

This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

## FEDERAL HOUSING FINANCE BOARD

12 CFR Parts 935 and 940

(No. 92-727)

### Advances

**AGENCY:** Federal Housing Finance Board.

**ACTION:** Proposed rule.

**SUMMARY:** The Federal Housing Finance Board (Board) is proposing to amend its regulations to establish revised and new requirements governing secured loans (called advances) made by the Federal Home Loan Banks (Banks). The proposed rule modifies or renews existing regulations and implements provisions in the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), which amended the Federal Home Loan Bank Act of 1982 (Act). The proposed rule also transfers the Board's Statements of Policy on Advances from one regulatory part to another, as discussed in the

**SUPPLEMENTARY INFORMATION:** Section.

**DATES:** Comments must be submitted in writing to the Board by November 30, 1992.

**ADDRESSES:** Written comments may be mailed to: Executive Secretariat, Federal Housing Finance Board, 1777 F Street, NW., Washington, DC 20006. Comments will be available for public inspection at this address.

**FOR FURTHER INFORMATION CONTACT:** Christine M. Freidel, Financial Analyst, (202) 408-2978; Thomas D. Sheehan, Assistant Director, District Banks Directorate, (202) 408-2870; James H. Gray, Jr., Associate General Counsel, (202) 408-2552; Sharon B. Like, Attorney-Advisor, (202) 408-2930; Charles J. Szelner, Attorney-Advisor, (202) 408-2554, Office of Legal and External Affairs; Federal Housing Finance Board, 1777 F Street, NW., Washington, DC 20006.

### SUPPLEMENTARY INFORMATION:

#### I. Background

The Federal Home Loan Bank System (System) is comprised of 12 District Banks. Each Bank is federally chartered, wholly owned by its members and managed by a board of directors that sets policies pursuant to regulations and guidelines established by the Board. The Banks act as intermediaries in the capital markets, raising funds on favorable terms and passing the proceeds on to member institutions in the form of advances. Advances are required to be fully secured, primarily by residential mortgage collateral, see 12 U.S.C. 1430(a), and are made available over a range of maturities. The Board is responsible for supervising the Banks, and ensuring that the Banks: (1) Remain adequately capitalized and able to raise funds in the capital markets; (2) operate in a safe and sound manner; and (3) carry out their housing finance mission. See 12 U.S.C. 1422a(a)(3).

All savings institutions insured by the Savings Association Insurance Fund (SAIF) of the Federal Deposit Insurance Corporation (FDIC) are members of the System, as are many savings banks insured by the FDIC's Bank Insurance Fund, and a limited number of insurance companies. With the passage of FIRREA, membership in the System also was opened to federally insured commercial banks and credit unions that make long-term home mortgage loans and that have at least 10 percent of their total assets in residential mortgage loans. See 12 U.S.C. 1424(a).

Each member is required to hold stock in its Bank based upon the level of the member's mortgage-related assets and outstanding advances. See 12 U.S.C. 1426. Bank stock pays dividends, is not publicly traded, and is redeemable at par. See *id.*

#### II. Analysis of Proposed Rulemaking

##### Subpart A—Advances to Members

##### A. Primary Credit Mission of the Banks

Section 935.2 of the proposed rule sets forth the primary credit mission of the Banks, which is to enhance the availability of residential mortgage credit by providing a readily available, economical and affordable source of funds in the form of advances to their member institutions. In order to carry out this mission, the Banks shall offer competitively priced advance products

and programs that satisfy their members' credit needs. Limitations on advances, beyond those specifically prescribed by statute, regulation, policy or other requirements of the Board, shall be those that protect the financial integrity of a Bank and accommodate the practical constraints associated with a Bank's ability to raise funds.

##### B. Bank Advances Policies and Application for Advances

Section 935.3 of the proposed rule continues the requirement in the Board's current regulation that each Bank's board of directors adopt, and review at least semiannually, a policy on extending advances to members of that Bank. Each Bank's policy shall be consistent with the requirements of the Act, 12 U.S.C. 1421 *et seq.*, this part, and general guidelines established by the Board, as reflected in its resolutions, orders, or manuals. A Bank's board of directors may designate officers authorized to extend or deny credit, or take other actions consistent with the Bank's advances policy. Exceptions to a Bank's policy must receive the approval of its board of directors, a committee thereof, or officers specifically authorized by the board of directors to approve exceptions. Such exceptions to Bank policy must comply with the Act, this part, and policies and guidelines of the Board.

Section 935.4 of the proposed rule requires the Banks to enter into advances and security agreements with their members that govern the terms and conditions under which credit will be extended. Section 935.4(a) permits a Bank to accept oral or written applications for advances from its members. Section 935.4(b) specifies that a Bank shall require any member applying for an advance to enter into a primary and unconditional obligation to repay such advance and all other indebtedness to the Bank. Section 935.4(c)(1) provides that a Bank shall make only fully secured advances to its members. Section 935.4(c)(2) provides that a Bank shall execute a written security agreement with each borrowing member that gives the Bank a perfectible security interest in the collateral pledged to secure the advances. In practice, the advances and security agreements may be consolidated in one document. Such document may also constitute a master

agreement covering all outstanding advances by a Bank to a member.

Section 935.4(d) of the proposed rule requires a Bank's board of directors, or a delegated committee thereof, to approve the Bank's advances application forms, advances agreements, and security agreements. A Bank's board is not required to approve each revision to an already approved form, if the resulting document is substantially the same as the previously approved form. The Act requires that the form for the advance application, as well as the form of the document evidencing a member's obligation to repay outstanding advances, be approved by the Board, 12 U.S.C. 1429, 1430(d). The proposed rule deems the forms to be approved by the Board, if the terms of the documents comply with the prescribed requirements of this part. The Banks are required to provide the Board with copies of their standard advances and security agreements, as well as any substantive revisions thereto.

#### C. Limitations on Access to Advances

Section 935.5(a) of the proposed rule implements 12 U.S.C. 1429 by authorizing the Banks, in their discretion, to limit or deny a member's application for an advance, or to approve it on such additional terms as the Bank may prescribe, subject to the Act, this part, and Board policy guidelines. Advances may be limited or denied if, in the Bank's judgment, a member is engaged or has engaged in any unsafe or unsound business practices, has inadequate capital, is sustaining operating losses, has financial or managerial deficiencies that bear upon the member's creditworthiness, or has any other deficiencies as determined by the Bank.

Section 935.5(b) of the proposed rule sets forth new requirements for Bank lending to certain capital deficient members. These requirements were adopted in part as Board policy in April, 1992 (see Board Resolution No. 92-277.1). The Board today proposes to revise and incorporate these guidelines into its advances regulation, and specifically requests comment on all aspects of the new requirements.

Prior to the adoption of the policy guidelines, there were no Board-mandated restrictions on a Bank's ability to lend to an insolvent member. Although the secured nature of advances protects the Banks from credit risk, the Board is concerned that, by making advances available to certain capital deficient members, a Bank may inadvertently be acting contrary to the wishes of a member's primary Federal regulator. Section 935.5(b)(1) of the

proposed rule, therefore, restricts a Bank from making a new advance to a member that does not have positive tangible capital, unless the member's appropriate Federal banking agency or insurer requests in writing that funding be made available to such member, and the Bank determines in its discretion that it may safely make such advance to the member.

Section 935.1 of the proposed rule defines "tangible capital" as capital, calculated according to Generally Accepted Accounting Principles (GAAP), less intangible assets, as reported in a savings association member's Thrift Financial Report (TFR), or a commercial or savings bank member's Report of Condition and Income (Call Report). GAAP capital currently is reported as "equity" capital on the Call Report and TFR. For credit unions and insurance company members, the level of tangible capital will be determined by the Bank, consistent with the parameters used for savings association and commercial bank members.

In defining tangible capital, the Board is proposing a standard that is consistent with the approach suggested by the FDIC in its proposed rulemaking on prompt corrective action. See 57 FR 29662 (July 6, 1992). The prompt corrective action procedures provide a framework for determining supervisory action. The FDIC has proposed to implement prompt corrective action procedures based on an institution's level of Tier 1 capital or core capital. GAAP capital less intangible assets results in a definition of tangible capital that is similar to Tier 1 or core capital, as defined by the Federal banking regulators. See *e.g.*, 12 CFR part 3, appendix A, section 2(a) (Office of the Comptroller of the Currency); 12 CFR part 208, appendix A, II.A.1 (Federal Reserve Board); 12 CFR 325.(m) (FDIC); 12 CFR 567.5(a) (Office of Thrift Supervision (OTS)).

The proposed definition will allow the Banks to easily verify most federally insured depository institution members' capital positions, using information from members' TFRs, Call Reports or financial statements, since these documents are reviewed at the time of application for an advance. Each Bank will determine the level of tangible capital held by credit union and insurance company members, since regulatory capital for these members is more variable and includes certain insurance and reserve accounts that may not be appropriate to the definition of tangible capital.

The Board realizes that placing restrictions on advances to members

without positive tangible capital could cause liquidity problems for these members. Therefore, proposed § 935.5(b)(2) permits renewals of existing advances to these members for periods of up to 30 days, if the Bank determines that such renewals can be safely made. Such renewals may be extended for successive 30-day terms if the Bank determines that it may safely make such extensions to the member. The renewal authority should provide the member with time to identify alternative sources of funds that can be used to repay maturing advances and fund ongoing operations. Renewals may be for periods longer than 30 days if requested by the member's appropriate regulator or insurer and agreed to by the Bank.

Section 935.5(c) of the proposed rule provides that, in the case of members that are not federally insured depository institutions, the provisions in § 935.5(b) may be implemented upon a written request from the member's state regulator.

Section 935.5(d) of the proposed rule requires each Bank to provide the Board with a monthly report of outstanding Bank advances and commitments to all members. It also directs the Banks, upon written request from a member's appropriate Federal banking agency, insurer or state regulator, to provide to such entity information on advances and commitments outstanding to the member.

The proposed rule does not include an existing Board policy provision that directs each Bank to honor written requests from a member's regulator or insurer to limit or deny a tangibly solvent member's access to advances. This provision has been removed in acknowledgment of the sufficiency of current mechanisms available to the members' regulators for denying an institution's access to outside funding.

Section 935.5(e) of the proposed rule requires that the written advances agreement required by § 935.4(b)(2) of the proposed rule shall stipulate that a Bank shall not fund commitments for advances previously made to members whose access to advances has subsequently been restricted pursuant to § 935.5(b).

In proposing the above restrictions on advances, the Board recognizes the authority and responsibility of the regulators and the insurer to supervise and regulate member activities. The restrictions are designed solely to ensure that the Banks do not unintentionally undermine regulatory intent. The Board specifically requests comment on all aspects of this proposal

to restrict access to advances by members without positive tangible capital.

#### D. Terms and Conditions for Advances

Section 935.6(a) of the proposed rule continues the Board's regulatory requirement that the Banks offer advances with maturities of up to ten years. The proposed rule also authorizes each Bank to offer advances with maturities of any length, consistent with the safe and sound operation of the Bank. This is consistent with the Board's recently promulgated interim final rule, see 57 FR 42,888 (Sept. 17, 1992), eliminating an earlier Board regulatory requirement that advance maturities not exceed 20 years.

The requirement that the Banks offer advances with maturities of up to ten years is designed to ensure that a sufficient variety of advance maturities is available to assist members in their asset/liability management. Members frequently hedge against interest rate movements by funding their long-term home mortgage loans, which generally have an average life between five and ten years, with matching term Bank advances. Long-term advances provide an important funding source for non-conforming loans for which the secondary market has not been a viable financing alternative.

The Board's recent rulemaking that allows the Banks to offer advances with maturities greater than 20 years facilitates the Bank's support of affordable housing finance. Some participants in the Affordable Housing Program (AHP), see 12 U.S.C. 1430(j), had requested AHP loans from Bank members with maturities greater than 20 years in order to lock in financing over the life of a project. However, members were often understandably reluctant to provide such long-term financing without matched funding. The availability of Bank advances with maturities greater than 20 years enables members to match fund such projects and avoid interest rate risk exposure.

Although offering longer-term funding could expose the Banks to additional interest rate risk, their ability to raise long-term debt, the availability of hedging options, and the Bank's expertise in asset/liability management will allow them to offer advances with a broad range of maturities without undue financial risk. The Banks will offer such funding only to the extent they are able to control their own interest rate risk exposure.

Section 935.6(b)(1) of the proposed rule eliminates a current Board policy requirement that the Banks generally price advances within a prescribed

schedule of minimum and maximum mark-ups over their cost of issuing consolidated obligations (COs). Each Bank would instead be required to price advances taking into account its marginal cost of raising matching maturity funds in the marketplace, as well as any administrative and operating costs associated with making the advances. Advances offered through a Bank's AHP are exempt from this requirement. See 12 U.S.C. 1430(j).

Under the Board's current policy pricing schedule, the Banks are required to price advances within a specified range above their estimated cost of issuing COs. A required minimum mark-up of 20 basis points over the cost of COs applies across the maturity spectrum. The maximum permissible mark-up on advances declines from a high of 120 basis points over the cost of COs for advances with maturities greater than six months and less than or equal to one year, to a low of 60 basis points over the cost of COs for advances with maturities greater than nine years.

At the time the pricing schedule was established, COs dominated Bank funding. However, while COs remain the Banks' primary funding source, member deposits now comprise about 24 percent of the System's liabilities. Since deposits can be a lower cost funding alternative for short-term advances, a Bank's overall short-term cost of funds may at times be lower than the cost of issuing COs. By removing the minimum mark-up, the Board is encouraging the Banks' efforts to provide attractively priced funding to their members.

Moreover, the minimum and maximum mark-ups have not met their intended policy objectives. The intent of the 20 basis point minimum mark-up was to preclude the Banks from pricing advances below their total cost of funding the advances. When the pricing schedule was established, individual Bank operating expenses, as a percentage of assets, ranged from ten to 18 basis points. The Banks have subsequently introduced operating efficiencies that have significantly reduced the cost of their operations.

Rather than continuing to use a pricing schedule based on static expense figures, which may or may not be accurate over time, § 935.6(b)(1) of the proposed rule provides each Bank with the discretion to determine the appropriate minimum mark-up on advances based upon its current administrative and operating costs. This flexibility should enhance the Banks' regional competitiveness, since the minimum mark-up on advances will reflect an individual Bank's, rather than the System's, administrative costs.

The current maximum mark-up, which declines as advance maturities increase, was principally intended to encourage long-term lending for housing finance purposes, as well as to ensure a supply of longer-term funds at a reasonable cost to assist members in their asset-liability management. However, over the past several years the maximum mark-up has not been a binding constraint. Banks generally have priced advances well below the pricing ceiling and at relatively constant margins across the maturity spectrum.

Since the current Board policy has not significantly influenced pricing behavior, and there is no indication that the Banks are applying relatively higher mark-ups for longer-term advances, the proposed rule eliminates the maximum mark-up as well. The Board believes that the Banks will continue to price short- and long-term advances competitively absent an explicit pricing schedule. In addition, pricing flexibility allows the Banks to include hedging costs when pricing advances, particularly when market constraints inhibit their ability to match fund advances.

Section 935.6(b)(2)(i) of the proposed rule authorizes the Banks to extend credit to individual borrowers on varying terms, based upon the amount of credit risk associated with lending to a particular borrower or other reasonable criteria, provided the criteria apply equally to all members.

Section 7(j) of the Act requires that each Bank's board of directors administer the affairs of the Bank fairly and impartially and without discrimination in favor of or against a member borrower. See 12 U.S.C. 1427(j). Section 9 of the Act gives the Banks broad authority to determine the terms of an advance, subject to statutory and regulatory requirements. Specifically, it provides that a Bank may at its discretion deny any such application for an advance, or, subject to the approval of the Board, may grant it on such conditions as the Bank may prescribe. 12 U.S.C. 1429 (emphasis added).

The Board has concluded that the extension of credit on differing terms to Bank members based on the member's creditworthiness, or other reasonable criteria applied equally to all members, does not constitute "discrimination" under section 7(j) of the Act. Such a practice is consistent with the Banks' broad discretion to make advances under section 9 of the Act. It also is consistent with a Federal district court ruling in 1983 that sections 9 and 7(j) of the Act, when read together, confer upon the Banks plenary discretion in the

exercise of their lending authority. See *Fidelity Financial Corp. v. Federal Home Loan Bank of San Francisco*, 589 F. Supp. 886, 897 (N.D. Cal. 1983) *aff'd*, 792 F.2d 432 (9th Cir. 1986), *cert. denied*, 479 U.S. 1084 (1987).

Furthermore, risk-based pricing of advances should enhance the fairness of the Banks' credit programs, since terms on advances and other Bank credit products to more creditworthy members should be more favorable than those to members posing a greater credit risk to a Bank. Risk-based pricing will allow the Banks to offer competitive rates to their more creditworthy members, thereby enabling the Banks to better carry out their housing finance mission. It also will compensate the Banks for bearing any increased credit exposure associated with lending to higher risk members.

Differential pricing of advances based upon criteria other than credit risk also would be allowed, subject to the application of consistent standards to all borrowing members. For example, certain Banks have offered "volume discounts" to members who finance a certain percentage of their total assets with Bank advances. Section 935.6(b)(2)(iii) of the proposed rule requires each Bank to establish written standards and criteria for differential pricing and to apply such standards and criteria consistently and without discrimination to all borrowers.

Section 10(f) of the Act, as amended by the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), Public Law 101-73, 103 Stat. 183 (August 9, 1989), requires each Bank to establish a Community Investment Program (CIP) to provide funding for members to undertake community-oriented mortgage lending. See 12 U.S.C. 1430(i). "Community-oriented mortgage lending" is defined in section 10(f) to include loans to finance the purchase and rehabilitation of housing for low- and moderate-income families, and commercial and economic development activities benefiting low- and moderate-income families or activities located in low- and moderate-income neighborhoods. *Id.*

The Act requires that the Banks price CIP advances at the cost of consolidated Bank obligations of comparable maturities, taking into account reasonable administrative costs. *Id.* However, as noted previously, the Banks' overall short-term funding costs can at times be lower than their cost of issuing COs. Section 935.7 of the proposed rule, therefore, directs the Banks to price CIP advances as provided in proposed § 935.6, except that the cost of such CIP advances shall

not exceed the Bank's cost of issuing COs of comparable maturity, taking into account reasonable administrative costs.

#### E. Fees

The Banks currently are required by Board policy to charge prepayment fees that make them financially indifferent to a borrower's decision to prepay advances. These fees are designed to protect the Banks from interest rate risk and can be considered the price of the member's option to prepay. Since many advances are match funded and prepayments occur when interest rates fall, the Banks can suffer losses if the principal portion of the prepaid advances must be invested in lower yielding assets which continue to be funded by higher cost debt.

Under current Board policy, prepayment fees must equal 90 to 110 percent of the present value of the lost cash flow to the Bank, based upon the difference between the contract rate on the prepaid advance and the rate for a new advance of the same remaining maturity. The discount rate for calculating the present value is the current offering rate for a new advance with the same remaining maturity.

Although prepayment fees theoretically are designed to insulate the Banks from interest rate risk, the current prepayment fee structure may not adequately compensate a Bank for the loss in future cash flows due to an advance prepayment. The discount rate used in the calculation assumes that the Bank can replace the prepaid advance with a new advance. However, in the current operating environment, such opportunities have not always been readily available. The Bank is then forced to invest the prepaid principal and fees in lower-yielding assets, generally at a reduced, and sometimes even a negative, spread or to retire the underlying debt, possibly at a loss.

Therefore, § 935.8(a)(1) of the proposed rule continues the requirement that the Banks charge prepayment fees, but authorizes each Bank to determine the cost of the prepayment option. The fee shall sufficiently compensate the Bank for providing a prepayment option on an advance, and act to make the Bank financially indifferent to the borrower's decision to repay the advance prior to its maturity date.

Under proposed § 935.8(a)(2), prepayment fees are not required for advances with terms to maturity or repricing periods of six months or less, for advances funded by callable debt, or for advances which are otherwise appropriately hedged so that the Bank is financially indifferent to their

prepayment. Proposed § 935.8(a)(3) provides that a prepayment fee may be waived only by a Bank's board of directors, a designated committee of the board of directors, or officers specifically authorized by the board, and only if such waiver will not result in an economic loss to the Bank. Any such waiver must subsequently be ratified by the board of directors. The Board specifically requests comment on the proposed change to the prepayment fee requirements.

Section 935.8(b) of the proposed rule eliminates a current Board policy requirement that the Banks charge commitment fees, and provides each Bank with the discretion to charge such fees. Section 935.8(c) authorizes a Bank to charge other fees as it deems necessary and appropriate.

#### F. Eligible Collateral

Section 10(a) of the Act requires a Bank to obtain and thereafter maintain a security interest in specific types of eligible collateral at the time of origination or renewal of an advance. See 12 U.S.C. 1430(a). Prior to FIRREA, a Bank could accept without limit any collateral that had a readily ascertainable value and in which the Bank could perfect a security interest. See 12 CFR 525.7(b)(4)(1989) (superseded).

In accordance with the requirements imposed by FIRREA in section 10(a) of the Act, § 935.9(a) of the proposed rule specifies four categories of eligible collateral:

(1)(i) Fully disbursed, whole first mortgage loans on improved residential real property not more than 90 days delinquent; or  
(ii) Whole mortgage pass-through securities as defined in § 935.1 of this part.

(2) Securities issued, insured or guaranteed by the United States Government, or any agency thereof, including without limitation mortgage-backed securities as defined in § 935.1 of this part, issued or guaranteed by the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association, or the Government National Mortgage Association.

(3) Deposits in a Bank.

(4)(i) Except as provided in paragraph (a)(4)(iii) of this section, other real estate-related collateral acceptable to the Bank, if:

(A) Such collateral has a readily ascertainable value; and  
(B) The Bank can perfect a security interest in such collateral.

(ii) Eligible other real estate-related collateral may include, but is not limited to:  
(A) Non-agency mortgage-backed securities not otherwise eligible under paragraph (a)(1)(ii) of this section;

(B) Second mortgage loans, including home equity loans or lines of credit;

(C) Commercial real estate loans; and  
(D) Mortgage loan participations.

(iii) A Bank shall not permit the aggregate amount of outstanding advances to any one member, secured by such other real estate-related collateral, to exceed 30 percent of such member's capital, as calculated according to GAAP, at the time the advance is issued or renewed.

Bank in its discretion may further restrict the types of collateral it will accept based upon the creditworthiness and operations of the borrower, the quality of collateral, or other reasonable criteria.

Section 10(a)(1) of the Act provides that eligible mortgage loans under category (1) must be on "improved residential real property." See 12 U.S.C. 1430(a)(1). Section 935.1 of the proposed rule defines "residential real property" as: One-to-four family property; multifamily property; real property to be improved or in the process of being improved by the construction of dwelling units; or combination business or farm property, where at least 50 percent of the total appraised value of the combined property is attributable to the residential portion of the property. (In such cases, 100 percent of the appraised value of the combined property could be used to secure an advance.) The term "residential real property" does not include "nonresidential real property" as defined in § 935.1 of the proposed rule. "Improved residential real property" is defined as residential real property, excluding real property to be improved, or in the process of being improved, by the construction of dwelling units. The Board specifically requests comment on these definitions.

A "whole mortgage pass-through security" is narrowly defined in the proposed rule so that under category (1)(ii), only privately issued mortgage pass-through securities that represent ownership of all of the fully disbursed, whole first mortgages in an underlying pool under category (1)(i), may be pledged as collateral. Other privately issued mortgage-backed securities, including privately issued mortgage debt securities, that do not meet this requirement may qualify as collateral under category (4), see 12 U.S.C. 1430(a)(4) (other real estate-related collateral).

The Board also is considering at least two other alternative approaches that would significantly broaden the collateral eligible under category (1)(ii). First, the Board is considering the possibility that the final rule will broaden category (1)(ii) to permit the acceptance of any privately issued mortgage pass-through security that represents an equity interest in a *pro rata* share of the principal and interest

payments from the underlying fully disbursed, whole first mortgage loans, including mortgage pass-through securities that do not represent ownership of the entire pool of underlying fully disbursed, whole first mortgage loans.

Second, the Board is considering the possibility that the final rule will broaden category (1)(ii) to permit the acceptance of any privately issued mortgage-backed security that represents a *pro rata* share of principal and interest payments from an underlying pool of fully disbursed, whole first mortgage loans. This second alternative would include treating collateralized mortgage obligations or other mortgage debt securities as eligible collateral under category (1)(ii).

The approach taken in the proposed rule is based on the most conservative interpretation of the phrase "securities representing a whole interest in . . . mortgages." *Id.* This interpretation is consistent with the Joint Explanatory Statement of the Committee of Conference, H.R. Conf. Rep. No. 222, 101st Cong., 1st Sess. 427-28 (1989) reprinted in 1989 U.S. Code Cong. & Admin. News 432, 466-67 (FIRREA Conference Report). The FIRREA Conference Report states that the collateral requirements in 12 U.S.C. 1430(a), imposed by FIRREA, were intended to enable the Banks to continue to accept privately issued mortgage-backed securities as collateral. The approach taken in the proposed rule is consistent with the FIRREA Conference Report because some privately issued mortgage pass-through securities may continue to be eligible under category (1)(ii).

The FIRREA Conference Report also indicates that the Bank collateral requirements imposed by FIRREA,

preclude[ ] acceptance of interest payments or the principal payments on such loans, (iii) any security representing a subordinated interest in mortgage loans, or (iii) any security that represents an interest in a residual or other high risk mortgage derivative product.

*Id.* The proposed rule, as well as the alternative positions under consideration, would preclude these classes of securities identified in the FIRREA Conference Report from qualifying as acceptable collateral for advances, except under category (4). Accordingly, the Finance Board believes that the approach taken in the proposed rule, as well as the two alternatives under consideration, are consistent with the requirements of the Act and the legislative history as expressed in the Conference Report.

The Board is seriously considering broadening its interpretation of "whole interest" to include privately issued mortgage pass-through securities representing a *pro rata* share of principal and interest payments from the underlying mortgage loans (the first alternative above), because virtually all securities representing an interest in mortgages do not represent ownership of all of the mortgages in the underlying pool. They represent a share of the beneficial interest in the underlying pool of mortgages.

Furthermore, by specifically excluding primarily and interest only "stripped" securities, the FIRREA Conference Report can be interpreted to allow the Banks to accept privately issued securities as qualifying collateral under category (1)(ii), provided they represent a *pro rata* share of the principal and interest payments from the underlying mortgage loans. *Id.*

The second alternative, pursuant to which the Board would include in category (1)(ii) all privately issued mortgage-backed securities, including the lower risk tranches of privately issued collateralized mortgage obligations, would allow the Banks maximum flexibility to treat mortgage-related securities as eligible collateral under category (1)(ii), while still precluding acceptance of certain high risk securities specifically identified in the FIRREA Conference Report language quoted above.

The Board specifically requests comment on its interpretation of the phrase "securities representing a whole interest" in section 10(a)(1) of the Act, as well as the approach taken in the proposed rule, and the two alternatives under consideration.

Section 10(a)(2) of the Act authorizes the Banks to accept, without limitation, all types of securities issued, insured, or guaranteed by the United States government, or any agency thereof. See 12 U.S.C. 1430(a)(2). Eligible securities include, but are not limited to, those issued by the FHLMC, the FNMA, and the GNMA. Section 935.9(a)(2) of the proposed rule implements section 10(a)(2), and allows a Bank to accept as collateral stripped, residual and other high risk securities that are issued, insured or guaranteed by the United States government or one of its agencies.

Although the Board's Financial Management Policy (see Board Resolution No. 91-214, dated June 25, 1991), prohibits Bank investment in such securities due to the interest rate risk associated with holding these instruments, the Board believes that, for

collateral purposes, the Banks can protect themselves by adequately discounting the securities. It is expected that a Bank accepting such securities as collateral will have established systems in place to accurately value the collateral and will establish appropriate loan-to-value ratios.

Securities issued by the former Federal Savings and Loan Insurance Corporation (FSLIC) are considered eligible collateral under category (2). The Board has concluded that not only should FSLIC notes be considered securities issued by an agency of the United States government, but also that FIRREA, in transferring liability for the notes to the FSLIC Resolution Fund and making the United States Treasury ultimately responsible for their repayment, has effectively bestowed the full faith and credit of the United States on the FSLIC notes. As of August 31, 1992, there were only \$158 million in outstanding Bank advances secured by FSLIC notes, which is less than one percent of the System's total outstanding advances.

Mortgage-backed securities packaged by the Resolution Trust Corporation (RTC) are not issued, insured or guaranteed by the RTC in its corporate or agency capacity, and therefore are not eligible collateral under category (2). However, such securities may qualify as category (3)(ii) or category (4) collateral.

The Board interprets the inclusive language of category (4), in conjunction with the 30 percent of capital limitation, to mean that category (4) permits limited amounts of mortgage-related collateral otherwise ineligible under category (3). For example, the following types of collateral may be considered eligible under category (4): Privately-issued mortgage-backed securities not otherwise eligible under category (1)(ii); second mortgage loans, including home equity loans; commercial real estate loans; and mortgage loan participations. This list is not intended to be exclusive.

Section 935.9(a)(4) of the proposed rule interprets category (4) broadly to include any other real estate-related collateral acceptable to the Bank, if such collateral has a readily ascertainable value and the Bank can perfect a security interest in such collateral. See 12 U.S.C. 1430(a)(4). Each Bank will determine the particular types of other real estate-related collateral acceptable to that Bank, consistent with the regulatory definition of eligible collateral, and will apprise its members accordingly. However, a member's use of category (4) collateral to secure advances is limited to 30 percent of its capital, calculated according to GAAP.

at the time the advance is issued or renewed.

Proposed § 935.9(c) implements section 10(a)(5) of the Act by authorizing each Bank to require a member to pledge additional collateral to protect the Bank's secured position on outstanding advances, even though such collateral may not constitute "eligible collateral" under proposed § 935.9(a). See 12 U.S.C. 1430(a)(5). Section 935.9(d) of the proposed rule implements section 10(c) of the Act by providing that a Bank shall automatically have a lien upon, and shall hold, the Bank capital stock owned by a member as further collateral security for all indebtedness of the member to the Bank. See 12 U.S.C. 1430(c).

Section 935.9(e) of the proposed rule implements section 10(b) of the Act by prohibiting a Bank from accepting as collateral for an advance a home mortgage loan otherwise eligible as collateral for an advance, if any director, officer, employee, attorney or agent of the Bank or of the borrowing member is personally liable thereon, unless the board of directors of the Bank has specifically approved such acceptance by formal resolution, and the Board, or its designee, has endorsed such resolution. See 12 U.S.C. 1430(b).

#### G. Maintenance of Bank Security Interest in Pledged Collateral

Section 935.10 of the proposed rule implements section 10(f) of the Act (sometimes referred to as the "superlien" provision), by providing that, notwithstanding any other provision of law, the Banks have a priority interest in collateral pledged by a member ahead of other lien creditors, including a receiver or conservator, but not including bona fide purchasers for value of such collateral or creditors with a perfected security interest in the collateral under applicable state law. See 12 U.S.C. 1430(f).

This provision was added to the Act by the Competitive Equality Banking Act of 1987, Public Law 100-86, 101 Stat. 575, section 306(d) (1987). Congress, in establishing the Bank's senior creditor status, stated that the provision "recognizes the special position of the [Banks] \* \* \* as lenders to the home finance industry. H. Rep. No. 281, 100th Cong., 1st Sess. 163 (1987). The FDIC has adopted a regulation recognizing the special status of the Banks where the borrower of a Bank is in receivership. See 12 CFR 360.1.

Proposed § 935.11(a)(1) provides that a Bank may allow a borrowing member that is a depository institution to retain documents evidencing collateral pledged to the Bank, provided the member

executes an agreement with the Bank to hold the collateral solely for the benefit of the Bank and subject to the Bank's direction and control.

A Bank's ability to perfect its security interest in collateral pledged by non-depository institution members, such as insurance companies, is dependent on state law to a greater extent than is the Bank's ability to perfect its security interest in collateral pledged by depository institutions. Proposed § 935.11(a)(2) requires a Bank to take any steps necessary to ensure that its security interest in all collateral pledged by non-depository institutions for an advance is as secured as its security interest in collateral pledged by depository institutions.

Section 935.11(a)(3) of the proposed rule provides that a Bank may at any time perfect its security interest in pledged collateral securing an advance to a member. This may include requiring a member to segregate pledged collateral, or to physically deliver collateral to the Bank or to a designated third party custodian operating on behalf of the Bank.

Proposed § 935.11(b) requires the Banks to regularly verify that collateral pledged to secure advances exists. A Bank shall establish written collateral verification procedures, with standards similar to those established by the Auditing Standards Board of the American Institute of Certified Public Accountants, for verifying the existence of collateral.

Under proposed § 935.12, each Bank is required to determine the value of the collateral securing its advances, according to established written valuation procedures. The valuation procedures used to determine the value of collateral shall be applied consistently and fairly to all borrowers. A Bank may require a member to obtain an appraisal to ascertain the value of collateral pledged to the Bank.

#### H. Restrictions on Advances to Members That are not Qualified Thrift Lenders (QTLs)

While FIRREA opened membership in the System to federally insured commercial banks and credit unions, it imposed further restrictions on borrowing by members that do not hold a certain level of housing-related assets, as specified in the Qualified Thrift Lender test (OTL test). See 12 U.S.C. 1430(e)(1). Section 935.13 of the proposed rule implements these new restrictions.

The QTL test, as defined in section 10(m) of the Home Owners' Loan Act (HOLA), as amended, 12 U.S.C.

1467a(m), requires that savings associations maintain at least 65 percent of their assets in "qualified thrift investments" (QTI).<sup>1</sup>

Section 10(e) of the Act, as amended by FIRREA, 12 U.S.C. 1430(e), permits members that are not QTLs to borrow from the Banks under the following conditions: (1) Non-QTLs may only use advances for housing finance purposes; (2) each Bank's aggregate amount of advances to non-QTL members shall not exceed 30 percent of the Bank's total advances; and (3) a Bank must grant priority for advances to QTL borrowers over non-QTL borrowers. *Id.* at 1430(e)(1), (2). In addition, a non-QTL borrower must hold Bank stock at the time it receives an advance in an amount equal to at least five percent of the borrower's total advances, divided by its actual thrift investment percentage (ATIP). See *id.* at 1430(e)(1).

The ATIP, used to determine compliance with the QTL test, is a ratio whose numerator is QTI and whose denominator is "portfolio assets." "Portfolio assets" is statutorily defined as total assets, less goodwill and other intangible assets, the value of an institution's business property, and a limited amount of liquid assets. See 12 U.S.C. 1467a(m)(4)(A), (B); 12 CFR 563.51(a), (e).

These limitations do not apply to: (1) A savings bank, as defined in section 3(g) of the Federal Deposit Insurance Act, as amended, 12 U.S.C. 1813(g); (2) a Federal savings association in existence as such on August 9, 1989 that (i) was chartered as a savings bank or cooperative bank prior to October 15, 1982 under state law, or (ii) that acquired its principal assets from an institution that was chartered prior to October 15, 1982 as a savings bank or cooperative bank under state law.

Section 10(m) of the HOLA further restricts non-QTL savings associations' access to Bank advances. Savings associations that fail the QTL test may not take down new Bank advances. See 12 U.S.C. 1467a(m)(3)(B)(i)(III). In addition, if such a savings association fails to regain its QTL status within three years, it must repay all outstanding Bank advances. See 12 U.S.C. 1467a(m)(3)(B)(ii)(II).

<sup>1</sup> QTI assets are divided into two "baskets," one available in unlimited amounts and the other limited to an amount equal to 20 percent of a savings association's portfolio assets. (See following discussion in text.) The unlimited basket contains housing-related assets (mortgage loans, home equity loans, and mortgage-backed securities, as well as certain government agency obligations); the 20 percent basket contains consumer loans and assets associated with community lending. See 12 U.S.C. 1467a(m)(4)(C); 12 CFR 563.51(f).

Since the QTL test, as defined in the HOLA, has application only to savings associations, the requirements in section 10(e) of the Act arguably may be interpreted as applying only to non-QTL savings association members. However, the HOLA specifically prohibits non-QTL savings associations from borrowing advances, making the section 10(e) restrictions, which merely limit advances access, irrelevant for these institutions. It seems unlikely that Congress would create special restrictions on access to advances only for a class of members that, for separate reasons, are not eligible to borrow from a Bank.

In addition, the fact that Congress specifically exempted state-chartered savings banks from section 10(e), but not commercial banks, credit unions or insurance companies, suggests that the requirement was intended to have broader application than just to savings associations. It seems clear, therefore, that Congress used the QTL test to determine access to advances because the test provides a benchmark for measuring a member's commitment to housing finance. The section 10(e) restrictions therefore are being interpreted to have application to all non-QTL System members which are eligible to borrow.

The OTS is responsible for monitoring savings associations' compliance with the QTL test, and for enforcing penalties applicable to institutions that fail the test. See 12 U.S.C. 1467a(m), 1813(q). Therefore, unless otherwise informed by the OTS, a Bank may assume that a member savings association is a QTL. Section 935.13(a) of the proposed rule provides that upon receipt of written notification from the OTS that a savings association member has been designated by the OTS as a non-QTL and is subject to the restrictions on advances applicable to non-QTL savings associations, a Bank shall not extend any new advances or renew existing advances to such member. Proposed § 935.13(b) provides that, upon receipt of written notification from the OTS that all advances held by a non-QTL savings association must be repaid because the association has not requalified as a QTL member within the three-year period, the Bank, in conjunction with the member, shall develop a schedule for the prompt and prudent repayment of all outstanding advances. The schedule shall be consistent with the Bank's and the member's safe and sound operations and shall be forwarded promptly by the Bank to the OTS and the Board.

Proposed § 935.13(c) implements the statutory restrictions on advances to

non-QTL members other than savings associations. The Act requires that non-QTL borrowers use advances only for "housing finance" purposes. See 12 U.S.C. 1430(e)(1). ("Housing finance" is defined as "residential housing finance" for the purposes of this part 935). However, the fungibility of money makes it very difficult and costly to track the actual use of an advance. Therefore, § 935.13(c)(1)(i) of the proposed rule ties on non-QTL member's ability to borrow advances to its level of "residential housing finance assets," as determined pursuant to proposed § 935.13(c)(2). The Board believes that a member's level of residential housing finance assets is a reasonable and measurable indicator of a non-QTL borrower's commitment to housing finance and its use of Bank advances for the purpose.

Section 935.1 of the proposed rule defines "residential housing finance assets" as loans secured by residential real property; securities representing an ownership interest in, or collateralized by, loans secured by residential real property; participations in such loans; loans financed by CIP advances; or any loan or investment that the Board, in its discretion, otherwise determines is a residential housing finance asset. This definition includes home equity loans.

The definitions of residential housing finance assets in proposed § 935.1 includes all loans funded by CIP advances, although some of these loans may be for community and economic development projects and thus may be nonresidential. Section 10(i) of the Act specifically includes the financing of commercial and economic activities that benefit low- and moderate-income families and neighborhoods in the definition of community-oriented mortgage lending. See 12 U.S.C. 1430(i). The Board believes that this definition indicates that all loans funded under the CIP should be included in the definition of residential housing finance assets. Otherwise, the Banks could not provide CIP advances to a non-QTL, non-savings association member, or long-term CIP advances to any member, if the advances funded community and economic development projects. (The Act, as amended, requires that long-term advances only be used for purposes of funding residential housing finance, 12 U.S.C. 1430(a). See Section I below.) The Board specifically requests comments on the inclusion of CIP loans in its definition of residential housing finance assets.

Section 935.13(c)(1)(ii) of the proposed rule implements section 10(e)(1) of the Act by providing that a Bank shall

require a non-QTL non-savings association member to hold stock in its Bank at the time it receives an advance in an amount equal to at least five percent of the outstanding principal amount of the member's total advances, divided by the member's ATIP. The ATIP shall be calculated pursuant to proposed § 935.13(c)(3). See 12 U.S.C. 1430 (e)(1).

Proposed § 935.13(c)(1)(iii) implements sections 10(e)(2) of the Act by providing that a Bank may not extend an advance to a non-QTL non-savings association member if the advance would cause the Bank's aggregate amount of outstanding advances to non-QTL non-savings associations members to exceed 30 percent of the Bank's total outstanding advances. See 12 U.S.C. 1430(e)(2). In the event that a Bank's level of outstanding advances to QTL members declines such that existing non-QTL advances exceed 30 percent of total advances, the Bank will not be required to call any outstanding non-QTL advances in order to comply with the requirement.

Section 935.13(c)(2) of the proposed rule provides that prior to granting a non-QTL non-savings association member's request for an advance, a Bank shall determine that the principal amount of outstanding advances to the members does not exceed the total book value of the member's residential housing finance assets, as indicated on the most recent Call Report or financial statement made available by the member.

The Board believes that the proposed compliance monitoring mechanism for residential housing finance assets is an operationally feasible method for implementing the statutory requirement in 12 U.S.C. 1430(e)(1)(B), and is consistent with the legislative intent of FIRREA. The Board specifically requests comments on any alternative methods for verifying that advances are used for housing finance purposes.

Under proposed § 935.13(c)(3), the Banks are responsible for monitoring the ATIP of non-savings association members in order to determine their required capital stock holdings to support outstanding advances. The proposed rule requires a Bank to calculate a non-savings association member's ATIP annually, between January 1 and April 15, based upon financial data as of December 31 of the prior year. The Bank will use this calculation to determine the member's stock purchase requirement for the remainder of the current calendar year and until such time as the next annual calculation is performed. The Board specifically requests comment on this

proposal for monitoring the ATIP of non-savings association members.

Section 935.13(c)(4) of the proposed rule provides that the requirements of paragraphs (c)(1), (2) and (3) of this section do not apply to certain state-chartered savings banks and Federal savings associations. Applications for AHP and CIP advances are exempt from the requirements of paragraph (c)(2). The Board is permitting this exemption because, as part of the AHP and CIP advance application process, members supply documentation which certifies that the funds will be used for residential housing finance purposes.

Proposed § 935.13(d) provides that if a Bank is unable to meet its members' aggregate demand for advances, the Bank shall give priority to the demands of its QTL members, taking into consideration the member's creditworthiness, the effect of making such advances on the Bank's financial integrity, the availability of compatible funding, and any other factors that the Bank determines to be relevant. The requirements of paragraph (d) do not apply to special, or otherwise limited, advance offerings by a Bank, which may be offered on a first come, first served basis. This section of the proposed rule implements section 10(e)(2) of the Act. See 12 U.S.C. 1430(e)(2).

Section 935.13(e) of the proposed rule requires that the written advances agreement required by § 935.4(b)(2) of this part stipulate that a Bank shall not fund commitments for advances made to then-QTL savings association members whose access to advances is subsequently restricted pursuant to paragraph (a) of this section, or to then-QTL members other than savings associations whose access to advances is restricted pursuant to paragraph (c) of this section.

#### I. Limitations on Long-Term Advances

Section 10(a) of the Act, as amended by FIRREA, provides that all *long-term* advances shall only be made for the purpose of providing funds for *residential housing finance*. 12 U.S.C. 1430(a) (emphasis added). Section 935.1 of the proposed rule defines a "long-term advance" as an advance with an original term to maturity greater than five years. Although there is no explicit definition of long-term advance in the Act, this proposed definition is consistent with the historic System definition of long-term, and with the definition of "long-term advances" provided in the Community Support Regulation promulgated by the Board. See 56 F.R. 58639, 58647 (Nov. 21, 1991).

The designation of five years or less as short-term and greater than five years

as long-term derives in part from section 11(g) of the Act, see 12 U.S.C. 1431(g). That section requires that each Bank maintain investments in an amount equal to current member deposits, and includes advances with maturities of up to five years in the list of investments eligible to fulfill this liquidity requirement. In addition to this statutory foundation, the housing finance mission of the Banks points to a definition that exceeds five years, since as noted earlier, residential mortgage loans, which long-term advances are designed to finance, generally have an average life greater than five years.

Section 935.14(a) of the proposed rule implements section 10(a) of the Act by requiring that the Banks make long-term advances only for the purpose of enabling a member to fund or purchase new or existing residential housing finance assets. The Board intends to require that the Banks monitor the use of long-term advances for this purpose by using the same method proposed for monitoring advances to non-QTL borrowers.

Specifically, § 935.14(b)(1) of the proposed rule provides that, before funding an advance with a maturity greater than five years, a Bank shall determine that the borrowing member's level of outstanding advances with original maturities greater than five years does not exceed the total book value of the member's residential housing finance assets. The bank shall use the member's most recent TFR, Call Report or other financial statement to determine the total book value of the member's residential housing finance assets.

Applications for AHP and CIP advances are exempt from this requirement. As noted above, the definition of residential housing finance assets includes loans funded with CIP advances, which means that long-term CIP advances also may fund community and economic development projects.

#### J. Capital Stock Requirements and Redemption of Excess Stock

The Act sets forth two minimum stockholding requirements for System members (minimum subscription requirements). See 12 U.S.C. 1426(b)(1), (4); 1430(e)(3). The first minimum stock subscription requirement provides that each member shall purchase Bank capital stock in an amount equal to one percent of the aggregate unpaid principal of its home mortgage loans, home-purchase contracts and similar obligations, but not less than \$500. See 12 U.S.C. 1426(b)(1), (4).



The second minimum subscription requirement provides that each member shall purchase and maintain stock, pursuant to the one percent requirement, as if at least 30 percent of its assets consisted of home mortgage loans (i.e., the minimum purchase requirement equals .3 percent of a member's total assets). This provision only has application to members that have less than 30 percent of their assets in home mortgage loans. For these institutions, the .3 percent of total assets requirement is greater than the one percent of aggregate unpaid loan principal requirement. See 12 U.S.C. 1430(e)(3). These statutory minimum subscription requirements will be addressed more fully in a future Board rulemaking on Bank membership requirements.

In addition to the minimum subscription requirements, the Act specifies two stock purchase requirements based on advance levels (the advances-to-stock requirements). These requirements are implemented in proposed § 935.15(a). All members must hold stock in an amount equal to at least five percent of outstanding advances (i.e., the aggregate amount of advances to a member may not exceed 20 times the amount paid in by such member for capital stock in the Bank). In addition, non-QLT non-savings association members applying for an advance must hold capital stock in the Bank at the time the advance is received in an amount equal to at least five percent of the member's total advances, divided by the member's ATIP. See 12 U.S.C. 1430(c), (e)(1), and proposed § 935.13(c)(1)(ii) discussed *supra*. A member's Bank stockholdings must be at least equal to the greater of its minimum subscription requirement for membership or its respective advances-to-stock requirement.

The Act authorizes the Banks to redeem stock in excess of the minimum requirements at a member's request. See 12 U.S.C. 1426(b)(1). The Banks annually recalculate a member's minimum subscription requirement, and members holding stock in excess of the recalculated amount may request that the Bank redeem the excess stock. *Id.* The Act also authorizes the Banks to unilaterally redeem stock upon the termination of a stockholder's membership in the System if the terminated member has no outstanding indebtedness to the Bank. See *id.* at 1426(e). The Act does not specifically address the issue of whether a Bank has the authority to redeem Bank stock held by a member in excess of the advances-to-stock requirements. In practice, the Banks redeem stock, at the request of a

member, in excess of its advances-to-stock requirement throughout the year as advances are repaid, as long as the minimum subscription is maintained.

Section 935.15(b) of the proposed rule provides that a Bank, after providing 15 calendar days advance written notice to a member, may unilaterally redeem the portion of a member's stockholdings in excess of its advances-to-stock requirement, as long as the member's minimum subscription requirement is maintained. The Board believes that this express authority is a reasonable interpretation of the Act, and will aid the Banks in managing their equity levels as part of their financial planning. The 15-day advance notice requirement is designed to allow each member an opportunity to identify alternative investments for the amount received from redemption of the stock.

#### K. Advance Participations and Intradistrict Transfers of Advances

Section 10(d) of the Act requires Board approval for the participation or sale of advances to other Banks. Section 935.18 of the proposed rule incorporates existing Board policy which provides that, subject to the approval of the boards of directors of the relevant Banks and consistent with Board policy, a Bank may allow any other Bank to purchase a participation interest in any advance, together with an appropriate assignment of the underlying security therefor. See 12 U.S.C. 1430(d). Participation agreements already in place are deemed to meet the requirements of this part, and will not require further approval by the Bank's board or the Board.

Proposed § 935.17 provides that a Bank may allow one of its members to assume advances outstanding to another of its members, provided the assumption conforms to the requirements in this part 935 for the issuance of a new advance. A Bank may charge an appropriate fee for processing the transfer.

#### L. Special Advances to Savings Associations

Section 935.18(a) of the proposed rule implements section 10(h) of the Act by providing that, upon receipt of a written request from the Director of the OTS, the Banks may extend short-term advances to troubled but solvent member savings associations having reasonable and demonstrable prospects of returning to a satisfactory financial condition. See 12 U.S.C. 1430(h). Proposed § 935.18(b), consistent with section 10(h) of the Act, provides that any advance made pursuant to this section shall be at the interest rate applicable to short-term advances of

similar type and maturity made available to members that do not pose such a supervisory concern and shall be subject to the same collateral requirements applicable to other advances. The requirements of the Act, therefore, preclude risk-based pricing of advances made available under this section. The statutory provision regarding these liquidity advances specifies that extending such advances is not mandatory. See 12 U.S.C. 1430(h). The Board expects that a Bank will consider the effect on its own financial integrity of agreeing to make such advances.

#### M. Liquidation of Advances Upon Termination of Membership

Section 935.19 of the proposed rule implements section 6(e) of the Act by specifying that if an institution's membership in a Bank is terminated, the indebtedness of such institution to the Bank shall be liquidated in an orderly manner, as determined by the Bank. See 12 U.S.C. 1428(e). Such liquidation shall be deemed a prepayment of any such indebtedness and subject to any applicable prepayment fees. A Bank shall not be required to call any such indebtedness prior to maturity if doing so would be inconsistent with the Bank's safe and sound operation.

#### Subpart B—Advances to Nonmembers

##### A. Scope

Section 935.20 of the proposed rule provides that advances to nonmembers shall be subject to the provisions in subpart A of this part 935, except as otherwise provided in §§ 935.21 and 935.22 of subpart B of this part 935. This requirement is designed to ensure that nonmember advance programs operate within the same regulatory framework as member advance programs and without special benefits to nonmembers.

##### B. Advances to SAIF

Section 935.21(a) of the proposed rule implements section 11(k) of the Act, providing that upon receipt of a written request from the FDIC, a Bank may make advances to the FDIC for the use of the SAIF. Pursuant to proposed § 935.21(b), such an advance shall: (1) Bear a rate of interest not less than the Bank's marginal cost of funds, taking into account the maturities involved and reasonable administrative costs; (2) be for a maturity acceptable to the Bank; (3) be subject to any prepayment, commitment or other appropriate fees; and (4) be adequately secured by collateral acceptable to the Bank. See 12 U.S.C. 1431(k).

**C. Advances to Nonmember Mortgagees**

Under Section 10b of the Act, a Bank may make advances to nonmembers that are approved mortgagees under title II of the National Housing Act (NHA) (12 U.S.C. 1707 *et seq.*). See 12 U.S.C. 1430b. The administration of title II of the NHA is the responsibility of the Federal Housing Administration (FHA), a unit of the Department of Housing and Urban Development (HUD). Approved mortgagees have HUD authorization to buy and sell FHA-insured mortgages.

The Board has approved a program permitting the Dallas Bank to lend up to \$2 million over a period of two years to the New Mexico Mortgage Finance Authority to promote the availability of affordable housing in that state. Similar programs are being considered by other Banks. The Board believes that these programs are in keeping with the System's mission to provide housing finance for low- and very low-income families. The proposed rule revises the Board's current regulation to include specific criteria for nonmember mortgagee eligibility for advances, and requirements governing Bank advances to such entities.

Section 935.22(a) of the proposed rule authorizes a Bank, subject to the Act and subpart B of this part 935, to make advances to an entity that is not a member of a Bank, if the entity qualifies as a nonmember mortgagee pursuant to section 10b of the Act and proposed § 935.22(b).

Proposed § 935.22(b) contains the four statutory conditions that a nonmember mortgagee must meet in order to borrow from a Bank:

(1) The mortgagee must be chartered under law and have succession. A corporation, or other entity that has rights, characteristics and powers under applicable law similar to those granted a corporation, or a government agency, meet this requirement:

(2) The mortgagee must be subject, pursuant to statute or regulation, to the inspection, supervision and oversight of a Federal, state or local government agency;

(3) The mortgagee must lend its own funds as its principal activity in the mortgage field; and

(4) The mortgagee must be approved by HUD as a "mortgagee" pursuant to HUD's regulations (24 CFR part 203), under title II of the NHA (12 U.S.C. 1707—1715z-20).

Pursuant to the Act, advances made under this section are not subject to certain other provisions of the Act, *e.g.*, member stock purchase and collateral requirements. See 12 U.S.C. 1430b. However, as noted above, where

appropriate, the proposed rule makes the regulatory requirements that are applicable to the Banks' member advances programs also applicable to their nonmember advances programs, except as specifically provided in this proposed § 935.22. The Banks are expected to apply to nonmember mortgagees the same advance application requirements, credit underwriting standards, collateral safekeeping requirements, restrictions on lending to institutions without positive tangible capital, advance maturity requirements, prepayment fees, and other regulatory requirements applicable to members under subpart A of this part 935.

Section 935.22(c) of the proposed rule provides that prior to establishing a program to lend to nonmember mortgagees, each Bank shall adopt a policy on advances to nonmember mortgagees consistent with the requirements of the Act, part 935 of the Board's regulations, and general guidelines of the Board.

Section 935.22(d)(1)(i) of the proposed rule requires the Banks to price advances to nonmember mortgagees to cover the funding, operating and administrative costs associated with making such advances. The pricing may reflect the credit risk associated with lending to the nonmember mortgagee, or other reasonable differential pricing criteria, provided that the terms for differential pricing are applied equally to all nonmember mortgagee borrowers.

In addition, proposed § 935.22(d)(ii) provides that the pricing of advances shall compensate the Bank for the absence of a capital investment by the nonmember mortgagee in the Bank. A Bank may implement this provision by requiring that the nonmember mortgagee hold a compensating balance in a deposit account with the Bank. Proposed § 935.22(d)(2) provides that, in accordance with section 10b of the Act, the principal amount of any advance made to a nonmember mortgagee may not exceed 90 percent of the unpaid principal of the collateral pledged as security.

Proposed § 935.22(e)(1) implements the Act by providing that nonmember mortgagee advances may be collateralized with FHA-insured mortgages. See 12 U.S.C. 1430b. Section 935.22(e)(2) of the proposed rule permits a Bank to additionally accept as collateral, securities representing a *pro rata* share of the principal and interest payments due on a pool of FHA-insured mortgage loans (GNMAs), provided that a Bank shall require a nonmember mortgagee to provide evidence that the

securities are backed solely by FHA-insured mortgages.

Section 935.22(f)(1) of the proposed rule provides that a Bank shall require a nonmember mortgagee applying for an advance to agree in writing to inform the Bank promptly of any change in its status as a nonmember mortgagee. The Bank will not be required to call outstanding advances to a nonmember that loses its HUD-approved mortgagee status or otherwise ceases to fulfill the eligibility qualifications for a nonmember mortgagee under proposed § 935.22(b). However, pursuant to proposed § 935.22(f)(2), it may not extend a new advance or renew an existing advance to the nonmember until the Bank is satisfied that the entity again fulfills the requirements for a nonmember mortgagee provided herein.

Under proposed § 935.22(g), a Bank may, from time to time, require a nonmember mortgagee borrower to provide evidence that it continues to satisfy all of the qualifications and requirements contained in this section. The Board specifically requests comment on all aspects of the proposed nonmember mortgagee requirements.

#### **Board Statements of Policy and Former Federal Home Loan Bank Board Policy on Advances**

The proposed rule would incorporate the Statements of Policy on advances currently contained in 12 CFR part 940 to the extent the Board deems appropriate. The proposed rule would remove and reserve part 940. The proposed rule also is intended to supersede the former Federal Home Loan Bank Board's policy on advances, adopted by minute entry on July 6, 1988. This minute entry was not published in the Federal Register.

#### **Regulatory Flexibility Act**

The proposed rule largely implements statutory requirements applicable to all System members, regardless of their size. The Board is not at liberty to make adjustments to those statutory requirements to accommodate small entities. The Board has not imposed any additional regulatory requirements that will have a disproportionate impact on small entities. The only significant requirement added by the Board is limits on advances to members without positive tangible capital. The Board has written the proposed rule specifically so that in many cases members can meet the requirements of the proposed rule by providing copies of reports already generated for other purposes. For these reasons, it is certified, pursuant to section 605(b) of the Regulatory

Flexibility Act, 5 U.S.C. 605b, that this proposed rule, as promulgated, will not have a significant economic impact on a substantial number of small entities.

#### List of Subjects

##### 12 CFR Part 935

Advances, credit, Federal home loan banks.

##### 12 CFR Part 940

Advances, Federal home loan banks.

The Finance Board hereby proposes to amend chapter IX, title 12, Code of Federal Regulations, as follows:

1. Part 935 is revised to read as follows:

### PART 935—ADVANCES

#### Subpart A—Advances to Members

##### Sec.

- 935.1 Definitions.
- 935.2 Bank credit mission.
- 935.3 Bank advances policy.
- 935.4 Authorization and application for advances; obligation to repay advances.
- 935.5 Limitations on access to advances.
- 935.6 Terms and conditions for advances.
- 935.7 Interest rates on Community Investment Program advances.
- 935.8 Fees.
- 935.9 Collateral.
- 935.10 Banks as secured creditors.
- 935.11 Pledged collateral; verification.
- 935.12 Collateral valuation; appraisals.
- 935.13 Restrictions on advances to members that are not Qualified Thrift Lenders.
- 935.14 Limitations on long-term advances.
- 935.15 Capital stock requirements; unilateral redemption of excess stock.
- 935.16 Advance participations.
- 935.17 Intradistrict transfer of advances.
- 935.18 Special liquidity advances to savings associations.
- 935.19 Liquidation of advances upon termination of membership.

#### Subpart B—Advances to Nonmembers

- 935.20 Scope.
  - 935.21 Advances to the Savings Association Insurance Fund.
  - 935.22 Advances to nonmember mortgagees.
- Authority: 12 U.S.C. 1422b(a)(1), 1426, 1429, 1430, 1430b, 1431.

#### Subpart A—Advances to Members

##### § 935.1 Definitions.

As used in this part:

*Act* means the Federal Home Loan Bank Act, as amended (12 U.S.C. 1421 *et seq.*).

*Actual thrift investment percentage* or *ATIP* means generally the percentage of a member's assets actually invested in, or held as, qualified thrift investments, as defined more specifically in section 10(m)(4) of the Home Owners' Loan Act (12 U.S.C. 1467a(m)(4)) and in the implementing regulations of the OTS at 12 CFR 563.51. The ATIP will be

calculated and used for purposes of this part for all members of the Banks, whether or not they are savings associations.

*Advance* means a loan from a Bank pursuant to the Act that is:

- (1) Provided pursuant to a written agreement;
- (2) Supported by a note or other written evidence of the borrower's obligation; and
- (3) Fully secured by collateral in accordance with the Act.

*Affordable Housing Program* or *AHP* means the program described in section 10(j) of the Act (12 U.S.C. 1430(j)) and part 960 of the Board's regulations.

*Appropriate Federal banking agency.* The term "appropriate Federal banking agency" has the same meaning as used in 12 U.S.C. 1813(q) and for federally insured credit unions shall mean the National Credit Union Administration.

*Bank* means a Federal Home Loan Bank established under the authority of the Act.

*Board* means the Federal Housing Finance Board established under the authority of the Act, its governing Board of Directors, or an official duly authorized to act on its behalf.

*Combination business or farm property* means real property for which the total appraised value is attributable to residential, and business or farm uses.

*Community Investment Program* or *CIP* means the program(s) described in section 10(i) of the Act (12 U.S.C. 1430(i)).

*Depository institution* means a bank or savings association, as defined in 12 U.S.C. 1813, or a credit union, as defined in 12 U.S.C. 1752.

*Dwelling unit* means a single, unified combination of rooms designed for residential use by one household.

*FDIC* means the Federal Deposit Insurance Corporation.

*GAAP* means Generally Accepted Accounting Principles.

*HUD* means the Department of Housing and Urban Development.

*Improved residential real property* means residential real property excluding real property to be improved, or in the process of being improved, by the construction of dwelling units.

*Insurer* means:

- (1) the FDIC for banks and savings associations; or
- (2) the National Credit Union Share Insurance Fund for credit unions.

*Long-term advance* means, for the purposes of this part, an advance with an original term to maturity greater than five years.

*Manufactured housing* means a manufactured home as defined in

section 603(6) of the Manufactured Home Construction and Safety Standards Act of 1974, as amended (42 U.S.C. 5402(6)).

*Member* means an institution that has been admitted to membership in a Bank and, [pursuant to the requirements of § 933.7 of this chapter], has purchased capital stock in the Bank.

*Mortgage-backed security* means, for purposes of this part, an equity security representing an ownership interest in a pool of fully disbursed, whole mortgage loans on improved residential property or a collateralized mortgage obligation, mortgage-backed bond or other debt security backed entirely by fully disbursed, whole first mortgage loans on improved residential real property.

*Multifamily property* means:

- (1) Real property containing five or more dwelling units; or
- (2) Real property containing five or more dwelling units with commercial units combined, provided the property is primarily residential.

*Nonresidential real property* means real property not used for residential purposes, including business or industrial property, hotels, motels, churches, hospitals, nursing homes, educational and charitable institutions, dormitories, clubs, lodges, association buildings, "homes" for elderly persons, golf courses, recreational facilities, farm property not containing a dwelling unit, or similar types of property, except as otherwise determined by the Board in its discretion.

*OCC* means The Office of the Comptroller of the Currency within the United States Department of the Treasury.

*One-to-four family property* means any of the following:

- (1) Real property containing:
  - (i) One-to-four dwelling units; or
  - (ii) More than four dwelling units if each unit is separated from the other units by dividing walls that extend from ground to roof, including rowhouses, townhouses or similar types of property;
- (2) Manufactured housing if:

(i) Applicable state law defines the purchase or holding of manufactured housing as the purchase or holding of real property; and

(ii) The loan to purchase the manufactured housing is secured by such manufactured housing as evidenced by a mortgage or other lien on real property;

(3) Individual condominium dwelling units or interests in individual cooperative housing units that are part of a condominium or cooperative building without regard to

the number of total dwelling units therein; or

(4) Real property containing one-to-four dwelling units with commercial units combined, provided the property is primarily residential.

OTS means the Office of Thrift Supervision.

Qualified Thrift Lender or QTL means the term defined in section 10(m)(1) of the Home Owners' Loan Act (12 U.S.C. 1467a(m)(1)) and in the implementing regulations of the OTS (12 CFR 563.50). A non-savings association member which otherwise meets the QTL test will be treated as a QTL for purposes of this part.

Qualified Thrift Lender test or QTL test means the formula described generally in section 10(m) of the Home Owners' Loan Act (12 U.S.C. 1467a(m)) and in the implementing regulations of the OTS (12 CFR 563.50). The QTL test will be applied to all members of a Bank for purposes of this part.

Residential housing finance assets means any of the following:

- (1) Loans secured by residential real property;
- (2) Mortgage-backed securities;
- (3) Participations in loans secured by residential real property;
- (4) Loans financed by CIP advances;

or

(5) Any loans or investments which the Board, in its discretion, otherwise determines to be residential housing finance assets.

Residential real property means any of the following:

- (1) One-to-four family property;
- (2) Multifamily property;
- (3) Real property to be improved by the construction of dwelling units;
- (4) Real property in the process of being improved by the construction of dwelling units;
- (5) Combination business or farm property, provided that at least 50 percent of the total appraised value of the combined property is attributable to the residential portion of the property;
- (6) The term does not include nonresidential real property as defined in this section.

Savings association means a savings association as defined in section 3(b) of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1813(b)).

State means a state of the United States, the District of Columbia, Guam, Puerto Rico or the U.S. Virgin Islands.

State regulator means a state insurance commissioner or state regulatory entity with primary responsibility for supervising a member that is not a federally insured depository institution.

Tangible capital means:

(1) Capital, calculated according to GAAP, less "intangible assets" as reported in the member's Thrift Financial Report for members whose primary Federal regulatory is the OTS, or as reported in the Report of Condition and Income for members whose primary Federal regulator is the FDIC, the OCC or the Board of Governors of the Federal Reserve System; or

(2) Capital calculated according to GAAP, less intangible assets, as defined by a Bank for members which are not regulated by the OTS, the FDIC, the OCC, or the Board of Governors of the Federal Reserve System.

Whole mortgage pass-through security means, for purposes of this part, a security representing the entirety of the beneficial interest in a pool of fully disbursed, whole first mortgage loans on improved residential real property.

#### § 935.2 Bank credit mission.

(a) The primary credit mission of the Banks shall be to enhance the availability of residential mortgage credit.

(b) Each Bank shall fulfill its primary credit mission by:

- (1) Providing a readily available, economical and affordable source of funds in the form of advances to its members; and
- (2) Offering such advances products or programs that satisfy the credit needs of its members.

(c) Notwithstanding paragraph (b) of this section, each Bank shall place such limitations on the making of advances to its members as shall:

- (1) Be specifically prescribed by statute, regulation or policy;
- (2) Protect the financial integrity of such Bank and accommodate the practical constraints associated with the Bank's ability to raise funds; or
- (3) Be required by the Board.

#### § 935.3 Bank advances policy.

(a) Each Bank's board of directors shall adopt, and review at least semiannually, a policy on advances to members consistent with the requirements of the Act, this part, and the general guidelines of the Board, as reflected in its resolutions, orders or manuals.

(b) A Bank's board of directors may designate officers authorized to extend or deny credit and take other action consistent with the Bank's advances policy.

(c) A Bank may make exceptions to its advances policy only with the approval of its board of directors, a committee thereof, or officers specifically authorized by the board of directors to approve such exceptions, provided that

any such exceptions shall comply with the Act, this part and Board policies and guidelines.

(d) A Bank's board of directors shall:

(1) Require the officers designated pursuant to paragraph (b) of this section to report promptly to it, or a designated committee of the board, all actions taken under this section; and

(2) Review such actions for compliance with this section.

#### § 935.4 Authorization and application for advances; obligation to repay advances.

(a) Application for advances. A Bank may accept oral or written applications for advances from its members.

(b) Obligation to repay advances. (1) A Bank shall require any member applying for an advance to enter into a primary and unconditional obligation to repay such advance and all other indebtedness to the Bank, together with interest and any unpaid costs and expenses in connection therewith, according to the terms under which such advance or other indebtedness was made.

(2) Such obligations shall be evidenced by a written advances agreement that shall be reviewed by the Bank's legal counsel to ensure such agreement is in compliance with applicable law.

(c) Secured advances. (1) Each Bank shall make only fully secured advances to its members as set forth in the Act, the provisions of this part and policies established by the Board.

(2) The Bank shall execute a written security agreement with each borrowing member which establishes the Bank's security interest in collateral securing advances.

(3) Such written security agreement shall, at a minimum, describe the type of collateral securing the advances and give the Bank a perfectible security interest in the collateral.

(d) Approval—(1) By the Bank's board of directors. Applications for advances, advances agreements and security agreements shall be in substantially such form as approved by the Bank's board of directors, or a committee thereof specifically authorized by the board of directors to approve such forms.

(2) By the Board. Each Bank's forms for all advances applications, advances agreements and security agreements are deemed approved by the Board if such forms are consistent with the requirements of this part. Each Bank shall provide copies of its current forms for all advances agreements and security agreements, and any

substantive revisions thereto, to the Board.

**§ 935.5 Limitations on access to advances.**

(a) *Credit underwriting.* A Bank, in its discretion, may:

- (1) Limit or deny a member's application for an advance if, in the Bank's judgment, such member:
  - (i) Is engaging or has engaged in any unsafe or unsound business practices;
  - (ii) Has inadequate capital;
  - (iii) Is sustaining operating losses;
  - (iv) Has financial or managerial deficiencies, as determined by the Bank, that bear upon the member's creditworthiness; or
  - (v) Has any other deficiencies, as determined by the Bank; or

(2) Approve a member's application for an advance subject to such additional terms as the Bank may prescribe, pursuant to the provisions of the Act, this part and any policy guidelines of the Board.

(b) *Advances to members without positive tangible capital—(1) New Advances.* A Bank shall not make a new advance available to a member without positive tangible capital unless:

- (i) The member's appropriate Federal banking agency or insurer requests in writing that the Bank make such advance; and
- (ii) The Bank determines in its discretion that it may safely make such advance to the member. The Bank shall promptly inform the Board of any such request.

(2) *Renewal of maturing advances.* (i) A Bank may renew an existing advance to a member without positive tangible capital for successive terms of up to 30 days each if the Bank determines that it may safely make such renewals to the member.

(ii) A Bank may renew an existing advance to a member without positive tangible capital for a term greater than 30 days at the written request of the appropriate Federal banking agency or insurer, if the Bank determines that it may safely make such renewal.

(c) *Members without Federal regulators.* The provisions of paragraph (b) of this section, in the case of members that are not federally insured depository institutions, may be implemented upon written request to the Bank from the member's state regulator.

(d) *Reporting.* (1) Each Bank shall provide the Board with a monthly report of the Bank's advances and commitments outstanding to each of its members.

(2) Such monthly report shall be in a format or on a form prescribed by the Board.

(3) Each Bank shall, upon written request from a member's appropriate Federal banking agency, insurer or state regulator, provide to such entity information on advances and commitments outstanding to the member.

(e) *Advance commitments.* The written advances agreement required by § 935.4(b)(2) of this part shall stipulate that the Bank shall not fund commitments for advances previously made to members whose access to advances is restricted pursuant to this section.

**§ 935.6 Terms and conditions for advances.**

(a) *Advance maturities.* Each Bank shall offer advances with maturities of up to ten years, and may offer advances with longer maturities consistent with the safe and sound operation of the Bank.

(b) *Advance pricing—(1) General.* Each Bank shall price its advances to members taking into account the following factors:

- (i) The marginal cost to the Bank of raising matching maturity funds in the marketplace; and
- (ii) The administrative and operating costs associated with making such advances to members.

(2) *Differential pricing.* (i) Each Bank may, in pricing its advances, distinguish among members based upon its assessment of:

- (A) The credit risk to the Bank of lending to any particular member; or
- (B) Other reasonable criteria that may be applied equally to all members.

(ii) Each Bank shall establish written standards and criteria for such differential pricing and shall apply such standards and criteria consistently and without discrimination to all members applying for advances.

(3) *Affordable Housing Program Advances.* The advance pricing policies and procedures contained in paragraph (b)(1) of this section shall not apply in the case of a Bank's AHP advances made pursuant to part 960 of this chapter.

(c) *Authorization for pricing advances.* (1) A Bank's board of directors, a committee thereof, or the Bank's president, if so authorized by the Bank's board of directors, shall set the rates of interest on advances consistent with paragraph (b) of this section.

(2) A Bank president authorized to set interest rates on advances pursuant to this paragraph (c) may delegate any part of such authority to any officer or employee of Bank.

**§ 935.7 Interest rates on Community Investment Program advances.**

Each Bank shall price its CIP advances as provided in § 935.6 of this part, provided that the cost of such CIP advances shall not exceed the Bank's cost of issuing consolidated obligations of comparable maturity, taking into account reasonable administrative costs.

**§ 935.8 Fees.**

(a) *Prepayment fees.* (1) Each Bank shall establish and charge a prepayment fee which sufficiently compensates the Bank for providing a prepayment option on an advance, and which acts to make the Bank financially indifferent to the borrower's decision to repay the advance prior to its maturity date.

(2) Prepayment fees are not required for:

- (i) Advances with terms to maturity or repricing periods of six months or less;
- (ii) Advances funded by callable debt; or
- (iii) Advances which are otherwise appropriately hedged so that the Bank is financially indifferent to their prepayment.

(3) The board of directors of each Bank, a designated committee thereof, or officers specifically authorized by the board of directors, may waive a prepayment fee only if such waiver will not result in an economic loss to the Bank. Any such waiver must subsequently be ratified by the board of directors.

(b) *Commitment fees.* Each Bank is authorized to charge a fee for the Bank's commitment to fund an advance.

(c) *Other fees.* Each Bank is authorized to charge other fees as it deems necessary and appropriate.

**§ 935.9 Collateral.**

(a) *Eligible security for advances.* At the time of origination or renewal of an advance, each Bank shall obtain, and thereafter maintain, a security interest in collateral that meets the requirements of one or more of the following categories:

(1) *Mortgage loans and privately issued securities.* (i) Fully disbursed, whole first mortgage loans on improved residential real property not more than 90 days delinquent; or

(ii) Whole mortgage pass-through securities as defined in § 935.1 of this part.

(2) *Agency securities.* Securities issued, insured or guaranteed by the United States Government, or any agency thereof, including without limitation mortgage-backed securities.

as defined in § 935.1 of this part, issued or guaranteed by:

- (i) the Federal Home Loan Mortgage Corporation;
- (ii) the Federal National Mortgage Association; or
- (iii) the Government National Mortgage Association.

(3) *Deposits.* Deposits in a Bank.

(4) *Other collateral.* (i) Except as provided in paragraph (a)(4)(iii) of this section, other real estate-related collateral acceptable to the Bank if:

- (A) Such collateral has a readily ascertainable value; and
- (B) The Bank can perfect a security interest in such collateral.

(ii) Eligible other real estate-related collateral may include, but is not limited to:

- (A) Non-agency mortgage-backed securities not otherwise eligible under paragraph (a)(1)(ii) of this section;
- (B) Second mortgage loans, including home equity loans;
- (C) Commercial real estate loans; and
- (D) Mortgage loan participations.

(iii) A Bank shall not permit the aggregate amount of outstanding advances to any one member, secured by such other real estate-related collateral, to exceed 30 percent of such member's capital, as calculated according to GAAP, at the time the advance is issued or renewed.

(b) *Bank restrictions on eligible collateral.* A Bank at its discretion may further restrict the types of eligible collateral acceptable to the Bank as security for an advance, based upon the creditworthiness or operations of the borrower, the quality of the collateral, or other reasonable criteria.

(c) *Additional collateral.* The provisions of paragraph (a) of this section shall not affect the ability of any Bank to take such steps as it deems necessary to protect its secured position on outstanding advances, including requiring additional collateral, whether or not such additional collateral conforms to the requirements for eligible collateral in paragraph (a) of this section or section 10 of the Act (12 U.S.C. 1430).

(d) *Bank stock as collateral.* (1) Pursuant to section 10(c) of the Act (12 U.S.C. 1430(c)), a Bank shall have a lien upon, and shall hold, the stock of a member in the Bank as further collateral security for all indebtedness of the member to the Bank.

(2) The written security agreement used by the Bank shall provide that the borrowing member's Bank stock is assigned as additional security by the member to the Bank.

(3) The security interest of the Bank in such member's Bank stock shall be entitled to the priority provided for in

section 10(f) of the Act (12 U.S.C. 1430(f)).

(e) *Collateral security requiring formal approval.* No home mortgage loan otherwise eligible to be accepted as collateral for an advance by a Bank under this section shall be accepted as collateral for an advance if any director, officer, employee, attorney or agent of the Bank or of the borrowing member is personally liable thereon, unless the board of directors of the Bank has specifically approved such acceptance by formal resolution, and the Board or its designee has endorsed such resolution.

#### § 935.10 Banks as secured creditors.

(a) Except as provided in paragraph (b) of this section, notwithstanding any other provision of law, any security interest granted to a Bank by a member, or by an affiliate of such member, shall be entitled to priority over the claims and rights of any party, including any receiver, conservator, trustee or similar party having rights of a lien creditor, to such collateral.

(b) A Bank's security interest as described in paragraph (a) of this section shall not be entitled to priority over the claims and rights of a party that:

- (1) Would be entitled to priority under otherwise applicable law; and
- (2) Is an actual bona fide purchaser for value of such collateral or is an actual secured party whose security interest in such collateral is perfected in accordance with applicable state law.

#### § 935.11 Pledged collateral; verification.

(a) *Collateral safekeeping.* (1) A Bank may permit a member that is a depository institution to retain documents evidencing collateral pledged to the Bank, provided that the Bank and such member have executed a written security agreement pursuant to § 935.4(c) of this part whereby such collateral is retained solely for the Bank's benefit and subject to the Bank's control and direction.

(2) A Bank shall take any steps necessary to ensure that its security interest in all collateral pledged by non-depository institutions for an advance is as secured as its security interest in collateral pledged by depository institutions.

(3) A Bank may at any time perfect its security interest in collateral securing an advance to a member.

(b) *Collateral verification.* Each Bank shall establish written procedures, with standards similar to those established by the Auditing Standards Board of the American Institute of Certified Public Accountants, for verifying the existence

of collateral securing the Bank's advances, and shall regularly verify the existence of the collateral securing its advances in accordance with such procedures.

#### § 935.12 Collateral valuation; appraisals.

(a) Each Bank shall establish written procedures for determining the value of the collateral securing the Bank's advances, and shall determine the value of such collateral in accordance with such procedures.

(b) Each Bank shall apply the valuation procedures consistently and fairly to all borrowing members, and the valuation ascribed to any item of collateral by the Bank shall be conclusive as between the Bank and the member.

(c) A Bank may require a member to obtain an appraisal of any item of collateral, and to perform such other investigations of collateral as the Bank deems necessary and proper.

#### § 935.13 Restrictions on advances to members that are not qualified thrift lenders.

(a) *Restrictions on advances to non-QTL savings associations.* A Bank shall not make a new advance or renew an existing advance to a savings association member after receiving written notification from the OTS that such savings association has been designated as a non-QTL and that the restrictions on advances that apply to non-QTLs should be enforced.

(b) *Repayment of advances by non-QTL savings associations.* (1) Upon receipt of written notification from the OTS that all advances held by a savings association must be repaid because the association has not requalified as a QTL member, the Bank, in conjunction with the non-QTL savings association member, shall develop a schedule for the prompt and prudent repayment of outstanding advances by that member, consistent with the member's and the Bank's safe and sound operations.

(2) Notice of the agreed upon schedule referred to in paragraph (b)(1) of this section shall be provided promptly by the Bank to the OTS and the Board.

(c) *Restrictions on advances to non-QTL members other than savings associations.* (1) Except as provided in paragraphs (c)(4) and (c)(5) of this section, a Bank may make or renew an advance to a non-QTL member that is not a savings association only under the following conditions:

(i) Non-QTL members of a Bank that are not savings associations may only receive advances for the purpose of funding or purchasing new or existing

residential housing finance assets, as determined pursuant to paragraph (c)(2) of this section:

(ii) The member holds Bank stock at the time it receives the advance in an amount equal to at least five percent of the outstanding principal amount of the member's total advances, divided by such member's ATIP, calculated pursuant to paragraph (c)(3) of this section; and

(iii) The aggregate amount of a Bank's advances to non-QTL non-savings association members shall not exceed 30 percent of the amount of the Bank's total outstanding advances, at the time such advances are made or renewed.

(2) Prior to approving an application for an advance, a Bank shall determine that the principal amount of all advances outstanding to the non-QTL non-savings association member at the time the advance is requested does not exceed the total book value of residential housing finance assets held by such member, which shall be determined using the member's most recent Report of Condition and Income or financial statement made available by the member.

(3) The Bank shall calculate each non-QTL non-savings association member's ATIP annually, between January 1 and April 15, based upon financial data as of December 31 of the prior calendar year.

(4) The requirements of paragraphs (c)(1), (2) and (3) of this section shall not apply to:

(i) A savings bank, as defined in section 3(g) of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1813(g)); or

(ii) A Federal savings association in existence as such on August 9, 1989 that:

(A) Was a state chartered savings bank or cooperative bank before October 15, 1982; or

(B) Acquired its principal assets from an institution that was a state chartered savings bank or cooperative bank before October 15, 1982.

(5) The requirements of paragraph (c)(2) of this section shall not apply to applications from members for AHP or CIP advances.

(d) *Priority for QTL members.* (1) Except as provided in paragraph (d)(3) of this section, if a Bank is unable to meet the aggregate advance demand of all of its members, the Bank shall give priority to applications for advances from its QTL members, subject to the following considerations:

(i) The effect of making the advances on the financial integrity of the Bank;

(ii) The member's creditworthiness;

(iii) The availability of funding with maturities compatible with advance applications; and

(iv) Any other factors that the Bank determines to be relevant.

(2) The institutions identified in paragraph (c)(4) of this section shall be treated as QTLs for purposes of this paragraph.

(3) The requirements of paragraphs (d)(1) and (2) of this section shall not apply to a Bank's special, or otherwise limited, advance offerings.

(e) *Advance commitments.* The written advance agreement required by § 935.4(b)(2) of this part shall stipulate that the Bank shall not fund commitments for advances previously made to members whose access to advances is restricted pursuant to paragraph (a) or (c) of this section.

#### § 935.14 Limitations on long-term advances.

(a) A Bank shall make long-term advances only for the purpose of enabling a member to fund or purchase new or existing residential housing finance assets.

(b)(1) Prior to approving an application for a long-term advance, a Bank shall determine that the principal amount of all long-term advances currently held by the member does not exceed the total book value of residential housing finance assets held by such member. The Bank shall determine the total book value of such residential housing finance assets, using the member's most recent Thrift Financial Report, Report of Condition and Income, or financial statement made available by the member.

(2) Applications for AHP and CIP advances are exempt from the requirements of this section.

#### § 935.15 Capital stock requirements; unilateral redemption of excess stock.

(a) *Capital stock requirement for advances.* (1) At no time shall the aggregate amount of outstanding advances made by a Bank to a member exceed 20 times the amount paid in by such member for capital stock in the Bank.

(2) A non-QTL non-savings association member shall hold stock in the Bank at the time it receives an advance in an amount equal to at least the amount of stock required to be held pursuant to § 935.13(c)(1)(ii) of this part.

(b) *Unilateral redemption of excess stock.* A Bank, after providing 15 calendar days' advance written notice to a member, may unilaterally redeem that amount of the member's Bank stock that exceeds the stock requirements set forth in paragraph (a) of this section provided the minimum amount required in section 6(b)(1) of the Act is maintained.

#### § 935.16 Advance participations.

A Bank may allow any other Bank to purchase a participation interest in any advance, and any other Bank may accept a participation interest therein, together with an appropriate assignment of security therefor, subject to the approval of the boards of directors of the relevant Banks and consistent with Board policy.

#### § 935.17 Intradistrict transfer of advances.

A Bank may allow one of its members to assume an advance obligation of another of its members, provided the assumption complies with the requirements of this part governing the issuance of new advances. A Bank may charge an appropriate fee for processing the transfer.

#### § 935.18 Special liquidity advances to savings associations.

(a) *Eligible institutions.* (1) A Bank, upon receipt of a written request from the Director of the OTS, may make short-term advances to a member savings association.

(2) Such request must certify that the member:

(i) Is solvent but presents a supervisory concern to the OTS because of the member's financial condition; and

(ii) Has reasonable and demonstrable prospects of returning to a satisfactory financial condition.

(b) *Terms and conditions.* Advances made by a Bank to a member savings association under this section shall:

(1) Be subject to all applicable collateral requirements of the Bank, this part and section 10(a) of the Act (12 U.S.C. 1430(a)); and

(2) Be at the interest rate applicable to advances of similar type and maturity that are made available to other members that do not pose such a supervisory concern.

#### § 935.19 Liquidation of advances upon termination of membership.

If an institution's membership in a Bank is terminated, the Bank shall determine an orderly schedule for liquidating any indebtedness of such member of the Bank; provided that this section shall not require a Bank to call any such indebtedness prior to maturity of the advance, if so doing would be inconsistent with the Bank's safe and sound operation. The Bank shall deem any such liquidation a prepayment of the member's indebtedness, and the member shall be subject to any fees applicable to such prepayment.

**Subpart B—Advances to Nonmembers****§ 935.20 Scope.**

The requirements of subpart A of this part apply to this subpart, except as otherwise provided in §§ 935.21 and 935.22 of this subpart.

**§ 935.21 Advances to the Savings Association Insurance Fund.**

(a) A Bank may, upon receipt of a written request from the FDIC, make advances to the FDIC for the use of the Savings Association Insurance Fund. The Bank shall provide a copy of such request to the Board.

(b) Such advances shall:

(1) Bear a rate of interest not less than the Bank's marginal cost of funds, taking into account the maturities involved and reasonable administrative costs;

(2) Be for a maturity acceptable to the Bank;

(3) Be subject to any prepayment, commitment or other appropriate fees of the Bank; and

(4) Be adequately secured by collateral acceptable to the Bank.

**§ 935.22 Advances to nonmember mortgagees.**

(a) *Authority.* Subject to the provisions of the Act and this part, a Bank may make advances to an entity that is not a member of a Bank, if the entity qualifies as a nonmember mortgagee pursuant to section 10b of the Act (12 U.S.C. 143b) and paragraph (b) of this section.

(b) *Qualified nonmember mortgagee.* To qualify for an advance as a nonmember mortgagee, an entity must meet the following requirement:

(1) *Charter.* It must be chartered under law and have succession. A corporation, another entity that has rights, characteristics and powers under applicable law similar to those granted a corporation, or a government agency, meets this requirement;

(2) *Examination.* It must be subject, pursuant to statute or regulation, to the inspection, supervision and oversight of a Federal, state, or local government agency;

(3) *Lending activity.* (i) The entity's principal activity in the mortgage field must consist of lending its own funds, which may include appropriated funds in the case of a Federal, state or local government agency;

(ii) An entity meets the requirement in paragraph (b)(3)(i) of this section, notwithstanding that the majority of its total operations are unrelated to mortgage lending, if the majority of its mortgage activity conforms to this requirement;

(iii) An entity that acts principally as a broker for others making mortgage

loans, or makes mortgage loans for the account of others, does not meet the requirement in paragraph (b)(3)(i) of this section; and

(4) *HUD approval.* The entity must be approved by the Department of Housing and Urban Development (HUD) as a "mortgagee" pursuant to HUD regulations (24 CFR part 203), under title II of the National Housing Act (12 U.S.C. 1707—1715z-20).

(c) *Bank advance policy for nonmember mortgagees.* Prior to establishing a program to lend to nonmember mortgagees, a Bank's board of directors shall adopt a policy on advances to nonmember mortgagees consistent with the requirements of the Act, this part, and general guidelines of the Board, as reflected in its resolutions, orders or manuals. Such policy shall be reviewed by the Bank's board of directors at least semiannually.

(d) *Terms and conditions—(1) Advance pricing—(i) Costs.* Each Bank making an advance to a nonmember mortgagee shall price the advance so as to cover the funding, operating and administrative costs associated with making the advance. The price of the advance may reflect the credit risk or other reasonable differential pricing criteria associated with lending to the nonmember mortgagee, provided that the criteria are applied equally to all nonmember mortgagee borrowers.

(ii) *Capital investment.* The price of the advance shall compensate the Bank for the lack of a capital stock investment by the nonmember mortgagee in the Bank. This requirement may be satisfied by requiring the nonmember mortgagee to maintain a compensating deposit balance with the Bank.

(2) *Limitation on advances.* The principal amount of any advance made to a nonmember mortgagee may not exceed 90 percent of the unpaid principal of the mortgage loans or securities described in paragraph (e) of this section that are pledged as security for the advance.

(e) *Collateral.* A Bank may grant an advance to a nonmember mortgagee pursuant to this section only on the security of the following collateral:

(1) Mortgage loans insured by the Federal Housing Administration of the Department of Housing and Urban Development, pursuant to title II of the National Housing Act (12 U.S.C. 1707—1715z-20); or

(2) Securities representing a *pro rata* share of the principal and interest payments due on a pool of mortgage loans, all of which mortgage loans meet the requirements of paragraph (e)(1) of this section. A Bank shall require a nonmember mortgagee using collateral

as described in this paragraph (e)(2) to provide evidence that such securities are backed solely by mortgages of the type described in paragraph (e)(1) of this section.

(f) *Loss of nonmember mortgagee eligibility.* (1) A Bank shall require each nonmember mortgagee that applies for an advance under this section to agree in writing to inform the Bank promptly of any change in its status as a nonmember mortgagee.

(2) If a nonmember mortgagee borrower ceases to fulfill the eligibility requirements for a nonmember mortgagee pursuant to paragraph (b) of this section, a Bank may not extend a new advance or renew an existing advance to such entity, until the Bank is satisfied that the entity again fulfills the requirements for a nonmember mortgagee contained in this section.

(g) *Verification of nonmember mortgagee requirements.* A Bank may, from time to time, require a nonmember mortgagee borrower to provide evidence that such institution continues to satisfy all of the qualifications and requirements contained in this section.

**PART 940—[REMOVED]**

2. Part 940 is removed and reserved.

By the Federal Housing Finance Board.  
Daniel F. Evans, Jr.,  
Chairman.

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BILLING CODE 6725-1-M

**OFFICE OF NATIONAL DRUG CONTROL POLICY****21 CFR Part 1401****Proposed Rule Regarding Public Availability of Information**

**AGENCY:** Office of National Drug Control Policy.

**ACTION:** Proposed rule and request for comments.

**SUMMARY:** The Freedom of Information Act (FOIA) requires every Federal agency to make available to the public official documents and other records upon request, unless the material requested falls under one of several limited exceptions. FOIA also requires agencies to publish rules stating the time, place, fees, and procedures to apply in making records available to any person upon request. Further, Section 1803 of the Freedom of Information Reform Act of 1986 requires each agency to establish a system for recovering costs associated with