensions
 - a. Unsecured extensions of credit to a single U.S. Government Sponsored Agency or Instrumentality or a single Level I counterparty shall not exceed 50 percent of a Bank's capital.
 - b. Unsecured extension of credit to a single Level II counterparty shall not exceed 25 percent of a Bank's capital.
 - c. Unsecured extensions of credit to a single Level III counterparty shall not exceed 10 percent of a Bank's capital.
 - d. The maximum amount of unsecured credit that may be extended to any counterparty shall not exceed 50 percent of that counterparty's Tier I capital (or tangible capital if Tier I is not available).
 - e. Limitations on extensions of unsecured credit apply only to the specific counterparty receiving the credit. Each Bank, however, is expected to evaluate its unsecured credit exposure to related counterparties and consider imposing limits on such extensions of credit to related counterparties, if necessary.
 - f. A Bank may not extend additional credit to any Level III counterparty if, after the transaction, the total amount of unsecured credit extended to all Level III or below counterparties would exceed 50 percent of the Bank's capital.
 - g. Unsecured extensions of credit (excluding swap agreements and similar transactions) to Level III counterparties may not be made for terms in excess of one (1) business day.

h. Maximum Effective Maturities for Unsecured Extensions of Credit Arising from Interest Rate Swap Agreements and Similar Transactions: ¹²

Credit Rating --Maximum Effective Maturity of Agreements--

Long Term

Aaa, AAA

The greater of 10 years or the remaining maturity of the matching liability

Aa, AA

7 years

A, A

5 years

Short Term

A1, P1, A, B

18 months

Contingent Collateralization of Agreements: Contracts for interest rate agreements or similar transactions with effective maturities longer than 10 years shall require full collateralization of the agreement value plus accrued interest (maintenance margin) in the event of a downgrade below Level III.

VI. INTEREST RATE RISK GUIDELINES

A. Purpose: To set prudent limits on the extent to which each Bank may be exposed to interest rate risk.

B. Interest Rate Risk Limitation:

1. Each Bank is required to maintain the duration of its equity (at current interest rate levels using the consolidated obligations cost curve) within a range of +5 years to -5 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 the Finance Board based upon data supplied by the Banks at intervals prescribed by the Finance Board. Banks which have internal duration models may submit their results, if different from those calculated by the Finance Board, to evidence compliance with this policy. Determination of compliance will ultimately rest with the Finance Board.

VII. IMPLEMENTATION GUIDELINES

A. The Board of Directors of each Bank shall:

1. Adopt and forward to the Finance Board a Bank Financial Management Policy consistent with this Policy within 90 calendar days of the effective date of this Policy. If the Board of Directors decides to exercise the expanded mortgage-backed securities authority provided in section If of this Policy, the Bank's policy shall specifically identify the tolerable risk limits for mortgage-backed securities investments including the amount of capital (market value) the Bank is willing to expose under a 200 basis point movement in interest rates.
2. Authorize specific individuals to develop financial strategies and to execute financial transactions governed by this Policy. 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.
3. Approve the opening of any unsecured checking or settlement accounts with counterparties that do not meet the credit standards established in this Policy. The justification for such approval shall be forwarded to the Finance Board for review.
4. Decide whether to maintain any existing unsecured checking or settlement accounts with counterparties that have been downgraded below credit standards established in this Policy. The justification for such a determination shall be forwarded to the Finance Board for review.
5. Approve a list of brokers, reporting dealers, and futures commission merchants authorized to execute transactions at the direction of the Bank under this Policy.

B. Management of each Bank shall:

1. Establish internal control systems to ensure compliance with this Policy.
2. Submit a monthly report to its board of directors and to the Finance Board regarding the activities governed by this Policy. At a minimum, the report shall cover the areas of investments, liquidity, hedging, unsecured counterparty risk, and interest rate risk. It will also discuss compliance with the limitations in Financial Management Policy and the Banks' internal policy. Any exceptions to the Policy shall be highlighted and explained in the compliance report. The compliance report shall be in a format defined by the Finance Board.
3. Provide periodic data, as requested by the Finance Board, to facilitate its financial analysis of this Policy. The data shall be in a format defined by the Finance Board.
4. Establish one or more securities safekeeping agents and notify the Finance Board accordingly.
(Authorized agents include Federal Reserve Banks, Federal Home Loan Banks, the Office of Finance, and eligible domestic financial institutions, as defined in this Policy).
5. Account for financial transactions executed under this Policy in accordance with Generally Accepted Accounting Principles.

C. The Internal Auditor of each Bank shall:

1. Establish internal auditing programs that test for compliance with this Policy.
2. Submit a semiannual report to the Board of Directors and to the Finance Board regarding the Bank's compliance with this Policy.

D. The Federal Housing Finance Board shall:

1. Monitor each Bank's compliance with this Policy.
2. Interpret any questions related to this Policy.
3. Consider exceptions to this Policy.

F. This Financial Management Policy shall:

1. Become effective on July 1, 1991.
2. Replace the following Bank System Policies: Funds Management Policy Guidelines dated January 8, 1988; Federal Funds Purchased Policy Guidelines dated March 6, 1981; Hedging policy Guidelines dated June 10, 1985; and Interest Rate Swap, Cap, Collar, and Floor Policy Guidelines dated August 28, 1987.
3. Financial transactions that were specifically authorized under any of these four policies, and that are still outstanding on the effective date of this Policy, shall continue to be authorized transactions for purposes of complying with this Policy. Such transactions may not be extended unless they comply with this Policy.

FOOTNOTES

1. Authorized investment types, other than those specifically authorized by statute, must satisfy the statutory criterion of other "securities as fiduciary and trust funds may be invested in under the laws of the state in which the Bank is located." Each Bank is responsible for ensuring compliance with this criterion.
2. The term "eligible financial institutions" includes:
 - a. Federal Home Loan Banks;
 - b. FDIC-insured financial institutions whose most recently published financial statements exhibit Tier I (or tangible) capital of not less than \$100 million, and which have been rated not lower than C by Thomson Bankwatch or single A by Standard & Poor's or Moody's.
 - c. The Home Office of foreign commercial banks whose most recently published financial statements exhibit Tier I (or Tangible) capital of not less than \$100 million, and which have been rated at least C (company rating) by Thomson Bankwatch or C (individual rating) by IBCA and I country risk by Thomson Bankwatch.
 - d. Branches or agency offices of eligible financial institutions located in the United States or in other countries with a country risk rating of I by Thomson Bankwatch.
3. The term "eligible counterparties for resale agreements" includes eligible financial institutions, the Federal Reserve Bank of New York, Primary Dealers in Government Securities recognized by the Federal Reserve whose capital exceeds \$100 million or which are guaranteed by parent firms whose capital exceeds \$100 million, and U.S. Government Sponsored Agencies for which the credit of such institution is pledged for repayment. Members of the Federal Home Loan Bank System are eligible counterparties for the Bank in which they are a member.

Resale agreements, using for collateral securities which are eligible investments under subsection II.B, or FHA and VA mortgages, may be consummated using a designated custodian, provided the custodian is an eligible domestic financial institution and documentation is provided which evidences the Bank's security interest in the collateral held by the custodian.

4. Commercial Paper Issuers must exhibit at least \$100 million of tangible capital on their most recently published audited financial statements and be included in Moody's Global Short-Term Money Market Record under the industry classifications of banking, finance, or securities.
5. Effective July 1, 1993, Section II.C.1 shall read: The total book value of mortgage-backed securities (II.B.8, 11.8.9, and II.B.10) may not exceed 50 percent of Bank's capital on the day such investments are made. No Bank shall be required to divest securities authorized pursuant to this Policy solely to bring the absolute level of its holdings into compliance with the reduced limit.
6. As of January 1, 1992, the requirement for Legal Reserves is eliminated, at which time, III.B.2. is eliminated.
7. The Board of Directors of each Bank will be responsible for developing a policy to ensure diversity in the Bank's funding sources.
8. A highly rated institution is defined as:
 - (1) a domestic institution rated at least "B" by Thomson Bankwatch, Inc., or IBCA Banking Analysis Limited (this criteria may only be used as a basis for eligibility of contracts that have a remaining term maturity of eighteen months or less);
 - (2) a foreign financial institution rated "I" (country risk) by Thomson Bankwatch, Inc., and at least "B" (company rating) by Thomson Bankwatch, Inc., or "B" (individual rating) by IBCA Banking Analysis Limited (this Criteria may only be used as a basis for eligibility of contracts that have a remaining term to maturity of eighteen months or less);
 - (3) a domestic corporation or partnership with long-term unsecured debt, deposits, or letters of credit rated at least "A" by Standard & Poor's, Moody's, or IBCA Banking Analysis Limited, or with outstanding unsecured commercial paper rated "A1" by Standard & Poor's, or "P1" by Moody's (commercial paper ratings may be only used as a basis for eligibility of contracts that have a remaining term to maturity of eighteen months or less);
 - (4) an international organization, a foreign government **or** its agency, a foreign corporation, or a foreign corporation's domestic subsidiary with long-term unsecured US dollar debt, deposits, or letters of credit rated at least "A" by Standard & Poor's, Moody's, or IBCA Banking Analysis Limited;
 - (5) a U.S. government Sponsored Agency.

9. A Bank may enter into a swap agreement as intermediary between a member (or members) and a non-member counterparty. Such involvements will not require that the position taken reduce interest rate or basis risk in the Bank's portfolio, as required for swap agreements entered for hedging purposes.
10. For purposes of this Policy, off balance sheet unsecured extensions of credit shall be measured as the sum of:
 - a. the net market value of the agreement: plus
 - b. 0.5 percent of the notional amount: plus
 - c. net payments due the Bank.
11. The following independent credit rating services and their successor organizations are recognized for this purpose.
 - a. Thomson Bankwatch shall be the primary short-term rating service for domestic financial institutions and securities dealers and for rating the political and economic stability of countries in which foreign counterparties are domiciled.
 - b. International Bank Credit Analyst (IBCA) shall be the primary short-term rating service for foreign financial institutions, and a secondary long-term rating service for foreign or domestic counterparties.
 - c. Investment Dynamics Corporation (IDC) shall be a secondary rating service for domestic financial institutions.
 - d. Moody's Investor Service shall be a primary long-term rating service for domestic and foreign counterparties and a secondary short-term rating service except for commercial paper for which Moody's shall be a primary rating service.
 - e. Standard & Poor's shall be a primary long-term rating service for domestic and foreign counterparties and a secondary short-term rating service except for commercial paper for which Standard & Poor's shall be a primary rating service.

Secondary rating services may be used for purposes of this policy only if a rating for a particular counterparty is not available from a primary rating service. Whenever secondary ratings are used and different ratings are assigned to the same counterparty by different services, the lowest rating shall be used for purposes of this policy.

If an independent credit rating is not available for a potential domestic counterparty, a thorough credit evaluation shall be prepared and maintained appropriate to the circumstances. The credit evaluation shall conclude with the assignment of a credit rating consistent with those assigned by Thomson Bankwatch.

12. For indexed principal swaps, the effective maturity shall be the weighted average maturity using current consensus prepayment speed estimates for current interest rate levels.