FHLBNY Advantage

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The FHLBNY's Advance Modification Program: an Increasingly Utilized, Powerful Option in Balance Sheet Management

While members have continued to operate well in this prolonged and challenging economic and regulatory environment, they still face headwinds in their drive to optimize earnings. One way the FHLBNY can help is through its Advance Modification Program ("modifications") for Putable Advances. Advance modifications are a strategic option to help improve net interest margins (NIM), better manage interest rate risk, and capitalize on historically low rates by extending further out on the curve while not incurring an upfront prepayment fee. This edition discusses *why* current market conditions have made modifications appealing, *which* modification strategies members have used to achieve their objectives, and *what* operating guidelines and considerations members should be aware of before modifying an advance.

Why Now May be the Right Time to Modify a Putable Advance

Although modifications have been available since September 2010, where Putable Advances can be modified into either new Putable or Fixed-Rate Advances, modifications have recently become a popular and effective option for members. In fact, members (both large and small) have modified a total of over **$9 billion in Putable Advances since the initiation of the program**. Modifications are expected to continue to be an attractive strategy as members face declining NIMs (a 13 bp decline from 2011 to 2012), asset spread compression, and limited opportunities to help reduce liabilities.

Furthermore, current market conditions continue to make modifications advantageous. Advance rates and the cost to extend along the curve are near historic lows. Before analyzing the right modification strategy for your institution, having a general understanding of all the factors and market conditions that impact modifications is essential. The table below lists some general structural factors and market conditions that can impact modification rates.

Advance Modifications: Factors/Conditions to Consider

Typically Higher Rate on Modified Advance	Typically Lower Rate on Modified Advance
Structural Factors	
» Modified term close to old advance term	» Modified term extended beyond old advance term
» Higher original rate	» Lower original rate
» More time to exercise option	» Less time to exercise option
Market Conditions	
» Higher market rates (LIBOR)	» Lower market rates (LIBOR)
» Old and modified advance durations closely matched	» Old and modified advance durations not closely matched
» Steep yield curve	» Flatter yield curve
» Falling option volatility levels	» Increasing option volatility levels

Which Modification Strategies Worked for Members

Modifications appeal to members of varying sizes and types. The following table highlights how members have taken advantage of different modification strategies to improve their net interest margin, reduce optionality and interest expense, and capitalize on low rates.

Achieved Goal: Improved Net Interest Margin

Member #1: > $10 Billion in Assets

	Old Advance	Modified Advance	Change
Advance	$200 Million	$200 Million	--
Remaining Structure	3.5-Yr NP* 3-Mo	7-Yr NP 4-Yr	Increased Maturity/ Increased Put Term
Maturity	12/2016	12/2019	+ 3 Years
Rate	4.85%	3.55%	**130 bp savings**

Achieved Goal: Reduced Optionality and Interest Expense

Member #2: < $10 Billion in Assets

	Old Advance	Modified Advance	Change
Advance	$30 Million	$30 Million	--
Remaining Structure	2-Yr NP 3-Mo	5-Yr Fixed-Rate	Increased Maturity/ Eliminated Optionality
Maturity	5/2014	12/2019	+ 5 Years
Rate	4.222%	2.187%	**203.5 bp savings**

Achieved Goal: Capitalized on Low Rates for Curve Extension

Member #3: < $500 Million in Assets

	Old Advance	Modified Advance	Change
Advance	$4 Million	$4 Million	--
Remaining Structure	3.5-Yr NP 3-Mo	10-Yr NP 5-Yr	Increased Put Term
Maturity	7/2016	6/2022	+ 6 Years
Rate	4.57%	3.57%	**100 bp savings**

**Note: NP is the abbreviation for No Put/Not Putable.*

What are the Operating Guidelines and Considerations?

Currently, members can modify Putable Advances into either new Putable Advances or into new Fixed-Rate Advances. The table provided on the reverse lists the guidelines, considerations and requirements that all members should review before requesting a modification.

continued on reverse>

The FHLBNY's Advance Modification Program *(continued)*

Strategies to Consider as Alternatives to Modifications

» Prepaying existing advances and restructuring into Floating Rate Advances, while utilizing off-balance sheet derivative products (such as caps) as a way to effectively hedge the interest rate risk. This strategy could potentially have accounting implications that should be reviewed with your advisors.

» Utilizing the Callable Advance to build-in prepayment options that can help reduce interest rate risk and prepayment risk at minimal added cost. The Callable Advance is essentially a Fixed-Rate Advance that gives members the option of calling (terminating) the advance on predetermined dates, prior to maturity, without incurring a prepayment fee.

» Laddering maturities with medium- to long-term advances in the current low rate environment. This strategy has been implemented by members including those that are flush with deposits, but in need of managing interest rate risk with structures not offered in the deposits market.

To discuss how your institution can participate in the Advance Modification Program or discuss restructurings, the three alternate strategies mentioned, or any of the FHLBNY's funding options, contact a Calling Officer at **(212) 441-6700**.

Advance Modifications: Eligibility and Requirements

Original Putable Advance	New Modified Advance
» Remaining maturity of 12 months or less	» Not eligible for modification
» Remaining maturity of 2 years or less	» Maturity term cannot exceed 5 years
» Remaining maturity of 4 years or less	» Maturity term cannot exceed 7 years
» Remaining maturity over 4 years	» Maturity term cannot exceed 10 years

Note: the value of a modified advance must pass a 10% modification test.

FHLBNY Considerations

The FHLBNY must review and assess each proposed transaction to ensure it conforms to the FHLBNY's modification criteria. Three tests will need to be satisfied in order to complete a modification: 1.) structural similarity; 2.) 10% modification test; and 3.) prospective hedge analysis if the advance is hedged.

Member Considerations

» Execute the FHLBNY's current version of the "Callable Advance, Putable Advance and Putable Advance with Customized Strike Customer Certification" (HLB-126) and reviewed the related disclosure (HLB-125);

» Orally acknowledge, at time of transaction, the structured advance pre-transaction disclosure has been reviewed; and,

» Provide a suitability disclosure (HLB-127: Advances Modification Certification).

Have You Seen the FHLBNY's Resource Center for Members?

The FHLBNY recently added a Resource Center to its public website under the "Members" tab. The Resource Center was created to centralize information that is often requested by our members. This section also houses strategies and tools to help address members' funding needs.

What You Will Find in the Resource Center:

» Funding Strategies (*strategies for interest rate risk management, asset/liability, management, duration based pricing, etc.)*

» Webinars

» Education efforts (*Member-Director program, muncipal education, and workshops)*

» Tools (*the "All in" Rate Borrowing, Interest Expense Calculator, Amortizing Advance Schedule, Funding Comparison, Prepayment Fee Calculator, and Funding Mix Calculator tools)*

» Fact sheets and other information about the FHLBNY's products and services

Check it out at www.fhlbny.com/members/resource-center.

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