

Federal Housing Finance Board

Memorandum

October 11, 1991

TO: Philip L. Conover, Director
District Banks Directorate

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SUBJECT: Federal Home Loan Bank Membership Requirements

I) BACKGROUND

On several occasions, we have been asked to determine whether a specific type of loan or investment meets the requirement that an institution "makes" long-term home mortgage loans (the "'makes' requirement") or the requirement that a new (post January 1, 1989) eligible member have at least 10 percent of its total assets in residential mortgage loans (the "10 percent requirement"). 12 U.S.C.A. §§ 1424(a)(1)(C) & 1424(a)(2)(A) (West Supp. 1991). The purpose of this memorandum is to coordinate with the District Banks Directorate, ("DBD") in-order to clarify these requirements.

The "makes" requirement and the 10 percent requirement are two separate requirements in section 4 of the Federal Home Bank Act ("Bank Act") both of which applicants must satisfy to be eligible for membership in the Federal Home Loan Bank System ("FHLBank System"). The "makes" requirement is part of the original 1932 version of the Bank Act. The 10 percent requirement was added to the Bank Act by the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA"). Pub. L. 101-73, Title VII, § 704(a) (August 9, 1989).

There are two significant distinctions between these requirements. First, the "makes" requirement uses the term "home mortgage loans." In contrast, the 10 percent requirement uses the term "residential mortgage loans." Only the former of these two terms is defined in the Bank Act. However, based on the legislative history, it appears that certain loans that may qualify under the 10 percent requirement may fail to satisfy the "makes" requirement.

Second, the "makes" requirement, unlike the 10 percent requirement, does not explicitly state a minimum threshold for qualification. The practical effects of these differences are discussed below.

II) THE CRITERIA FOR LOANS THAT SATISFY THE REQUIREMENTS DIFFER

The criteria for loans that meet the "makes" requirement are different from the criteria for loans that meet the 10 percent requirement. The "makes" requirement uses the term "home mortgage loans" which is defined in sections 2(5) and 2(6) of the Bank Act to include only loans secured by first mortgages or similar first liens on real estate. 12 U.S.C.A. §§ 1422(5) & 1422(6) (West supp. 1991). Therefore, loans secured by second mortgages on real estate would not satisfy the "makes" requirement. Furthermore, the legislative history provides evidence that the intent of Congress was that the term long-term home mortgage loans was to include only fully amortizing loans with maturities exceeding five years. Thus, the legislative history suggests that loans that are not fully amortizing over the term of the loan would not satisfy the "makes" requirement. In addition, it appears that Congress intended that in order to satisfy the "makes" requirement that the loan be for a term greater than five years.

In contrast, the 10 percent requirement contains the term "residential mortgage loan." Unlike the term "home mortgage loan" which is used in the "makes" requirement, residential mortgage loan is not defined in the Bank Act. However, the Conference Report accompanying FIRREA provides evidence that Congress intended the term "residential mortgage loan" to include a broad list of loans secured by mortgages on residential real estate including funded residential construction loans.

Since the term "residential mortgage loans" may be interpreted to include a wider range of residential loans than the term "home mortgage loan," certain types of loans may satisfy the 10 percent requirement that would not meet the "makes" requirement. Examples of such loans include balloon payment loans that are made to purchase, refinance, construct, improve or repair domestic residential housing and home equity loans. However, since both tests must be met to be eligible for membership, an applicant must make long-term home mortgage loans in addition to balloon payment loans or home equity loans to be eligible for membership.

Currently, there are at least two FHLBank membership applicants that make only balloon payment home mortgage loans with five or ten year maturities and 30 year amortization schedules. As mentioned above, these loans would qualify under the 10 percent requirement. However, based on the legislative history, they do not appear to meet the "makes" requirement, since they are not fully amortizing. Thus, they would not be eligible for membership since they do not meet both tests.

There may be some flexibility, however, for the Federal Housing Finance Board (the "Board") to broaden the "makes" requirement. Although the legislative history of the "makes" requirement suggests that balloon payment loans would not satisfy

that requirement, Congress did provide the Board with the discretion to determine what constitutes long-term home mortgage loans. Consequently, the Board could undertake to re-examine what constitutes an institution that "makes such home mortgage loans as, in the judgment of the Board, are long-term loans." As part of its determination, the Board should weigh the legislative history against the changes that have occurred in the residential mortgage market since the enactment of the "makes" requirement. It could then create a revised standard of what is a long-term mortgage loan. This standard, if the Board was comfortable, possibly could include non-amortizing loans.

III) QUANTITATIVE REQUIREMENTS

In addition to the differences among the types of loans that may satisfy each requirement, the required level of involvement in such loans also differs under each requirement. The 10 percent requirement is a clearly established quantitative test. In contrast, the "makes" requirement sets out no bright line quantitative standard. Therefore, the amount of lending activity sufficient to satisfy the "makes" requirement is subject to interpretation by the Board. Consequently, as part of its review of what constitutes a long-term mortgage loan, the Board may want to examine the amount of activity that would satisfy the "makers" requirement. In establishing the appropriate threshold, as is the case with defining long-term mortgage loans, it is necessary that the Board consider previous rulings of the former Federal Home Loan Bank Board ("FHLBB") and the legislative history of the "makes" requirement.

The Office of General Counsel ("OGC") of the former FHLBB has consistently construed the "makes" requirement as not imposing any type of quantitative or minimum amount requirement respecting either the dollar or numerical volume of home mortgage loan activity of an applicant. See Opin. Gen. Coun. FHLBB (Jan. 25, 1988); Opin. Gen. Coun. FHLBB (Nov. 7, 1978); Opin. Gen. Coun. FHLBB (Oct. 11, 1978); and Opin. Gen. Coun. FHLBB (June 25, 1973). Nonetheless, the "makes" requirement has been construed to require that prospective members "be making at least some investments" in long-term home mortgage loans." Id. Furthermore, an applicant's mortgage lending activity must evince "continuing policy" rather than "mere isolated instances." Id. Finally, the former FHLBB opined that the purchase of home mortgage loans or mortgage backed securities is within the "makes" requirement. Thus, an applicant did not have to originate such loans in order to satisfy the requirement. Opin. Gen. Coun. FHLBB (Opinion Division) (March 23, 1977).

There are a number of approaches that the Board might wish to take in determining what minimum level of involvement is, sufficient to satisfy the "makes" requirement. For instance, is the Board comfortable if an institution is merely offering to make long-term home mortgage loans to the public without having any such loans on its books? Is there some minimum percentage of

long-term mortgage loans that, if held by an institution, would satisfy the Board as meeting the "makes" requirement? Must the applicant provide some evidence that it is in the process of approving and processing long-term home mortgage loans at the time it submits its application for membership? Must there be evidence of a continuing policy to make or buy long-term mortgage loans and not isolated instances of such lending or purchases? This could include a review of the applicant's previous lending policies and a determination of whether or not they continue to make or buy long-term home mortgage loans. The Board's policy could provide for alternative means of meeting the "makes" requirement depending upon the business activities of the applicant.

IV) CONCLUSION

The "makes" requirement and the 10 percent requirement are two separate requirements in section 4 of the Bank Act. Applicants must satisfy both requirements to be eligible for membership in the Bank System. Our interpretation of the existing law is that an applicant that only makes balloon payment home mortgage loans would not satisfy the "make" requirement for membership. However, the Board may re-examine the "makes" standard and revise and refine that standard. We would therefore recommend that DBD consider whether it wants to recommend to the Board that such a re-examination occur through a membership regulation or otherwise. OGC stands ready to assist DBD in formulating policy recommendations involving the definition of long-term home mortgage loans and what level of involvement in long-term home mortgage loans is sufficient to satisfy the "makes" requirement.

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