

No.: 98-41

Date: September 23, 1998

FEDERAL HOUSING FINANCE BOARD

Approval, Establishment and Operation of
Federal Home Loan Bank MPF Pilot Programs

WHEREAS, on December 23, 1996, the Board of Directors (BOD) of the Federal Housing Finance Board (Finance Board) adopted Resolution No. 96-111 (Res. 96-111) approving the request of the Federal Home Loan Bank (FHLBank) of Chicago to establish a pilot program, called "Mortgage Partnership Finance" (MPF), under which the FHLBank proposed to fund up to \$750 million in single-family mortgage loans originated by participating member institutions, subject to the conditions set forth in Res. 96- 111; and

WHEREAS, Res. 96- 111 reflects the conclusion of the BOD of the Finance Board that the MPF pilot program, as approved, satisfies the criteria for approval of mission-related FHLBank investments set forth in section II.B.12 of the Financial Management Policy for the FHLBank System (FMP), see Res. No. 96-45 (July 3, 1996) in that it: (a) ensures the appropriate management of risk exposure and preservation of the FHLBank's and the FHLBank System's triple-A rating by limiting the FHLBank's exposure to credit risk to that of a double-A rated mortgage-backed security; (b) assists in providing housing finance that would be available only at lower levels, or under less attractive terms, by paying the member to credit enhance the mortgage and by allowing members to originate mortgage loans on more flexible and attractive terms than are available through the existing secondary market; and (c) promotes the cooperative nature of the FHLBank System by aligning the risk components of mortgage lending between the FHLBank and its members based on each party's ability to manage each risk component, and by de-linking loan volume from the pricing criteria, thereby allowing members of various asset size and mortgage origination capabilities to enjoy the same price; and

WHEREAS, following a pre-implementation examination of the MPF pilot program by staff of the Finance Board's Office of Supervision (OS) that was required under the terms of Res. 96- 111, the Director of OS, in a June 23, 1997 letter to the President of the FHLBank of Chicago, confirmed that appropriate program policies, procedures and controls had been established by the FHLBank and that OS had no objection to the commencement of loan funding under the pilot program; and

WHEREAS, a follow-up examination of the MPF pilot program conducted by OS staff in June 1998 revealed no safety and soundness concerns and confirmed that the program, as operating, continues to meet the criteria set forth in FMP section II.B.12 and does not violate the conditions of Res. 96- 111; and

WHEREAS, since funding its first loan under the MPF pilot program in July 1997, the FHLBank of Chicago has entered into master commitments to fund mortgage loans in an amount approaching the \$750 million funding cap established for the program in Res. 96-111 and, because its members have shown strong and increasing interest in the program, the FHLBank has requested increased funding authorization from the Finance Board; and

WHEREAS, the boards of directors of the FHLBanks of New York and Pittsburgh have authorized their FHLBanks to offer MPF to their members, upon approval by the Finance Board, and the FHLBanks of Chicago and Dallas have submitted to the Finance Board a formal joint proposal, under which the FHLBank of Dallas would offer MPF to its members, with operational assistance and investment from the FHLBank of Chicago; and

WHEREAS, the Finance Board wishes to permit these and other FHLBanks to offer MPF, or substantially similar programs, to their members on pilot bases, so as to enable the Finance Board to judge the viability of permitting the FHLBanks to establish a national MPF program and to study and consider the related operational, profitability and supervisory issues; and

WHEREAS, the Finance Board has concluded that authorizing other FHLBanks to offer MPF, or substantially similar. pilot programs to their members requires the establishment of parameters and general terms for a national MPF pilot program, particular conditions applicable to any FHLBank offering an MPF, or substantially similar, pilot program in the future and a process by which staff will consider FHLBank proposals; and

WHEREAS, after reviewing comments on the establishment of such guidelines, see 63 Fed. Reg. 42,400 (Aug. 7, 1998), Finance Board staff has developed the attached Terms and Conditions for Approval, Establishment and Operation of Federal Home Loan Bank MPF Pilot Programs (Terms & Conditions), which, with this resolution, incorporate the conditions set forth in Res. 96-111, as well as establishing new guidelines and, as such, supercedes Res. 96- 111; and

WHEREAS, the BOD has reviewed the Office of Policy Action Memorandum and the attachments thereto, including the Office of General Counsel Opinion, and has relied thereon;

NOW THEREFORE BE IT RESOLVED THAT, the BOD of the Finance Board hereby adopts the attached Terms & Conditions, which are hereby incorporated by reference into and made a part of this resolution, and which, in conjunction with this resolution, shall from the date of this resolution govern all previously approved MPF programs, as well as the establishment and operation of all new MPF, or substantially similar, pilot programs;

FURTHER RESOLVED THAT, the BOD of the Finance Board hereby authorizes each FHLBank to establish and operate, or to continue to operate, a pilot program:

- (1) Under which the FHLBank acquires whole residential mortgage loans, originated by its member institutions, that have an original principal balance falling within the conforming loan limits applicable to the secondary market GSEs, either:
 - (a) by purchasing the loans from the originating member; or

- (b) by funding the loans at the time of closing using its member as an originating agent; and
- (2) Under which the risk components of mortgage lending are allocated between the FHLBank and its members and managed through:
 - (a) a first loss spread account (i.e., a reserve funded by a share of the interest payments on the mortgage) established by the FHLBank; and
 - (b) a second loss credit enhancement in an amount at least equal to the level of subordination afforded double-A rated mortgage-backed securities, provided by the member from which the mortgage loans are acquired; and
- (3) That has been approved by Finance Board staff, in accordance with this resolution, the attached Terms & Conditions and section II.B.12 of the FMP; and
- (4) That operates in conformity with this resolution, the attached Terms & Conditions and section II.B.12 of the FMP;

FURTHER RESOLVED THAT, the BOD of the Finance Board hereby authorizes staff to review and approve FHLBank applications to establish and operate MPF, or substantially similar, pilot programs, to collect and analyze data and to monitor performance, all in accordance with this resolution and the Terms & Conditions;

FURTHER RESOLVED THAT, the total principal amount of mortgage loans funded through members and purchased from members under all FHLBank pilot programs approved or operating pursuant to this resolution shall not exceed \$9 billion, which shall be a FHLBank System-wide cap not to be apportioned among FHLBanks except as may be deemed necessary by Finance Board staff considering each FHLBank's capacity, or for any other reason consistent with the supervisory authority of the Finance Board;

FURTHER RESOLVED THAT, funding provided by FHLBanks under the programs authorized by this resolution shall be excepted from the definition of "advance" in part 935 of the Finance Board's regulations, 12 C.F.R. § 935.1.

By the Board of Directors of the
Federal Housing Finance Board



Bruce A. Morrison, Chairman

Federal Housing Finance Board

Terms and Conditions for Approval, Establishment and Operation
of
Federal Home Loan Bank MPF Pilot Programs

1. Scope. These Terms and Conditions for Approval, Establishment and Operation of Federal Home Loan Bank MPF Pilot Programs (Terms & Conditions) are intended to govern the approval, establishment and operation of all Federal Home Loan Bank (FHLBank) pilot programs that fall within the authorization contained in Finance Board Resolution No. 98-41 (Sept. 23, 1998), including the continuing operation of programs that have been approved previously. That authorization is intended to encompass the Mortgage Partnership Finance program developed by the FHLBank of Chicago and all substantially similar programs that may be developed by the FHLBanks. Part II of these Terms & Conditions sets forth relevant definitions. Part III, "Terms of Conduct," sets forth guidelines, to which each pilot program individually, and all pilot programs collectively, must conform. Part IV, "Conditions for Approval," sets forth the requirements that each FHLBank must meet in order to obtain approval from Finance Board staff to establish an MPF pilot program.

II. Definitions: For purposes of these Terms & Conditions:

- A. FHLBank-Agent means a FHLBank that has agreed to carry out the administrative functions of another FHLBank's MPF program and whose MPF administrative office has been examined and approved by Finance Board staff to process MPF transactions.
- B. FHLBank-Investor means a FHLBank that purchases, or has agreed to purchase, MPF loans, or participation interests therein, from another FHLBank.
- C. FHLBank-Principal means a FHLBank that, as authorized by its board of directors, offers or intends to offer an MPF program to its member institutions.
- D. MPF or MPF program means a program that FHLBanks are authorized to offer to their members under the terms of Finance Board Resolution No. 98-41.
- E. MPF loan means a mortgage loan originated by a PFI that has been, or will be, delivered to a FHLBank-Principal under an MPF program.
- F. Participating financial institution or PFI means a member of an FHLBank-Principal that has been approved to deliver loans to the FHLBank-Principal under an MPF program and that has entered into an agreement with the FHLBank-Principal to participate in its MPF program.

III. Terms of Conduct. The following terms of conduct apply to all MPF programs approved under these Terms & Conditions and Resolution No. 98-41:

A. Requirements.

1. Participation Limited to FHLBank Members. A FHLBank may offer an MPF program only to its own member institutions. Specifically:
 - a. A FHLBank may fund MPF loans only through, and purchase MPF loans only from, and may enter contracts, agreements or commitments to fund or purchase MPF loans only with, its own member institutions.
 - b. A FHLBank may market MPF only to its own member institutions. *However*, at the request of a FHLBank, and with the permission of its member, staff of another FHLBank may contact, or meet with, that member to provide information on MPF.
 - c. An institution may become a PFI only with the express approval of the FHLBank-Principal of which it is a member. *However*, a FHLBank may grant to any FHLBank-Agent or FHLBank-Investor joint authority to approve or disapprove any member of the FHLBank-Principal as a PFI.
 - d. A FHLBank may accept deposits in connection with any MPF-related transaction only from its own member institutions, or from another FHLBank. *However*, for purposes of facilitating MPF transactions, a FHLBank-Principal may establish and maintain one or more beneficial accounts, on behalf of its PFI members, with an FHLBank-Agent or a FHLBank-Investor.
2. Administrative Requirements. Each FHLBank-Principal must direct its MPF loan processing through a FHLBank administrative office whose operations have been examined and approved by Finance Board staff.
3. Loan Pricing. Each FHLBank-Principal must set its MPF loan prices utilizing a pricing methodology that has been approved by Finance Board staff and that attempts to direct a portion of the program's funding to low- and moderate-income households.
4. Role of FHLBank Directors.
 - a. Conflicts. The board of directors of each FHLBank shall take appropriate precautions, in structuring its MPF program, to avoid conflicts of interest, or any appearance thereof, for board directors.
 - b. Reports. During the first year of operation of any FHLBank's MPF program, the board of directors of that FHLBank shall require MPF program progress reports from management at each regular board meeting. Thereafter, such reports shall be required on at least a quarterly basis.

B. Administrative/Investment Ties to Other FHLBanks.

1. FHLBank-Agent and FHLBank-Investor Status. Notwithstanding the requirements set forth in paragraph III.A:
 - a. A FHLBank-Principal may delegate the administration of its MPF program to a FHLBank-Agent. The existence of such a delegation, or the possibility that such a delegation may be made, must be disclosed to any potential PFI before any agreements are signed.
 - b. Once a FHLBank-Principal has acquired an MPF loan from a PFI, any FHLBank-Investor may purchase that MPF loan, or a participation interest therein, from the FHLBank-Principal, or from another FHLBank-Investor.
2. Limitations on Agent/Investor Agreements.
 - a. Terminability of Agreements. Any agreement made between two or more FHLBanks in connection with an administrative delegation or investment relationship described in paragraph III.B.1 shall be made terminable by either party after a reasonable notice period. A FHLBank may agree to continue to perform appropriate duties to protect its own or another FHLBank's investment in MPF loans already made, even after such an agreement has been terminated. However, no FHLBank shall be required to fund, purchase, sell, or process any new MPF loans after the termination of such an agreement.
 - b. Delegation of Pricing Authority. A FHLBank-Principal that has delegated its MPF loan pricing function to a FHLBank-Agent must retain a right to refuse to fund or purchase MPF loans at prices it does not consider appropriate.

C. Program Monitoring. Finance Board staff is authorized to:

1. require that any FHLBank submit to the Finance Board MPF program data, including loan-level data, on a quarterly basis, or less frequently as determined by staff; and
2. conduct examinations, as it deems necessary, of each FHLBank's MPF program to ensure continuous compliance with Resolution 98-41, these Terms & Conditions and section II.B.12 of the Financial Management Policy for the FHLBanks (FMP) (or any successor provisions).

IV. Conditions for Approval. A FHLBank that would like to offer MPF to its members must submit a request in writing to the Finance Board describing how the FHLBank's pilot program will comply with Resolution 98-41, these Terms & Conditions and section II.B.12 of the FMP (or any successor provisions). All Finance Board staff determinations regarding FHLBank pilot program requests shall be subject to pre- and post-implementation safety and soundness examinations. At a minimum, each request must address:

- A. The FHLBank's ability, and that of any FHLBank acting as its administrative agent, to manage the credit risk associated with holding mortgage loans in portfolio.
- B. The FHLBank's ability, and that of any FHLBank acting as its administrative agent, to manage the risks associated with increasing volumes of transactions, including:

1. the FHLBank's strategy on managing interest rate risk, including options risk, pipeline risk, and hedging strategies; and
 2. the FHLBank's capability to model the effect of MPF assets and liabilities, including the impact of future interest rate movements, using the FHLBank's interest rate risk model.
- C. The criteria that the FHLBank will use to determine the eligibility of its members to become PFIs in its MPF program.
- D. The FHLBank's administrative office capability, including:
1. the FHLBank's demonstrated ability to put in place the necessary policies, procedures, and controls;
 2. projections that show the new office will be cost efficient; and
 3. a justification that the new office will not deter efforts to achieve System-wide program coordination.
- If a FHLBank proposes to use the administrative office of a FHLBank-Agent, no further staff review or examination will be required on this point.
- E. In an opinion letter from the FHLBank's General Counsel or outside attorney, the conclusion that MPF loans are investments in which a fiduciary or trust may invest under the laws of the state in which the FHLBank is located, including appropriate citations to support such a conclusion.