



Federal Housing Finance Agency

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April 23, 2020

DBR-2020-SYS-028

Presidents and Chief Executive Officers
Federal Home Loan Banks

Re: Paycheck Protection Program (PPP) Loans as Collateral for FHLBank Advances

Dear Federal Home Loan Bank Presidents:

The Division of FHLBank Regulation (DBR) has received inquiries as to whether PPP loans established under the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) are allowable collateral for purposes of securing Federal Home Loan Bank (FHLBank) advances. Pursuant to 12 CFR §1266.7(a)(2)(ii), and under the conditions in this letter below, FHLBanks may accept PPP loans as collateral for advances under the “Agency Securities” provision of the regulation, given the Small Business Administration’s (SBA) 100 percent guarantee of the unpaid principal balance.

On April 3, 2020, the FHLBanks had requested relief from the SBA, including a waiver from certain regulatory requirements that must be satisfied before a lender may pledge any loans guaranteed by SBA under Section 7(a) of the Small Business Act, such as the PPP loans, to a third party. The FHLBanks also requested that SBA confirm that its guarantee of the PPP loans would transfer to the FHLBanks, in the event that they were to acquire the loans through foreclosure of their security interest, and could be enforced by the FHLBanks to the same extent as when held by the original lender.

On April 20, 2020, SBA published its third interim final rule relating to the PPP loans, one provision of which explicitly excludes pledges of PPP loans to a FHLBank from the otherwise applicable requirements for pledges of Section 7(a) loans, thus resolving the FHLBanks’ waiver request to SBA.¹

FHFA has conducted its own review of the relevant statutes and SBA regulations, and has determined that SBA does not allow third parties, *i.e.*, persons who are not SBA-approved lenders, to present and collect on SBA guarantees. SBA regulations include another provision, however, that allows an SBA lender, as well as any federal or state banking regulator or any receiver or conservator, to sell its Section 7(a) loans to another SBA lender, with SBA’s prior written consent.² Although that provision does not reference the FHLBanks, FHFA believes that the FHLBanks could request SBA’s consent under that provision to sell any PPP loans it may acquire through foreclosure, provided that the purchaser was an SBA-approved lender in good

¹ See 85 Fed. Reg. 21747 (April 20, 2020) (amending 13 CFR 120.435).

² See 13 CFR 120.432(a).

standing. If approved by SBA, such a sale would provide the FHLBanks with an alternative means of receiving the financial benefits associated with the SBA guarantee.

For prudential reasons, FHFA is establishing a series of conditions under which the FHLBanks may accept PPP loans as collateral. The first set of conditions is focused principally on the financial condition of the members, while the second set are focused more on discounts, caps, and dollar limits. The conditions are as follows:

Member-Related Conditions

- Members must have a CAMELS rating of “3” or better, or a member credit rating in the top 60 percent, or top three quintiles, of the FHLBank’s member rating system, *e.g.*, 6 out of 10 or 3 out of 5, using the lower (more severe) credit risk rating.
- If a member is subsequently downgraded after pledging PPP collateral to the FHLBank, the member is not required to replace the PPP collateral, but such collateral will be subject to other limitations.
- In the event the member does not immediately replace the PPP collateral with other eligible collateral, the FHLBank must take possession of the PPP collateral and implement higher haircuts based on the rating of the member. If the member is downgraded to a CAMELS rating of “4” or a rating under the FHLBank’s rating system in the fourth quintile (greater than 60 percent to 80 percent), the FHLBank must implement a 60 percent haircut. If the member is downgraded to a CAMELS rating of “5” or a rating under the FHLBank’s rating system in the lowest quintile (greater than 80 percent to 100 percent), the FHLBank must implement a 90 percent haircut.

Discounts, Caps, and Limits

- At a minimum, the FHLBanks shall have a collateral discount of at least 10 percent that is applied to no more than 100 percent of the unpaid principal balance (UPB), *i.e.*, PPP loans with a market value above 100 percent of the UPB are capped at the UPB.
- The FHLBank shall establish a 20 percent cap on the amount that PPP loans can constitute of a member’s lendable pledged collateral, *i.e.*, after haircuts and market valuations.
- Finally, the FHLBank shall limit the dollar amount of PPP loans that a single member may pledge to no more than \$5 billion in lendable collateral.

FHLBank staff should contact their assigned Associate Director of Safety and Soundness Examinations with any questions regarding this Supervisory Letter.

Sincerely,

A handwritten signature in blue ink, consisting of a large, sweeping loop on the left side that extends across the page.

Andre D. Galeano
Deputy Director