

2015 Annual Stress Test Disclosure

*Results of the Severely Adverse Scenario Prescribed by
the Federal Housing Finance Agency*

July 23, 2015

**As Required by the Dodd-Frank
Wall Street Reform and Consumer Protection Act**



Member driven.
Community focused.

Forward-Looking Information

This presentation contains forward-looking statements and projections that involve risks or uncertainties. Forward-looking statements in this presentation include projections of the Federal Home Loan Bank of Dallas' ("Bank") financial condition and results of operations under a hypothetical stress scenario, which incorporates a set of assumed economic conditions prescribed by the Bank's regulator, the Federal Housing Finance Agency. These projections are not intended to be, nor should they be construed as, the Bank's forecast of expected future economic conditions or a forecast of the Bank's expected future financial condition or results of operations. Rather, these projections reflect possible results under the prescribed hypothetical scenario. The Bank's future financial condition and results of operations will be influenced by actual economic and financial conditions as well as various other factors including, but not limited to, those described in the reports that the Bank files with the U.S. Securities and Exchange Commission. Any duty to update these forward-looking statements is disclaimed.

Executive Summary

Background

- The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) requires certain financial companies with total consolidated assets of more than \$10 billion, and which are regulated by a primary federal financial regulatory agency, to conduct annual stress tests to determine whether the companies have the capital necessary to absorb losses under adverse economic conditions.
- In September 2013, the Federal Housing Finance Agency (“FHFA”), regulator of the Federal Home Loan Banks (“FHLBanks”), implemented annual stress testing rules for the FHLBanks as required by the Dodd-Frank Act. Annually, the Federal Home Loan Bank of Dallas (“Bank”) is required to submit to the FHFA the results of stress tests based on three scenarios: baseline, adverse and severely adverse.
- In accordance with the FHFA’s rules, the Bank has disclosed in this document the stress test results for the severely adverse scenario.

Requirements

- The FHFA provided inputs and key assumptions for the severely adverse scenario.
- The stress test was based on the Bank’s portfolio as of September 30, 2014 and incorporates its expectations for future business during the period from the fourth quarter of 2014 through the fourth quarter of 2016, the nine-quarter plan horizon prescribed by the FHFA. Results were projected over that nine-quarter period, starting with balances as of September 30, 2014. By order of the FHFA, the results for the nine-quarter period are presented herein on a cumulative basis.
- The stress test results under the FHFA’s severely adverse scenario should not be viewed as forecasts of expected or likely outcomes of future results. Rather, the results from this hypothetical stress scenario provide a measure of the potential impact that the FHFA’s severely adverse scenario could have on the Bank’s future results and capital position.

Results

- The Bank's stress test results demonstrated capital adequacy under severely adverse economic conditions throughout the nine-quarter planning horizon. The projected capital balances and ratios as of December 31, 2016 (the end of the planning horizon) are set forth below.
 - Total projected regulatory capital of \$2.163 billion.
 - Projected permanent capital ratio of 4.99% as compared to the regulatory requirement of 4.00%.
 - Projected leverage capital ratio of 7.48% as compared to the regulatory requirement of 5.00%.
 - Total projected GAAP¹ capital of \$2.009 billion.

Use/Governance

- Stress testing has evolved as an important analytical tool for evaluating capital adequacy under adverse economic conditions. The Bank regularly uses stress tests in its capital planning to measure its exposure to material risks and to evaluate the adequacy of capital resources available to absorb potential losses arising from those risks.
- Among other things, the Bank takes the results of its annual stress tests required by the Dodd-Frank Act into account in making changes, as appropriate, to the Bank's capital structure (including the level and composition of capital); its exposures, concentrations and risk positions; any plans for recovery and resolution; and to improve its overall risk management. No changes to the Bank's current capital management activities or dividend practices were assumed in the stress test projections.
- The Bank's stress test policies and procedures were reviewed and approved by the Bank's Board of Directors. The Bank's stress test results were reviewed with the Bank's Board of Directors.

¹ Generally Accepted Accounting Principles in the United States.

Stress Test Components

Net Interest Income + Other Non-Interest Income, Net

- Includes net interest income, other income (loss) and other expenses.

Provision for Credit Losses on Mortgage Loans

- Provision for credit losses on mortgage loans held for portfolio.

OTTI Credit Losses

- Credit component of other-than-temporary impairment (“OTTI”) losses on non-agency (private-label) residential mortgage-backed securities (“MBS”) classified as held-to-maturity (“HTM”).

Mark-to-Market Gains (Losses)

- Fair value gains (losses) on derivatives and trading securities.

Global Market Shock

- Losses recognized in other comprehensive income (“OCI”) resulting from an instantaneous widening of option adjusted spreads (“OAS”) that were applied to the Bank’s holdings of agency and PEFCO debentures and agency commercial MBS (“CMBS”) classified as available-for-sale (“AFS”). This component also includes the non-credit component of OTTI losses which were based upon prescribed instantaneous price declines applied to other than temporarily impaired non-agency residential MBS (“RMBS”) classified as HTM, which are recognized in OCI.

Counterparty Default Losses

- Losses resulting from an instantaneous and unexpected default of the Bank’s largest counterparty (as measured by the amount of the loss) emanating from its secured and unsecured lending, reverse repurchase agreements and derivative positions.

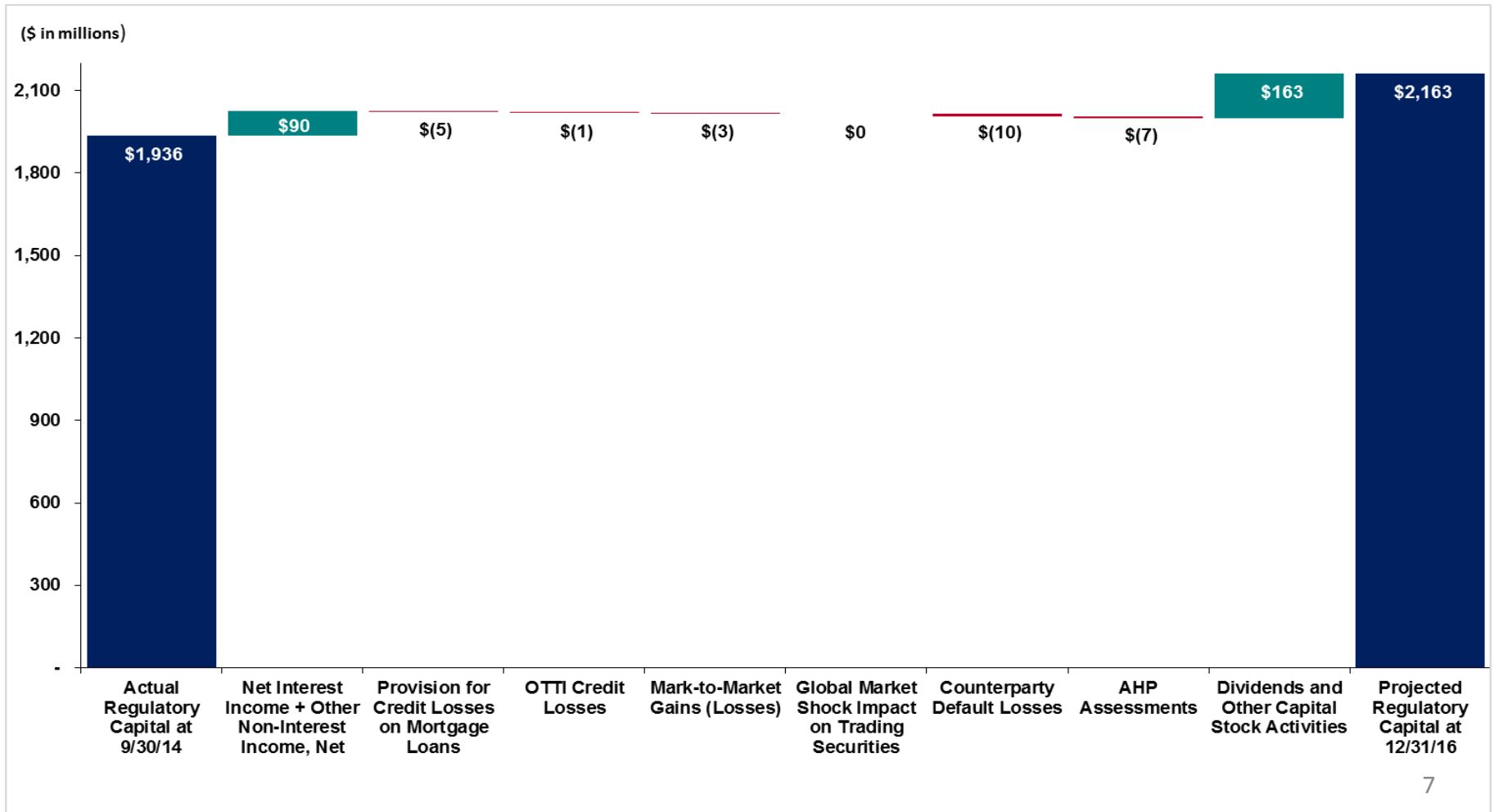
Severely Adverse Scenario Results

FHFA Dodd-Frank Stress Test Template - SEVERELY ADVERSE SCENARIO (In thousands, except percentages)

	Cumulative Projected Financial Metrics (Q4 2014 - Q4 2016)
1 Net interest income + other non-interest income, net	90,180
2 (Provision) benefit for credit losses on mortgage loans	(4,620)
3 OTTI credit losses	(880)
4 Mark-to-market gains (losses)	(2,970)
5 Global market shock impact on trading securities	-
6 Counterparty default losses	(9,640)
7 AHP assessments	(7,230)
8 Net income (loss)	64,840
9 Other comprehensive income (loss)	(158,190)
10 Total comprehensive income (loss)	(93,350)
11 Total capital (GAAP) - starting	1,939,545
12 Total capital (GAAP) - ending	2,008,860
13 Regulatory capital ratio - starting	5.17%
14 Regulatory capital ratio - ending	4.99%

Regulatory Capital Analysis Under Severely Adverse Scenario

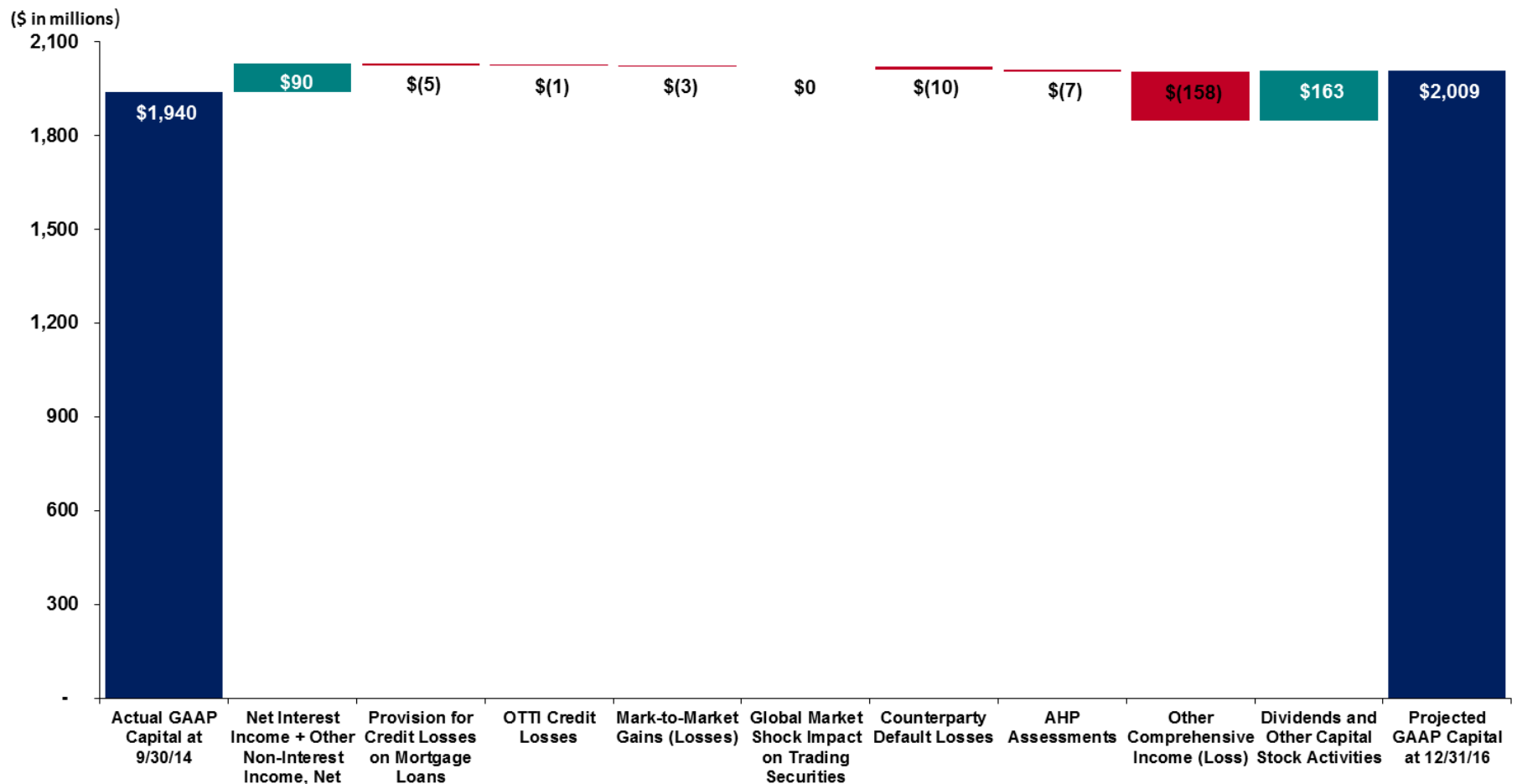
- Regulatory capital, which is comprised of capital stock - putable, retained earnings and mandatorily redeemable capital stock, increases from \$1.936 billion at 9/30/14 to \$2.163 billion at 12/31/16.
- Results shown below are modeled projections, except for actual regulatory capital at 9/30/14.



GAAP Capital Analysis

Under Severely Adverse Scenario

- GAAP capital, which is comprised of capital stock - putable, retained earnings and accumulated other comprehensive income (loss), increases from \$1.940 billion at 9/30/14 to \$2.009 billion at 12/31/16.
- Results shown below are modeled projections, except for actual GAAP capital at 9/30/14.



Severely Adverse Scenario

Key Assumptions Provided by FHFA

Macroeconomic Variables	
Residential House Prices (<i>Decline over the plan horizon</i>)	-25%
Commercial Real Estate Prices (<i>Decline over the plan horizon</i>)	-35%
Real Gross Domestic Product (<i>Annual GDP growth rate</i>)	-3.7% (2015)/+2.1% (2016)
Unemployment Rate (<i>Peak in Q2 2016</i>)	10.1%
Interest Rate Variables	
30-yr Mortgage Rate (<i>Average over the plan horizon</i>)	4.7%
10-yr Treasury Rate (<i>Average over the plan horizon</i>)	1.4%
Global Market Shock	
Instantaneous price shocks on non-agency OTTI HTM securities	-69.1% to -82.9%
Instantaneous OAS shocks on:	
Agency and PEFCO debentures classified as AFS	OAS widening of 20 basis points
Agency CMBS classified as AFS	OAS widening of 190 basis points

Component Methodologies

Net Interest Income + Other Non-Interest Income, Net

Description

- Reflects projections of net interest income, other income (expense) and other expenses over the nine-quarter plan horizon.
- Material risks covered include interest rate risk, operational risk and business risk.

Methodologies

- Net interest income was estimated by projecting portfolio balances, funding mix, and spreads using the macroeconomic variables provided by the FHFA and management assumptions. Notable management assumptions include those for advances and the Bank's mortgage loan, MBS and short-term liquidity holdings. Advances balances as of December 31, 2014, 2015 and 2016 were projected to approximate \$20.4 billion, \$21.8 billion and \$24.0 billion, respectively. At those same dates, mortgage loans held for portfolio (MPF) were projected to approximate \$70 million, \$0.5 billion and \$1.8 billion, respectively (the Bank intends to resume acquiring mortgage loans in the second half of 2015). MBS holdings were maintained throughout the plan horizon at an amount equal to 300% of the Bank's total regulatory capital. The Bank's short-term liquidity holdings were maintained throughout the plan horizon at approximately \$6.0 billion.
- Other income (loss) and other expenses were estimated based upon management's assumptions. Operating expenses, the most significant item comprising other income (loss) and other expenses, was based on actual expenses for the fourth quarter of 2014, the Bank's operating budget for 2015 and, for 2016, the 2015 budget increased by 1.4%. Operational risk losses, totaling \$9.8 million, were informed by the Bank's Annual Risk Assessment, management's judgment and relevant external data.

Provision for Credit Losses on Mortgage Loans

Description

- Reflects projected credit loss provisions for mortgage loans held for portfolio.
- Captures mortgage credit risk.

Methodologies

- Loan loss reserves related to projected mortgage loan acquisitions were forecasted using roll rates and loss severities based upon aggregate FHLBank system-wide MPF loan experience.

Component Methodologies

OTTI Credit Losses

Description

- Reflects projected credit-related losses on non-agency RMBS classified as HTM.
- Material risks covered include credit risk associated with the Bank's long-term investment portfolio, which is comprised of securities classified as AFS and HTM.

Methodologies

- OTTI credit losses on non-agency RMBS were estimated by projecting cash flow shortfalls based on FHFA-provided assumptions as well as management's assumptions for housing prices, interest rates and mortgage rates. No OTTI credit losses were assumed to occur on any of the Bank's holdings of agency RMBS or CMBS, agency debentures, PEFCO debentures or U.S. government-guaranteed obligations.

Mark-to-Market Gains (Losses)

Description

- Reflects projected fair value gains (losses) on derivatives and securities classified as trading.
- Material risk covered includes market risk.

Methodologies

- Based upon FHFA-provided assumptions, no losses were assumed to occur on the Bank's holdings of U.S. Treasury Bills classified as trading. For freestanding derivative positions (i.e., those not in a hedging relationship for accounting purposes), the Bank applied a combination of FHFA-specified interest rates and management's interest rate assumptions to derive the projected fair value changes throughout the plan horizon.

Component Methodologies

Global Market Shock

Description

- Reflects projected OCI losses resulting from an instantaneous OAS widening applied to agency CMBS, agency debentures and PEFCO debentures classified as AFS as well as instantaneous price declines applied to OTTI non-agency RMBS classified as HTM. The losses recognized in OCI are not recovered during the plan horizon.
- Material risk covered includes market risk.

Methodologies

- The Bank applied FHFA-specified shocks, in the first quarter of the nine-quarter plan horizon, to its holdings of agency debentures, PEFCO debentures, agency CMBS and OTTI non-agency RMBS:
 - OTTI non-agency RMBS: prescribed price declines ranging from -69.1% to -82.9%
 - Agency CMBS: OAS widening of 190 basis points
 - Agency and PEFCO debentures: OAS widening of 20 basis points

Counterparty Default Losses

Description

- Reflects instantaneous and unexpected default of the Bank's largest counterparty (as measured by the amount of the loss).
- Material risks covered include unsecured and secured lending, reverse repurchase agreements and derivative exposures, excluding advances and overnight federal funds sold.

Methodologies

- The largest counterparty net stressed exposure was identified by applying the FHFA-specified interest rate shock to all reverse repurchase agreements and derivative positions. For reverse repurchase agreements, the pledged securities collateral was priced using FHFA-specified assumptions to derive the amount of the loss. For each of the Bank's bilateral derivative counterparties, the cash collateral held or pledged was combined with the resulting net fair value of the derivatives to determine the net gain or loss position (no securities or other collateral was pledged to or from the Bank's bilateral derivative counterparties as of September 30, 2014). Based upon these calculations, the counterparty representing the largest net loss to the Bank was assumed to default. Recoveries were capped at 10% of the projected net loss amount. Based upon FHFA-provided assumptions, derivatives cleared through a third-party central clearinghouse were excluded from the counterparty default scenario component.

Key Risks Considered

Market Risk

- The risk to earnings or capital arising from changes in the estimated fair value of investment securities, mortgage loans and other financial instruments due to changes in the level, volatility, or correlations among financial market rates or prices, including interest rates. Specifically, market risk to the Bank includes the risk that the estimated fair value of the Bank's financial instrument portfolio (and, in particular, its long-term investment portfolio) will decline as a result of changes in interest rates and/or changes in spreads.

Credit Risk

- The risk to earnings or capital arising from the default, inability, or unwillingness of a borrower, obligor or counterparty to meet the terms of any financial obligation with the Bank or otherwise perform as agreed. Specifically, credit risk to the Bank as it pertained to the stress test included the risk of loss due to defaults on principal and interest payments on advances, mortgage loans, MBS, interest-rate exchange agreements and unsecured extensions of credit. No losses on advances were assumed to occur over the plan horizon.

Operational Risk

- The risk of loss resulting from inadequate or failed processes, systems, human factors or external events. Operational risk is inherent in the Bank's business activities and can manifest itself in various ways, including accounting or operational errors, business interruptions, fraud and technology failures. This definition includes legal risk, which is the risk of loss arising from defective transactions, litigation or claims made, or the failure to adequately protect company-owned assets.

Business Risk

- The risk of an adverse effect on the Bank's profitability resulting from external factors that may occur in both the short and long term. Business risk includes the impact of regulatory risk. Declines in business may affect the Bank's capital levels by reducing its activity-based capital stock balance and slowing the pace at which the Bank can build its retained earnings. In addition, a reduction in capital levels would limit the Bank's ability to purchase additional investments, thereby further limiting potential income and growth. No changes to the Bank's baseline projections of business activity were assumed to occur as a result of the severely adverse stress test scenario.