

Report of Examination Instructions

Report of Examination Form and Content

The report of examination must articulate examination conclusions and the analysis supporting those conclusions. It is a stand-alone document principally intended to communicate substantive conclusions and their basis to the FHLBank's board of directors and to serve as an examination record for the Finance Agency. In preparing the report of examination, the examiner should remember that the board of directors will generally not have day-to-day involvement in the operation of the institution or the detailed knowledge such involvement would normally confer. Consequently, the report of examination should provide broad, high-level, institution-wide conclusions and assessments, arranged by rating component factor under the FHLBRS, without unnecessary detail or length. Discussions should focus upon root causes of problems rather than upon symptoms.

Principal examination findings that support the assessment of an institution's corporate governance, market, credit and operational risk, condition and performance, and affordable housing and community investment activities should be presented to the board of directors and senior management at the conclusion of the on-site examination. They will not be detailed in the report of examination (ROE) although they will be cited in support of the examination conclusions and ratings and the ROE will include a table of Matters Requiring Board Attention (MRAs) in the Supplement. Examiners should cite and discuss specific examination findings in the body of the ROE to the extent that (i) such findings are necessary to the overall conclusion or a supporting assessment regarding the institution and (ii) their importance to the conclusion or assessment is not adequately captured through reference to a findings memorandum alone.

The report of examination will have three sections of narrative: the Preface, the Body, and the Supplement. The content of each section is described below.

1) Preface

A) Scope of the Examination Page

The preface should describe the scope of the examination. Examiners should not characterize the scope as a "limited" or "full-scope" examination. Examiners should identify all areas examined that are related to corporate governance, market risk, credit risk, operational risk, financial condition and performance, affordable housing program, and community investment activities.

2) Body

A) Summary And Conclusions Page

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The body should begin with the “Summary and Conclusions” page. The “Summary and Conclusions” page is the evaluation of the overall condition and practices of the FHLBank or Office of Finance and contains a discussion of the composite rating, the component ratings, and affordable housing and community investment activities. Examiners should identify any changes, particularly in the composite rating, since the last examination and establish the basis for those changes.

The “Summary and Conclusions” page should include a table at the top that depicts the date and ratings (both composite and component ratings) for the current examination and the previous examination. The table should be followed by a concise discussion of the composite rating. This portion of the report must describe the basis for the composite rating and any changes to the rating since the last examination. Examiners should present issues relevant to the rating assigned in a logical order, such as in order of importance. The discussion should articulate in a clear fashion the conclusion regarding the overall condition and practices of the FHLBank and the analysis used to reach that conclusion. Examiners need not discuss every rating component, but should address any component that is a significant factor in the composite rating or has changed since the previous examination.

B) Rating Component Pages

The rating component pages should discuss the rating for each component in the FHLBRS: corporate governance, market risk, credit risk, operational risk, and financial condition and performance, in that order. Examiners should discuss each rating component as to the level of risk, factors that influence the future direction of risk, and the quality of risk management. There should be a narrative for each rating component, irrespective of the rating and whether problems are identified, including discussion of positive as well as negative results. The discussion must include support for the conclusions reached. In addition, there should be a separate narrative on affordable housing and community investment activities. While the rating for affordable housing and community investment activities is incorporated in the corporate governance and operational risk components under the FHLBRS, its importance with respect to mission warrants a separate discussion.

Corporate Governance Rating Page

Examiners must support all conclusions and discuss positive as well as negative results. Examiners should assess:

- 1) The capability and performance of the board of directors and senior management;

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- 2) The adequacy of risk management policies and controls;
- 3) Board reporting and board minutes;
- 4) Compliance with laws, regulations and supervisory guidance;
- 5) Governance and administration of the FHLBank's affordable housing and community investment activities; and
- 6) Adequacy of the internal audit program.

Market Risk Rating Page

Examiners must support all conclusions and discuss positive as well as negative results. Discuss the level of market risk and the quality of market risk management. In addition, discuss practices that influence the future direction of risk (if known). Any discussion of trends should describe the applicable timeframe of the review.

Discussion of the level of market risk should address:

- 1) The sensitivity of the FHLBank's earnings and market value of equity to changes in interest rates and other market risk factors; and
- 2) The sensitivity of the FHLBank's earnings and market value of equity to changes in interest rates and other market risk factors in relation to its retained earnings and capital.

Discussion of the quality of market risk management should address the quality and effectiveness of:

- 1) Board and senior management oversight of market risk;
- 2) Risk management policies, procedures, and internal controls;
- 3) Risk modeling assessments;
- 4) Risk measurement, monitoring, and reporting systems; and
- 5) Hedging activities.

Credit Risk Rating Page

Examiners must support all conclusions and discuss positive as well as negative results. Discuss the level of credit risk and the quality of credit risk management. Also, discuss factors that influence the future direction of risk (if known). Any discussion of trends should describe the timeframe of the review.

Discussion of the level of credit risk should address:

- 1) The overall quality and diversification of the advance, investment and acquired member assets portfolios;

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- 2) The overall condition of the FHLBank's membership; and
- 3) The level and trend of nonperforming and non-accrual assets.

Discussion of the quality of credit risk management should address the quality and effectiveness of:

- 1) Credit reviews (advances/collateral, investments, AMA, and derivative counterparty);
- 2) Credit risk management policies and procedures;
- 3) Credit underwriting policies and procedures;
- 4) Collateral valuation and testing procedures;
- 5) Methodologies for evaluating and maintaining credit loss reserves;
- 6) Credit risk self-assessments and internal risk ratings;
- 7) Credit information systems; and
- 8) The volume and nature of credit documentation exceptions.

Operational Risk Rating Page

Examiners must support all conclusions and discuss positive as well as negative results. Discuss the level of operational risk and the quality of operational risk management. Also, discuss factors that influence the future direction of risk (if known). Any discussion of trends should describe the applicable timeframes of the review.

Discussion of the level of operational risk should address:

- 1) The level and frequency of losses resulting from inadequate or failed internal processes or management information systems, fraud or human error, or from external events;
- 2) The severity and frequency of accounting, financial, and regulatory reporting errors;
- 3) Whether the level of operational risk losses are increasing, decreasing or stable;
- 4) The degree to which processes are automated to minimize errors; and
- 5) The level of operational risk arising from the administration of the FHLBank's principal lines of business and its affordable housing and community investment activities.

Discussion of the quality of operational risk management should address the quality and effectiveness of:

- 1) Policies, procedures, and systems in place to measure, manage, and control operational risk;

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- 2) The measurement, monitoring and control of operation risks;
- 3) Policies and procedures to ensure secure, efficient and effective information and data processing;
- 4) Contingency and business continuity planning;
- 5) Operational risk reports;
- 6) Processes for identifying and controlling risk to business activities;
- 7) The operational risk self-assessment;
- 8) Operational risk management in the administration of the FHLBank's affordable housing and community investment activities; and
- 9) Reputation risk management.

Financial Condition and Performance Rating Page

Examiners must support all conclusions and discuss positive as well as negative results. Examiners, in conjunction with the financial analyst's report, should discuss the FHLBank's financial condition, performance, and prospects and assess the following:

- 1) Earnings and profitability;
- 2) Capital and retained earnings;
- 3) Liquidity; and
- 4) Operating efficiency.

Financial Condition and Performance Data Page

This information will be provided by the financial analyst assigned to the FHLBank. The analyst should include information relevant to the financial condition and performance of the FHLBank that supports the conclusion set forth in the Financial Condition and Performance section. The examiner possesses discretion to determine the information that will be included in this section. A default example of this page has been included in the sample report of examination.

Affordable Housing and Community Investment Activities Page

Provide an evaluation of whether the FHLBank's affordable housing and community investment activities are effective and comply with law and regulations. This discussion should address significant supervisory concerns and whether and how the FHLBank responds to supervisory criticism. Supporting paragraphs may include discussion of such areas as:

- 1) The level of engagement and oversight by senior management and the board of directors;

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- 2) The existence of a comprehensive and accurate management information system;
- 3) Accurate scoring of applications and the award and disbursement of the proper amount of the Affordable Housing Program subsidy;
- 4) Sound monitoring of compliance of approved projects and set-aside grants and prompt remedial action of identified problems;
- 5) Eligibility of projects and households for community investment cash advance funding; and
- 6) Disbursement of awarded funds to program sponsors.

Disposition of Findings from Previous Examination Page

This section should include a brief overview regarding the disposition of findings identified at the previous examination. If the FHLBank has not properly addressed prior examination findings, consider whether this comment should also be placed on the Summary and Conclusions pages.

3) Supplement

Matters Requiring Board Attention

Include in the schedule a listing of Matters Requiring Attention (MRAs) of an FHLBank's board of directors. The following characteristics should be considered when determining whether a finding is an MRA:

- Finding of Unsafe and Unsound Practice or Condition;
- Finding of Weakness;
- Violation of Law or Regulation;
- Matters with program or FHLBank-wide implications, or which establish precedents; or
- Matters where there is a likelihood of deterioration.

While a Recommendation will generally not be considered an MRA, it may be an MRA if, as noted above, there are wider implications, or deterioration in the condition of an FHLBank is likely unless there is prompt remediation. Include Recommendations in the schedule only when they are MRAs.

Include all MRAs from the current examination and any open MRAs from prior examinations. Also include any MRAs that have been resolved since the prior examination; a resolved MRA should appear in a Report of Examination MRA schedule only once. MRAs should be presented in the order of the rating components (Corporate Governance, Market Risk, Credit Risk, Operational Risk, and Financial Condition and Performance).

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4) Abbreviations

Examiners may add abbreviations to the “Abbreviations” page of the report of examination as is needed for the specific FHLBank or Office of Finance under examination.

5) Definitions of Findings and Ratings Categories



Division of Federal Home Loan Bank Regulation

REPORT OF EXAMINATION

Federal Home Loan Bank of [City]

Prohibition of Disclosure or Release

This document is the property of the Federal Housing Finance Agency and is furnished to the Bank for its confidential use. Access is limited to persons and organizations permitted under Part 911 of the Rules and Regulations of the Federal Housing Finance Board under the circumstances authorized in that part, including those authorized in Advisory Bulletin 2006-AB-03.

In accordance with Section 20 of the Federal Home Loan Bank Act of 1932, as amended, the Federal Housing Finance Agency conducted an examination of the Federal Home Loan Bank of [City] beginning [Date Exam Commenced]. This report of examination presents the results of the Federal Housing Finance Agency's examination. It was prepared for supervisory purposes and should not be considered an audit report.

**[Name of Examiner]
Examiner-in-Charge
Division of FHLBank Regulation
Federal Housing Finance Agency
[ROE "Signed" Date]**

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Scope of the Examination

Summary and Conclusions

	Current Examination	Prior Examination
Examination Date		
Composite Examination Rating		
Corporate Governance		
Market Risk		
Credit Risk		
Operational Risk		
Financial Condition and Performance		

Corporate Governance

Corporate Governance Rating:

Market Risk

Market Risk Rating:

Credit Risk

Credit Risk Rating:

Operational Risk

Operational Risk Rating:

Financial Condition and Performance

Financial Condition and Performance:

Financial Condition and Performance - Data

Federal Home Loan Bank of
(Dollars in Millions)
Period ending figures (unless noted)

	<u>Q4-xxxx</u>	<u>Q4-xxxx</u>	<u>Q1-xxxx</u>	<u>Q2-xxxx</u>	<u>System Q2- xxxx</u>
Assets					
Advances					
Mortgages					
Investments					
Agency MBS					
Private-Label MBS					
Other Investments					
MBS as a Multiple of Capital					
Classified PLMBS as a percent of regulatory capital ¹					
Consolidated Obligations					
Bonds					
Discount Notes					
Total GAAP Capital					
Total Regulatory Capital					
Regulatory Capital Stock					
Retained Earnings					
As Percent of Total Assets					
Advances					
Mortgages					
Investments					
Regulatory Capital					
Retained Earnings					
As Percent of Consolidated Obligations					
Bonds					
Discount Notes					
Advances Plus Mortgages					
Leverage (GAAP)					
Duration of Equity (in years)					
Market to Book Value of Equity					
Year To Date					
Return on (avg) Assets					
Return on (avg) Equity					
Return on (avg) Capital Stock					
Dividend Rate					
Payout Ratio					
Yield on Earning Assets					
Cost of Interest-Bearing Liabilities					
Net Spread					

¹ Information regarding Classified PLMBS is not contained in CRS.net and was manually calculated.

Affordable Housing and Community Investment Activities

Disposition of Findings from Previous Examination

Matters Requiring Board Attention

Number	Brief Description	Resolve By
Corporate Governance		
Market Risk		
Credit Risk		
Operational Risk		
Financial Condition and Performance		

Abbreviations

AB.....	Advisory Bulletin
Bank.....	Federal Home Loan Bank of [City]
CSA.....	Credit Support Annex
CO.....	Consolidated Obligation
COBIT.....	Control Objectives for IT
ERM.....	Enterprise Risk Management
FHLBank.....	Federal Home Loan Bank
FHFA.....	Federal Housing Finance Agency
GAAP.....	Generally Accepted Accounting Principles
ISDA.....	International Swaps and Derivatives Association
IT.....	Information Technology
LOAS.....	LIBOR Option Adjusted Spread
LBSF.....	Lehman Brothers Special Financing, Inc.
LIBOR.....	London Interbank Offered Rate
MBS.....	Mortgage-Backed Securities
MPF.....	Mortgage Partnership Finance
MVE.....	Market Value of Equity
ROE or Report.....	Report of Examination

Definition of Findings and Ratings Categories

Examiners use the following findings categories:

Unsafe or Unsound Practice or Condition: Any action or inaction that is contrary to prudent operation that has resulted in, or if continued could result in, abnormal loss or risk or damage to the Bank or the OF. Immediate corrective action is required. A Bank's condition need not deteriorate to the brink of insolvency before a practice or condition may be found to be unsafe or unsound.

Violation: Non-compliance with statute, regulation, or agency rule. Corrective action is required.

Weakness: An inadequate or otherwise unacceptable policy, procedure, or practice, or a lack of sufficient internal controls or risk management. Corrective action is required.

Recommendation: A suggested change to a policy, procedure, practice, or control to improve performance or operations.

Referral: A matter that raises a legal or policy issue requiring guidance from or development of a position by Finance Agency staff.

Examiners use the following composite rating categories:

Composite 1 – An institution that is rated “1” is considered to be operating in a safe and sound manner in every respect. It exhibits no material deficiencies in corporate governance, risk management, or financial condition, performance, and prospects. It is in substantial compliance with laws, regulations, and supervisory guidance.

Composite 2 – An institution that is rated “2” is considered to be operating in a satisfactory or acceptable manner. It may exhibit some moderate deficiencies in corporate governance, risk management, or financial condition and performance. The institution's board of directors and senior management have demonstrated the ability and willingness to address deficiencies in a timely manner. It is in substantial compliance with laws, regulations, and supervisory guidance. *The general policy is that examiners will monitor the correction of identified deficiencies or weaknesses through the normal supervisory process.*

Composite 3 – An institution that is rated “3” raises supervisory concern due to deficiencies in its corporate governance, risk management, or its financial condition or performance. Taken alone or in combination, these deficiencies are moderate to severe. The organization may be in substantial noncompliance with laws, regulations, or supervisory guidance. The institution's board of directors or management do not demonstrate the ability or willingness to address deficiencies. A composite “3” rated institution requires more than normal supervision. *The general policy is that supervisory action will be taken to address identified deficiencies or weaknesses.*

Composite 4 – An institution that is rated “4” is operating in an unacceptable manner. It may exhibit serious deficiencies in corporate governance, risk management, or financial condition and performance. It may be in substantial noncompliance with laws, regulations, or supervisory guidance. It requires close supervisory attention. Institutions in this group are considered to be operating in an unsafe or unsound condition or with unsafe and unsound practices. *The general policy is that a formal enforcement action will be taken to address identified deficiencies or weaknesses.*