



***Federal Housing Finance Board
Office of Supervision***

Date: October 7, 2002

To: Federal Home Loan Bank Presidents, Chief Financial Officers and Directors of Internal Audit

From: Stephen M. Cross
Director
Office of Supervision

Subject: Credit Watch for Unsecured Credit

Introduction

Section 932.9(a)(5)(iv) of the Federal Housing Finance Board (“Finance Board”) Unsecured Credit Rule (effective March 27, 2002) states that if a counterparty is placed on a credit watch for potential downgrade by a Nationally Recognized Statistical Rating Agency (NRSRO), the Federal Home Loan Bank must apply the credit rating from that NRSRO at the next lower grade. Furthermore, Section 932.9(d) states that a Federal Home Loan Bank may extend any additional unsecured credit to such counterparty, but only in compliance with the limitations that are calculated using the lower maximum exposure limits.

Guidance

The terminology “the next lower grade” applies to the five grades or categories referenced in Table 4 in Section 932.9(a)(4) of the regulation (e.g., AAA, AA, A, BBB and BB in the case of S&P and Fitch). Modifiers should be ignored. Therefore, when a counterparty is rated “AA+” (second highest investment grade) and is placed on credit watch, the rating that should be applied by the Bank in calculating the applicable unsecured credit limit is “A” (third highest investment grade) until such time as the counterparty is removed from credit watch either by downgrade or otherwise.