

Federal Housing Finance Board

Memorandum

October 31, 1991

TO: Philip L. Conover, Director
District Banks Directorate

FROM: Beth L. Climo
General Counsel

SUBJECT: The Negative Asset Pledge To Support The Consolidated
Bonds

This opinion is being rendered in response to a request from the Federal Home Loan Bank of Seattle ("FHLBank-Seattle") for an opinion regarding the negative asset pledge in section 910.1 of the Federal Housing Finance Board's ("Finance Board's") regulations.

ISSUE: Whether the requirement in section 910.1 of the Finance Board's regulations requiring that the FHLBanks hold eligible assets in a total amount at least equal to the amount of consolidated obligations outstanding ("negative pledge requirement") is an individual FHLBank requirement or an aggregate FHLBank System requirement.

CONCLUSION: The negative pledge requirement in section 910.1 of the Finance Board's regulations is a FHLBank systemwide requirement, rather than an individual requirement that must be met by each FHLBank.

DISCUSSION:

The authority of the Finance Board to issue consolidated bonds is set forth in subsection 11(c) of the Federal Home Loan Bank Act ("Bank Act"). Subsection 11(c) provides in pertinent part:

[T]he (Finance) Board may issue consolidated Federal Home Loan Bank bonds which shall be the joint and several obligations of all the Federal Home Loan Banks, and shall be secured and be issued upon such terms and conditions as the (Finance) Board may prescribe.

12 U.S.C. § 1431(c) (Supp. I 1989).

Section 910.1 of the Finance Board's regulations sets forth the conditions under which the Finance Board may issue FHLBank consolidated bonds. 12 C.F.R. § 910.1 (1991). Section 910.1 establishes two specific conditions for the issuance of FHLBank consolidated bonds.

The first condition limits the FHLBank System's leveraging capacity (the "leverage ratio requirement"). Specifically, section 910.1 states that the Finance Board "shall not issue consolidated bonds in excess of 12 times the total paid-in capital stock and reserves under section 16 of the Federal Home Loan Bank Act, as amended, of all the Federal Home Loan Banks." 12 C.F.R. § 910.1 (1991).

The second condition is the negative pledge requirement that requires the FHLBanks to hold eligible assets, free and clear of any liens or pledges, in an amount greater than or equal to the amount of consolidated bonds outstanding. Specifically, section 910.1 sets forth the negative pledge requirement as follows:

The Federal Home Loan Banks shall at all times maintain assets of the following types, free from any lien or pledge, in a total amount at least equal to the amount of consolidated bonds outstanding: (a) Cash; (b) obligations of or fully guaranteed by the United States; (c) secured advances; and (d) mortgages as to which one or more Federal Home Loan Banks have any guarantee or insurance, or commitment therefor, by the United States or any agency thereof.

Id.

At the direction of the Finance Board, the Office of Finance issues consolidated bonds which are joint and several liabilities of all the FHLBanks. The proceeds of the consolidated bonds are divided amongst the twelve FHLBanks to finance their operations. Each FHLBank receives a portion of the consolidated bonds based on its anticipated operational needs. This procedure gives rise to the issue of whether each FHLBank must maintain eligible assets equivalent to the portion of outstanding consolidated bonds attributable to it or whether it is sufficient that the FHLBanks in the aggregate maintain the required level of eligible assets.

There is very little regulatory history on either the leverage ratio requirement or the negative pledge requirement. Section 910.1 originally was promulgated by the former Federal Home Loan Bank Administration, which was the predecessor to the former Federal Home Loan Bank Board ("FHLBB"). The regulation was first published at section 4.3 of title 24 of the Code of Federal Regulations in substantially the same form as it exists today. Fed. Reg. 9925 (Sept. 10, 1946). More recently, the leverage

ratio requirement and the negative pledge requirement were codified in the former FHLBB's regulations as section 506.1 of title 12 of the Code of Federal Regulations. 12 C.F.R. § 506.1 (1989). Neither section 506.1 nor its predecessor, as they appeared in the Federal Register, contained any commentary or preamble to provide insight into the intent of the drafters. After the enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, which created the Finance Board, the FHLBB regulation was redesignated as section 910.1 of the Finance Board's regulations. However, the only change made in the regulation at that time was the agency's name. See 54 Fed. Reg. 36757 (Sept. 5, 1989).

TWO FHLBB General Counsel opinions have expressed the view that former section 506.1 sets forth requirements that are systemwide. In a memorandum to the director of the Office of District Banks, the General Counsel of the FHLBB observed that the FHLBanks are collectively responsible for complying with the negative pledge requirement and that it is a FHLBank systemwide requirement rather than an individual requirement that must be met by each FHLBank. Memorandum from Anne P. Jones, General Counsel FHLBB, to James W. McBride, Director Office Of District Banks, (March 9, 1979).

A more in depth discussion of the issue appears in an opinion that addressed whether former section 506.1 requires each individual FHLBank to maintain the leverage ratio requirement in order for the FHLBB to issue consolidated bonds. In that opinion, the General Counsel stated:

[O]nly the Bank System as a whole is required to have a debt to capital and reserves ratio of 12 to 1. Each individual FHLBank is not required to maintain the specific debt to capital and reserves ratio; however, the [FHLBB] is aware that the individual Banks have generally maintained that ratio, a practice which the (FHLBB) favors.

Pursuant to Section 11 of the Act, the FHLBanks are held jointly and severally liable for all the consolidated bonds and discount notes issued, regardless of the distribution of their proceeds. Thus, Section 11 of the Act views all the FHLBanks as an entity for purposes of any issuance of consolidated bonds by the [FHLBB]. It can be assumed that this perspective of viewing all the FHLBanks as an entity is also carried through to Section 506.1.

Letter from Thomas P. Vartanian to Timothy S. Wahl, (October 13, 1981).

These opinions indicate that the former FHLBB treated the conditions in section 506.1 (now section 910.1) as FHLBank systemwide requirements rather than requirements that applied to each individual FHLBank because section 11 of the Bank Act provides that the consolidated bonds "shall be the joint and several obligations of all the Federal Home Loan Banks." In essence, since the FHLBanks are collectively responsible for the entire debt, they are collectively responsible for seeing that the conditions set forth in section 910.1 are met.

Based on the foregoing, it is the opinion of the Office of the General Counsel that the negative pledge requirement set forth in section 910.1 of the Finance Board's regulations is a FHLBank systemwide requirement, rather than an individual requirement that must be met by each individual FHLBank.



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