



Federal Housing Finance Agency

REGULATORY INTERPRETATION

2009-RI-01

June 4, 2009

Subject: Eligibility of Federally Guaranteed Student Loans as Collateral.

Issue: Whether changes in the law relating to the manner in which federal guarantees on defaulted student loans are paid warrant the rescission of a regulatory interpretation that had excluded such loans as eligible collateral.

Conclusion: Statutory changes that provide holders of federally guaranteed student loans a direct claim on federal assets allow such loans to qualify as eligible collateral.

Background:

The Federal Home Loan Bank Act (Bank Act) requires a Federal Home Loan Bank (Bank) to obtain a security interest in certain types of eligible collateral whenever it makes or renews an advance to a member. One such category of eligible collateral includes securities that are issued, insured or guaranteed by the United States or an agency of the United States. 12 U.S.C. § 1430(a)(3)(B).

The regulations of the Federal Housing Finance Board (Finance Board) include within the category of “government securities” any “mortgages or other loans . . . to the extent that . . . [they are] insured or guaranteed by the United States or any agency thereof, or otherwise . . . [are] backed by the full faith and credit of the United States, and such insurance, guarantee or other backing is for the direct benefit of the holder of the mortgage or loan.” 12 C.F.R. § 950.7(a)(2). Any asset-backed securities that represent an interest in the above-described collateral also are eligible as government securities collateral.

In 1999, a Bank sought a regulatory interpretation confirming that it could accept guaranteed student loans (GSLs) made under the Federal Family Education Loan Program (FFELP) as collateral from one of its members. That member also served as the state “guaranty agency” responsible for administering the GSL program in its state, and as such

was entitled to make claims on defaulted GSLs directly to the Department of Education (DOE).

Under the FFELP as in effect at that time, a state guarantee agency provided a guarantee to the holders of GSLs in accordance with Title IV of the Higher Education Act of 1965, as amended. 20 U.S.C. §§ 1001, *et seq.* If a student loan borrower were to default, the holder of a GSL could file a claim with the state guarantee agency, which would pay the holder a portion of the unpaid principal balance and accrued interest on the GSL, provided the loan had been serviced properly and otherwise complied with applicable regulations. The amount guaranteed typically would be 97 percent of the outstanding principal balance, but could be less if the holder had not met its obligations with regard to servicing the loans. The state guarantee agency, in turn, would file a claim with the DOE, which reinsured the guarantee agency for the amounts it had paid to holders of defaulted GSLs, provided that the guarantee agency had met its obligations under applicable laws and regulations.

In response to the Bank's request, the Finance Board issued Regulatory Interpretation 1999-RI-12, which concluded that federally guaranteed student loans are not eligible collateral for Bank advances. In reaching that conclusion, the Finance Board cited statements it had made in an earlier rulemaking relating to eligible collateral. In that rulemaking, the Finance Board declined a commenter's request to include GSLs as "government securities" because the federal guarantee did not run directly to the holder of a GSL, *i.e.*, the holder would be paid by the guarantee agency, which was not a part of the United States government, rather than by the DOE. Though the Finance Board made clear that it did not intend to say that GSLs could never qualify as "government securities," it was not prepared to include any instruments as government securities in any case in which the holder was not the direct beneficiary of a guarantee from the United States or its agencies. 64 Fed. Reg. 16618, 16620 (April 6, 1999).

Relying on that earlier analysis, the regulatory interpretation concluded that the role of the state guarantee agency as an intermediary between the holder of a GSL and the DOE precluded the federal guarantee from being deemed to be for the "direct benefit" of the holder of the GSL, as was required by the regulations of the Finance Board. See 12 C.F.R. § 935.9(a)(2)(ii) (1999) (currently codified at 12 C.F.R. § 950.7(a)(2)(ii)). Because the particular member on behalf of which the Bank had submitted the request also served as the guarantee agency for its state, however, and thus had a right to file claims directly with the DOE, the regulatory interpretation further concluded that the Bank could accept GSLs as collateral for advances made to that particular member.

Higher Education Amendments. In 1998, Congress amended the Higher Education Act of 1965 to revise certain aspects of the statutes under which GSLs are administered and guaranteed. Public Law 105-244, 112 Stat. 1581 (October 7, 1998). The amendments most relevant to this issue significantly altered the manner in which the guarantee agencies

hold and administer the funds that are used to pay claims of lenders holding defaulted GSLs.

The 1998 amendments required each guarantee agency to establish two separate financial accounts: a “Federal Fund” and an “Agency Operating Fund”. The amendments explicitly stated that the monies in the Federal Fund are to be used solely to pay lender claims on defaulted GSLs (and certain related expenses) and that the assets and earnings of the Federal Fund are the sole property of the United States. 20 U.S.C. § 1072a(b), (d), (e). The amendments further stated that the monies in the Operating Fund are to be used for the operating expenses of the guarantee agency and are the property of the guarantee agency. 20 U.S.C. § 1072b(d), (e).

In 1999, the DOE proposed regulations to implement the 1998 amendments to the Higher Education Act. In the proposed rule, the DOE stated that the guarantee agencies serve as fiduciaries in safeguarding the monies in the Federal Fund, and may not use any assets of the Federal Fund for purposes not authorized by the DOE. 64 Fed. Reg. 42176, 42183 (August 3, 1999). When DOE issued final regulations, which took effect on July 1, 2000, it reiterated that the guarantee agency’s role with respect to the assets in the Federal Fund is that of a trustee for the benefit of the DOE. 64 Fed. Reg. 58622, 58624 (October 29, 1999). The current regulations of the DOE reflect those views, and provide that a guarantee agency may use monies in the Federal Fund only to pay insurance claims on GSLs, and certain related items, and that the assets and earnings of the Federal Fund are at all times the property of the United States. 34 C.F.R. § 682.419 (2008).

Analysis:


The applicable Finance Board regulations allow a loan to be deemed to be a government security for collateral purposes only if the loan is insured or guaranteed by the United States or its agencies, and that insurance or guarantee runs directly to the holder of the loan. 12 C.F.R. § 950.7(a)(2). The manner in which the guarantee agencies made payments to holders of defaulted GSLs under the law and regulations in effect in 1999 was a determinative factor in leading the Finance Board to conclude that the federal guarantee associated with GSLs did not run to the direct benefit of the holders of those loans, which effectively precluded them from being characterized as “government securities”.

With the amendments to the Higher Education Act in 1998 and the subsequent adoption of regulations by the DOE, however, the factors that prompted the Finance Board to decline to include GSLs within the category of government securities ceased to exist. Indeed, it is now clear that a state guarantee agency making payments to holders of defaulted GSLs is acting solely as a fiduciary for the DOE in disbursing federal monies directly to claimants under a federal loan guarantee program. In light of the changes to the legal nature of the monies used by the state guarantee agencies in administering the GSL programs, the Finance Agency has determined that the federal guarantee for defaulted GSLs does run to the direct benefit of the holder of those loans. Accordingly, such GSLs

and securities backed by such GSLs do qualify as government securities for purposes of 12 C.F.R. § 950.7(a)(2)(ii) and (iii), and may be accepted by a Bank as collateral for advances to its members.

This regulatory interpretation addresses only the legal aspects relating to the eligibility of GSLs as collateral for Bank advances. A Bank contemplating accepting GSLs as collateral from its members must file a new business activity submission with the Finance Agency before commencing this new activity, in order to demonstrate that it has the appropriate personnel and systems in place to manage the risks associated with this collateral. See 12 C.F.R. Part 980.

Effective as of the date of this regulatory interpretation, 1999-RI-12 is rescinded.

By: 
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