FHLBNY Advantage
FEDERAL HOME LOAN BANK OF NEW YORK
AUGUST 2013

Thoughts from the FHLBNY's Treasury Desk

The FHLBNY is an "advances" bank committed to providing liquidity to our members in all operating environments. The FHLBNY's Treasury Desk primarily focuses on making liquidity available at the lowest possible cost for members. Responsibilities of the Treasury Desk include advance pricing, prepayments and modifications, cash and liquidity management, debt issuance, hedging strategies, derivatives, and short-term investments. This edition of the *FHLBNY Advantage* shares some insight from the Treasury Desk, as well as some thoughts and observations regarding the capital markets and how regulatory actions can potentially affect the FHLBNY and its members in terms of funding costs and liquidity.

Access to Liquidity in Any Market Situation

The FHLBNY has substantial liquidity on-hand, ready to lend to members.

__Qualitative Reasons__

» The FHLBank System was created by Congress to extend liquidity in the market in any economic environment

» The FHLBanks have remained active and accessible providers of liquidity through every market disruption of the past 81 years

» The FHLBanks provided more than $1 trillion in advances during the most recent financial crisis when nearly all other funding sources locked up

» The FHLBNY has never denied funding as long as the member has collateral and the ability to purchase capital stock

» The FHLBanks are premier issuers of high-quality debt with deep access to the global markets even in times of crises

» The FHLBNY has maintained its triple-A rating from Moody's Investors Service

__Quantitative Reasons *(data as of June, 30 2013)*__

» Cash on hand: $5.9 billion
» Liquid investments: $11.4 billion
» Pledgeable securities: $12.9 billion

» **Total liquidity available to lend: $30.2 billion**

In addition to the substantial liquidity available, the Secretary of the Treasury is authorized to purchase up to $4 billion of consolidated obligations from the FHLBanks.

The "Tapering" of the Third Round of Quantitative Easing (QE3)

The recent wild market ride began following Federal Reserve Chairman Ben Bernanke's press conference held after the Federal Open Market Committee (FOMC) meeting on June 19, 2013. The market was led to believe QE3 would soon be reduced and perhaps stopped as early as mid-2014. The markets — both domestic and abroad — began to sell off. In a matter of days, the 10-year Treasury moved from 2.19% to 2.61%; it has since reached a high of 2.89%. The Fed had previously stated that it would continue to target the Fed Funds rate at near zero through 2014; now the question is whether rates will rise sooner. Investors wonder if the current rise in rates will stall the modest economic recovery.

Does the tapering happen at the next FOMC in September (18th-19th), or will the tapering happen later this fall, or in 2014? Strategists see the 10-year Treasury in a range of 2.40% to 2.80% with not much on the horizon to change that thinking; however, "Fedspeak" will likely continue to move markets. So now what? The question many members are grappling with given all this haze and volatility is "should I do some borrowing further out on the curve?" The answer seems to be moving toward "yes."

Dodd-Frank Implementation and Mandatory Derivative Clearing

The FHLBNY uses interest rate swaps to help manage its balance sheet. Being a spread lender, these financial instruments help the FHLBNY effectively hedge assets and liabilities in order to create a LIBOR-based balance sheet. Interest rate swaps are an essential tool to help lower the cost funding for members and allows for better matching of repricing cash flows.

As part of the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd–Frank), the FHLBNY is required to settle eligible derivative transactions with a Derivatives Clearing Organization (the FHLBNY uses the Chicago Mercantile Exchange and the London Clearing House). Currently, the FHLBNY is able to clear traditional swap structures, which include fixed, floating, and amortizing structures. Interest rate swaps containing options are currently not clearable. As with many new requirements, the additional layers of workflow needed to include new intermediaries, along with increased transaction and collateral maintenance costs, can potentially increase the FHLBNY's cost of funds. The Treasury Desk is assessing the new workflow and is determining the most efficient ways to trade in order to minimize any additional cost. Obviously, given the cooperative nature of the FHLBNY's business, these costs are borne by the membership; however, the FHLBNY is doing all it can to keep these required costs low.

Retail Deposits and How Money Market Reforms Affect Short-Term Advances and the Cost of Funds

Since Dodd-Frank repealed Regulation Q*, members have gained additional flexibility to re-price deposits and retain balances as short-term interest rates rise. Members with large

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*Regulation Q is a Federal Reserve Board regulation that prohibited banks from being able to pay interest on deposits within checking accounts. Regulation Q was enacted in accordance to the Glass-Steagall Act of 1933, to limit loan sharking and other such unseemly actions. In addition, it motivated consumers to release funds from these accounts and put them into money market funds. In 2010 the Dodd-Frank Act, for all intents and purposes, repealed Regulation Q and allowed for banks to offer interest on checking accounts for it business banking customers. This move was made, in part, to increase banking reserves to militate against credit illiquidity that was experienced in the initial days of the 2008-2009 credit crisis. *Source: Investopedia.com.*

Thoughts from the FHLBNY's Treasury Desk *(continued)*

asset bases can reduce the movement of institutional funds from deposits to alternative investments. However, smaller-sized members may have difficulty retaining retail deposits due to their elasticity. If the traditional movement of funds flowing from deposits into equities occurs, when investment returns are actually, or perceived as being, better than deposit rates, or if the Fed begins to increase short-term rates, the need for additional liquidity may arise.

Brokered CDs are an alternative investment for a number of members. The Repo market also provides an alternative to deposits and Fed Funds. However, Repos remain primarily an overnight borrowing tool and require high-quality, liquid securities that are generally only lent to counterparties with pristine credit. FHLBNY advances provide the ability to liquefy whole residential mortgage loans and can be a great source of wholesale funding. Should the economy grow more rapidly, investment opportunities may increase, particularly if the recent growth in housing can absorb higher rates. Therefore, there could be a great opportunity to reduce reliance on short-term deposits, unwind a bit of the carry trade, and extend advances before longer-term rates increase more than they have in the last few weeks.

In early June, the SEC released its long-anticipated money market reform proposals that had been in the works since the 2008 financial crisis. The effect on the FHLBank System should be minimal as FHLBank debt is included in the available investment class for Money Market Funds (MMFs), and taxable MMFs hold approximately 25% of the total short-term FHLBank debt outstanding. If the status quo holds or MMF balances grow, the benefits to the FHLBank System are continued or increased investor demand for FHLBank System debt issuances. If the Fed begins to increase short-term rates (or if the market perceives short-term rates increasing), rising rates have the potential to boost MMF holdings of FHLBank debt and incentivize longer-term advance demand as it would benefit members to hedge mortgage extension risk by locking-in term borrowings. Rising rates could also help advance pricing as higher rates should lead to spreads widening, yields normalizing, and investors targeting total return as they begin to re-enter the market. Better FHLBank debt funding execution helps lower the FHLBNY's cost of funds, which in turn results in lower advance rates to members that can boost advance volume and performance – and also result in the highest dividend possible for members.

Liquidity Requirements and Availability for Members

Liquidity is a hallmark of the FHLBNY — to be there for our members when funding needs arise. In the wake of the financial crisis, there has been an even greater focus on the amount of liquidity the FHLBank System holds for its members. The FHLBNY, as part of its commitment as a liquidity provider, holds over six times the amount of liquidity the regulatory guidelines require. The FHLBNY holds sufficient liquidity to roll existing maturing advances for at least the next 30 days for all members with assets below $100 billion. Bottom-line, the FHLBNY's balance sheet is positioned to fulfill its commitment to being a liquidity provider to members in all operating environments (as demonstrated in the Highlight Section).

If you would like to discuss the functions of the FHLBNY's Treasury Desk, the funding options available to you, or any of the topics presented, contact Louis Solimine, Treasurer, at **(212) 441-6601** or your Calling Officer at **(212) 441-6700**.

Have You Considered the Economic Impact of Your Dividend?

On August 16, 2013, the FHLBNY distributed a 4.00% dividend to members for the second quarter of 2013 (annualized). It is important for members to factor in the economic benefit of the FHLBNY's dividend rate, which, depending on the advance term, can substantially lower the "all-in" borrowing cost of the advance. Please refer to the July edition of the *FHLBNY Advantage* for an example of the "all-in" cost, or for a detailed analysis, contact your Calling Officer at **(212) 441-6700**.

Note: There is no guarantee that the level of future dividends will match or be comparable to the level of previous dividend payouts.

CONTACT US | 101 Park Avenue, New York, NY 10178-0599 | T: (212) 441-6700 | F: (212) 949-0230 | www.fhlbny.com

Federal Home Loan Bank of New York
101 Park Avenue, New York, NY 10178-0599

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