FHLBNY Advantage

FEDERAL HOME LOAN BANK OF NEW YORK NOVEMBER 2014

Callable Advances — The Proof is in the Performance

Since its roll out a few years back, the Callable Advance product has proven to be of great value to our members. With the economic uncertainty today, the Callable Advance offers members the flexibility to respond to current market trends and to changes in their balance sheets. The following article provides an in-depth analysis of the Callable Advance and how it may be potentially used as part of members' hedging and funding strategies.

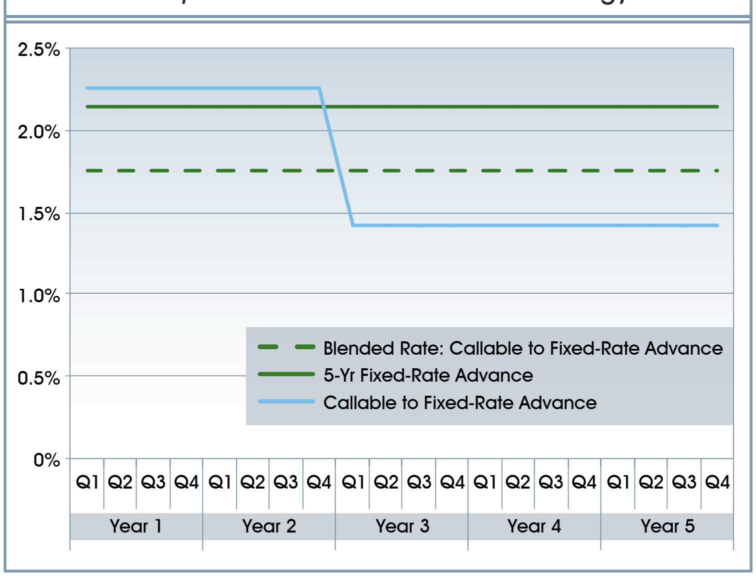
The Callable Advance is essentially a Fixed-Rate Advance that gives members the option of calling (terminating) part or all of the advance on predetermined dates (either on a one-time or quarterly basis; European or Bermudan options)[1], prior to maturity, without incurring a prepayment fee. Unlike our Putable Advance, where the FHLBNY holds the option to "put" the advance back to the member, with the Callable Advance, the member has the opportunity to "call" or extinguish the advance.

Valuable Versatility

Static Rate Environment: If rates stay relatively unchanged during the term of the Callable Advance, a member may elect to extinguish the advance after the pre-determined lockout period and enter into a new advance (at a lower rate) with a term that matches the remaining life of the original advance.

For example, if a 5-year Callable Advance with a non-call period of two years (Bermudan option) were to be issued (5NC2Y Bermudan), the cost would be 2.25% (using an indication from 11/12/14), or 11 basis points higher than the regular 5-year Fixed-Rate Advance. Should rates remain unchanged during the first two years of this advance strategy, the member can terminate this borrowing after the non-call period, and take out a new 3-year Fixed-Rate Advance at 1.42% (its current rate). This would enable the member to have the same remaining term of the extinguished Callable Advance, plus 83 basis points of cost savings. The "all-in" blended rate of this strategy over a 5-year period would be 1.75%, or 39 basis points cheaper than the regular 5-year Fixed-Rate Advance rate at the inception of this strategy.

Example: Static Rate Environment Strategy



A member may elect to go into another Callable Advance as well, such as a 3NC1Y Bermudan. Assuming the spread to the Fixed-Rate Advance remains the same, this new Callable Advance would cost 1.52%, translating into an "all-in" blended rate over the term of the 5-year strategy equal to 1.81% — with the member retaining yet another option to extinguish the advance after the 1-year non-call period.

Rising Rate Environment: A Callable Advance is term funding, which can enable you to lengthen the duration of your liabilities, match-fund long-term assets, and preserve spread. It can help assist members with managing their Net Interest Income at Risk and Economic Value of Equity at Risk.

Falling Rate Environment: Should the interest rate environment change and rates fall during the term of a Callable Advance, a member can extinguish the advance (after the non-call period) and take out a new one at a lower rate. Members will not be "stuck" with out-of-market term funding when using the Callable Advance. We saw this strategy implemented by some members in mid-October when the 10-year Treasury declined by over 40 basis points.[2]

Changes in Deposit Base: In the event a member's deposit base grows during the term of an outstanding Callable Advance, the member could elect to extinguish the advance (after the non-call period) with newly obtained liquidity. If the average life of a member's deposit base lengthens, the need for long-term wholesale funding may diminish, and the Callable Advance can either be partially or entirely extinguished based on their interest rate risk position.

Mortgage Prepayment/Extension Risk: Callable Advances can be used to match-fund a pool of mortgages or mortgage-backed securities — if prepayment speeds are faster than anticipated, the Callable Advance can be partially extinguished after the non-call period, relieving the member of excess funding. Members may elect to fund the "tail" of a mortgage pool with a Callable Advance to guard against "extension" risk, or the risk that mortgages remain on the books past their expected average lives. If the extension does occur, the Callable Advance protects and preserves spread; if the extension is not realized, then the Callable Advance may be extinguished after the non-call period.

Member Experience — the True Value

Clearly demonstrating the true value of the Callable Advance is our member experiences with this advance product. The vast majority of Callable Advances booked have in fact been extinguished when reaching the end of their non-call periods, for

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[1] The "Bermudan option" gives members the opportunity to extinguish the advance on a quarterly basis after the end of the "non-call" lockout period (on the quarterly anniversary dates). The "European option" offers members the ability to extinguish the advance just one time immediately after the end of the "non-call" period on its anniversary date.

[2] Their Callable Advance reset dates corresponded with October's sharp decline in rates, enabling them to be opportunistic and extinguish their Callable Advances and take out new advances at lower rates.

The Proof is in the Performance — Callable Advances *(continued)*

the reasons previously mentioned — either the funding was no longer needed or they could benefit from entering into a new advance at a lower rate, or with a different term structure. Members have appreciated this product as they were able to respond to their current situation and change directions because of its embedded prepay option.

As illustrated in the following rate comparison, there is a higher cost[3] to the Callable Advance versus straight Fixed-Rate Advances; however, its benefits and potential cost savings can be significant. Famous author and New York City resident Kurt Vonnegut put it well when he said, "In this world you get what you pay for." As our members who use the Callable Advance can attest, they received tremendous value for the additional premium.

"Quorum has utilized FHLBNY long-term Callable Advances to fund loan growth and help manage interest rate risk. The advance call feature provides Quorum with additional options to navigate through liquidity and interest rate risk scenarios at an attractive price."

» Jamie Hafer, Controller, Quorum Federal Credit Union

"The Callable Advance has been a tremendous tool for us in managing our balance sheet and our exposure to interest rate risk. Last year, we booked 5-Year Callables to protect us from rising rates and recognized that if rates fall during the term of the advance we could put back the borrowing to FHLBNY and refinance at a lower rate. Recently we executed that option, realizing just under 200 basis points in expense savings over the remaining life of the new advance term."

» Steven M. Fusco, Senior Executive Vice President and Chief Financial Officer, Sussex Bank

Comparison of Current Rate Levels (Indications from 11/12/14)

Callable Advance			Fixed-Rate Advance
Structure	Bermudan	European	
3NC1Y	1.52%	1.50%	1.42%
5NC1Y	2.32%	2.25%	2.14%
5NC2Y	2.25%	2.22%	2.14%
7NC1Y	2.99%	2.84%	2.67%
7NC2Y	2.91%	2.83%	2.67%
10NC1Y	3.53%	3.26%	3.16%
10NC2Y	3.45%	3.28%	3.16%

Features, Terms, and Restrictions of the Callable Advance

» Minimum advance size: $5 million per trade
» Final maturities available: 3, 5, 7, or 10 years
» Lockout periods: 1, 2, 3, or 5 years
» Call options: Bermudan (quarterly) or European (one-time)
» Interest payment: Quarterly based on an Actual/360 day count
» Required notification time to exercise call option: 9 business days
» Must complete product disclosure certification prior to execution of a Callable Advance

As your partner in funding, the FHLBNY strives to provide solutions to meet your liquidity and hedging needs. Should you have questions regarding this article, or for assistance finding the right advance and structure to fit your needs, contact a Calling Officer at **(212) 441-6700**.

[3]The premium on the borrowing rate of the Callable Advance versus a regular Fixed-Rate Advance is the cost of the option, which is a function of the implied volatility and the term structure of forward rates.

Note: In order to use Callable Advances, a member must complete a product disclosure certification agreement. The FHLBNY will require this agreement to be re-executed every two years. Prior to executing a trade, the member must also attest to observing and understanding the pre-disclosure examples posted on the FHLBNY's public website. Members will be sent a confirmation letter upon completion of a transaction.

Have You Considered the Economic Impact of Your Dividend?

On November 21, 2014, the FHLBNY distributed a dividend of 4.05% to members for the third quarter of 2014 (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. For a detailed analysis, contact your Calling Officer at **(212) 441-6700** or refer to the August 2014 edition of the *FHLBNY Advantage* for an example of the "all-in" cost.

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

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