REGULATORY INTERPRETATION 2015-RI-01

Subject: Transfer of Mortgage Servicing Rights under the Acquired Member Asset Regulations.

Issue: Does the Acquired Member Asset (AMA) regulation allow a Federal Home Loan Bank (Bank) to authorize the transfer of mortgage servicing rights for loans purchased under an AMA program to a non-member of the Bank System, including to an entity that is not eligible for membership.

Conclusion: Yes. The AMA regulation does not specifically address servicing requirements and nothing in the rule specifically prohibits the transfer of servicing rights to a non-member of the Bank System. Thus, so long as the transfer is accomplished in such a way as not to cause the associated mortgage loan to cease to comply with any of the specific requirements in the AMA regulation, including the credit-enhancement requirements, a Bank may allow the transfer of servicing rights to a non-Bank System member without affecting the status of the loan as AMA.

Background:

The Federal Housing Finance Board (Finance Board), the regulator for the Bank System prior to the creation of the Federal Housing Finance Agency (FHFA), adopted the AMA regulation in July 2000. The regulation authorizes a Bank to acquire and hold certain mortgage assets from its members subject to the conditions set forth in the rule. As discussed more fully below, the rule establishes a three-part test that mortgage assets must meet before a Bank can purchase and hold mortgages as AMA, including that the loans must be credit-enhanced by the member that sells them to the Bank. Under the Bank AMA programs, members that a Bank has approved to sell loans to it are known as participating financial institutions (PFIs).

While AMA loans are generally serviced by the member PFI that sold the loans, all of the Banks' AMA programs allow a PFI to sell servicing rights, subject to the Bank's approval, to a PFI that is a member of the Bank itself or of another Bank. A number of Banks are now considering whether to allow, or already have allowed, the sale of servicing rights to institutions that are neither members of any Bank nor affiliates of Bank System members. In most cases, these (potential) servicers are not a type of institution that would be eligible to seek membership in a Bank under the Federal Home Loan Bank Act (Bank Act).[1]

Moreover, since the financial crisis, a much larger percentage of mortgage servicing is performed by non-bank institutions that would not be eligible to seek membership in the Bank System. This

[1] *See* 12 U.S.C. § 1424(a)(1) (identifying institutions eligible to seek membership in a Bank).

change in the market is likely to make it more difficult for the Banks to find eligible members to take over servicing of AMA loans from those PFIs that either cannot or are no longer willing to continue servicing the loans and wish to transfer the servicing rights. While the Finance Board and FHFA have addressed whether the AMA regulation allows for the transfer of servicing rights from a PFI to other member PFIs or to non-member affiliates of a PFI, neither the Finance Board nor FHFA has specifically considered whether AMA loan servicing rights may be transferred to an institution that is neither a member of the Bank System nor an affiliate of such a member.

Analysis:

The AMA regulation sets forth three criteria that must be met in order for a mortgage asset to be bought and held by a Bank as AMA. First, the asset must be a conforming whole loan (or an interest in such a loan) eligible to secure advances or otherwise identified in the AMA regulation.[2] Second, the Bank must acquire the asset from one of its members or housing associates, another Bank or, in certain circumstances, a member or housing associate of another Bank, and the asset must have been originated or held for a valid business purpose by the Bank System member or housing associate prior to acquisition by the Bank.[3] Finally, the transaction through which the asset is purchased by the Bank must satisfy the risk-sharing requirements in the regulation under which a Bank System member or housing associate must credit-enhance the asset to at least investment grade or such higher level as required by the Bank. Moreover, the structure of the credit enhancement must assure that the Bank System member or housing associate maintains such enhancement for the life of the asset.[4] The AMA regulation does not specifically address the transfer of servicing rights.

While the AMA regulation does not address servicing directly, the Finance Board opined at various times that the AMA rule did not prohibit the sale of servicing rights from a member PFI to another member PFI of the Bank in question or of another Bank as long as certain conditions were met.[5] These conditions included that the Bank owning the AMA loan approve the transfer, and that, if the transferee PFI were a member of a Bank other than the Bank that owned the AMA loan, the transfer would occur only with the concurrence of the other Bank. The Finance Board further noted that, to assure that the transfer of servicing rights did not negatively affect the credit enhancement required by the AMA regulation, a Bank should have guidelines requiring the transferee PFI to meet the Bank's AMA servicing criteria and requiring the transferee PFI to be accepted by a Nationally Recognized Statistical Rating Organization (NRSRO) as conforming to the NRSRO's requirements for servicing proficiency.[6] More recently, FHFA allowed that

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[2] *See* 12 C.F.R. § 955.2(a). In the adopting release for the AMA regulation, the Finance Board identified the conditions that had to be met for an interest in an eligible whole loan to qualify as AMA. *See,* Final Rule: Federal Home Loan Bank Acquired Member Assets, Core Mission Activities, Investments and Advances, 65 FED. REG. 43969, 43977 (July 17, 2000) (hereinafter Final Rule).

[3] *See,* 12 C.F.R. § 955.2(b).

[4] *See,* 12 C.F.R. § 955.2(c) and § 955.3.

[5] *See, e.g.,* Final Rule 65 FED. REG. at 43977-978; Regulatory Interpretation 2002-RI-02 (Mar. 6, 2002).

[6] The Dodd-Frank Wall Street Reform and Consumer Protection Act requires agencies to remove regulatory requirements based on NRSRO ratings, § 939A, Public Law No. 111-203, 124 Stat. 1887 (July 21, 2010), and FHFA has a project underway to do so with respect to the AMA regulation.

servicing rights for AMA loans could be transferred to an affiliate of a PFI as long as the Bank had the same rights and protections against the affiliate as it had against the PFI.

As already noted, nothing in the AMA regulation prohibits a non-Bank System member from servicing AMA loans. The fact that previous interpretations related to servicing tended to discuss the transfer of servicing rights to other Bank System members is not dispositive of whether the regulation intended to prohibit such transfer, especially since neither the rule text nor the previous interpretations of servicing rights transfer specifically address the status of non-member servicers. Instead, these prior interpretations are only indicative of the fact that AMA loans have traditionally been serviced by Bank System members. Accordingly, as long as the transfer of servicing rights to the non-Bank System member entity does not cause the associated mortgage loan to cease to comply with any of the specific requirements in the AMA regulation, including the credit- enhancement requirements, a Bank can allow the transfer of servicing rights to a non-Bank System member without affecting the status of the loan as AMA.

FHFA, however, would expect the Bank to adopt guidelines for a non-member entity to qualify as a servicer that assure that the transfer does not negatively affect the credit enhancement on the loans in question or substantially increase the Bank's exposure to risk from what it would be if the servicing had remained with a Bank System member.[7] Moreover, a Bank may not allow the transfer of the member's credit-enhancement obligation to a non-Bank System member and continue to hold the underlying asset as AMA. In this respect, for certain AMA government products, especially, the transfer of servicing may result in the transfer of the credit enhancement obligation. This occurs because, as the Finance Board stated, the member PFI servicing the government-insured AMA loans meets the credit-enhancement requirements in the AMA rule by maintaining the government insurance and by bearing the risk of loss from unreimbursed servicing advances.[8] If a Bank System member ceased to bear these obligations after the transfer of servicing to a non-member entity, these loans would no longer appear to qualify as AMA and the Bank would be prohibited from continuing to own them under FHFA regulations.[9]

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This Regulatory Interpretation is issued pursuant to 12 C.F.R. § 1211.5 and is subject to modification or rescission by the Director of the Federal Housing Finance Agency.

[7] A Bank may enjoy more rights against a member in the case of the member's default on an obligation to the Bank than it would against a non-member. For example, the Bank Act provides enhanced status with regard to a Bank's lien on member assets, and the Bank's membership agreement may allow the Bank to take certain actions against a member in the case of a breach of an obligation that would not be available against a non-member.

[8] *See* Final Rule 65 FED. REG. at 43977 (explaining how government-insured loans meet the credit-enhancement requirements of the AMA rule).

[9] FHFA regulations prohibit a Bank from owning whole mortgage loans unless the loan qualifies as AMA or meets certain other specific requirements. *See* 12 C.F.R. § 1267.3(a)(4).