

# Federal Home Loan Bank Rating System

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## **Introduction**

The FHLBRS is a risk-focused rating system under which each FHLBank and the Office of Finance is assigned a composite rating based on an evaluation of various aspects of its operations. Specifically, the composite rating of each FHLBank is based on an evaluation and rating of five key components: corporate governance, market risk, credit risk, operational risk, and financial condition and performance. The composite rating of the Office of Finance is based primarily on an evaluation of two components: corporate governance and operational risk. The administration of an FHLBank's affordable housing and community investment activities is taken into account under the corporate governance and operational risk components of the rating system.

Under the rating system, each FHLBank and the Office of Finance is assigned a composite rating from "1" to "4." A "1" rating indicates the lowest degree of supervisory concern, while a "4" rating indicates the highest degree of supervisory concern. The composite rating of each institution is based on the ratings of the underlying components, which are also rated on a scale of "1" to "4." The composite rating assigned to an institution is not an arithmetic average of the component ratings. Instead, the relative importance of each component is determined case-by-case within the parameters established by this rating system.

The ratings assigned under the FHLBRS are to be viewed within the context of the risk profiles of the FHLBanks. For example, the rating system employs three risk categories "Low Risk," "Moderate Risk," and "High Risk" to designate the level of risk exposure of an FHLBank's market risk, credit risk, and operational risk. These risk levels are intended to measure risk within the context of the FHLBanks. They are not intended to measure risk relative to risk levels of other types of financial institutions. In this regard, the ratings assigned under the FHLBRS should not be viewed as comparable to the ratings used by any other rating system or rating agency.

## **Composite Ratings**

Composite ratings are based on an evaluation of an institution's corporate governance, market, credit, and operational risk, and its overall financial condition and performance. An institution will be assigned a composite rating of "1" to "4" as described in the FHLBRS.

## **Component Ratings**

The composite rating is derived from the five component ratings. For each of the components, the FHLBRS provides a rating description that includes a non-exclusive list of the principal evaluative factors that relate to that component. The rating components are described briefly below.

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## **A. Corporate Governance**

An institution's corporate governance is rated based upon, but not limited to, an assessment of evaluative factors relating to the board of directors and senior management, risk management and controls, and compliance. The quality of corporate governance is rated in accordance with definitions set forth in the FHLBRS.

## **B. Market, Credit, and Operational Risk**

The market, credit and operational risk ratings of an institution are based upon, but not limited to, an assessment of evaluative factors relating to the level of risk exposure and the quality of risk management for each risk. Examiners will assess the level of each risk of an institution, within the context of a government sponsored enterprise, as "low," "moderate" or "high," as defined in the FHLBRS. Examiners will also assess the quality of risk management of each risk as "strong," "adequate" or "weak," as defined in the FHLBRS.

In deriving component ratings for market, credit and operational risk, examiners will use a matrix to combine the level of risk exposure and the quality of risk management:

QUALITY OF RISK MANAGEMENT	LEVEL OF RISK		
	LOW RISK	MODERATE RISK	HIGH RISK
Strong	1	1-2	2-3
Adequate	1-2	2-3	3-4
Weak	2-3	3-4	4

Each rating is described in the FHLBRS.

## **C. Condition and Performance**

The financial condition and performance of an institution is rated based upon, but not limited to, an assessment of evaluative factors relating to earnings and profitability, operating efficiency, capital and retained earnings, and liquidity. The financial condition and performance of an institution includes as an important element the FHLBank's prospects, and is rated generally in accordance with definitions set forth in the FHLBRS.

The FHLBRS is contained by reference in Advisory Bulletin 06-04 (December 2006). Examiners should refer to that document for specific provisions of the FHLBRS.