

March 16, 1998

OPINION OF THE OFFICE OF GENERAL COUNSEL
[Redacted]

ISSUE: Whether the FHLBank of [] may accept as collateral for advances to a member 100 percent participation interests owned by the member's second-tier REIT subsidiary.

CONCLUSION:

Based on the FHLBank's descriptions of the transaction, and in reliance upon the opinions of the FHLBank's counsel, the FHLBank may be considered to have a security interest in collateral eligible under section 10(a) of the Federal Home Loan Bank Act (Bank Act), 12 U.S.C. § 1430(a), because, through pledges of 100 percent of the voting stock of the member's second-tier REIT subsidiary and its first-tier REIT holding company subsidiary, a pledge of the member's remaining legal interests in the mortgage loans, and other pledge and security agreements, the FHLBank will have obtained a complete security interest in the whole first mortgage loans underlying the participation interests and will have all of the rights that would exist in connection with a direct pledge of whole mortgage loans by its member.

I. Introduction

The Federal Home Loan Bank (FHLBank) of [] has asked the Federal Housing Finance Board's (Finance Board) Office of General Counsel (OGC) to opine as to whether, under the Bank Act and the regulations of the Finance Board, the FHLBank may permit [MEMBER], a FHLBank member, to secure FHLBank advances through a guarantee and surety agreement (G & S Agreement) with a second-tier subsidiary of [MEMBER] that will be secured by participation interests owned by the subsidiary.¹ [MEMBER] intends to transfer to the newly-created second-

¹ See Letter from [], FHLBank of [] General Counsel, to Deborah F. Silberman, Finance Board Acting General Counsel (Dec. 29, 1997) ([FHLBank General Counsel] Letter) (attachment 1); Memorandum from [], FHLBank of [] General Counsel, to Eric M. Raudenbush, Finance Board Attorney-Advisor (March 11, 1998) (Update) (attachment 2).

tier operating subsidiary 100 percent participation interests in certain mortgage loans and legal title to certain mortgage-backed securities (MBSs), all of which currently are pledged as collateral to secure outstanding FHLBank advances to [MEMBER]. The FHLBank has asked whether the subsidiary's G & S Agreement, secured by a pledge of the participation interests to be owned by the subsidiary, would constitute eligible collateral for the outstanding advances to [MEMBER] under section 10(a)(1) of the Bank Act.²

II. Background

According to the [FHLBank General Counsel] Letter, the Update and supplemental telephone conversations, [MEMBER] intends to establish a subsidiary real estate investment trust (REIT), called [REIT], which will be organized as a business trust under [] law. In order to gain certain tax advantages with respect to the income derived from mortgage loans and mortgage-backed securities (MBSs) that [MEMBER] now holds in its portfolio, [MEMBER] intends ultimately to transfer these loans and MBSs to [REIT]. As a prelude to this, [MEMBER] has established [HOLDING CO.], a [] Investment Holding Company, which will serve as a holding company for [REIT]. In exchange for a \$3,000 capital contribution, [MEMBER] has received all of the common stock of [HOLDING CO.].

[MEMBER] intends to transfer to [HOLDING CO.], in the form of an additional capital contribution, approximately \$4 billion worth of assets consisting of: (a) participation certificates representing 100 percent undivided participation interests in pools of whole mortgage loans to be assembled from [MEMBER]'s current portfolio of outstanding loans; and (b) MBSs culled from [MEMBER]'s investment portfolio.³ [HOLDING CO.] will then assign these participation interests and MBSs to [REIT] in exchange for all of the common stock of [REIT]. In addition, [HOLDING CO.] will invest \$1 million in [REIT] in exchange for 1,000 shares of non-voting preferred stock of [REIT]. 110 of these preferred shares then will be paid as a dividend to [MEMBER], which will distribute the shares to approximately 110 of its employees as bonus income. According to the FHLBank, these preferred shareholders will have a preference upon liquidation only as to accrued dividends that will be fixed at eight percent per share, but will have no voting rights and no other interests in the assets of [REIT].⁴

² See 12 USC. § 1430(a)(1). The FHLBank also has asked for an opinion regarding any safety and soundness concerns to which the proposed plan might give rise. This memorandum, however, addresses only the relevant legal issues.

³ With respect to the whole mortgage loans, [MEMBER] has chosen to transfer 100 percent participation interests therein, as opposed to merely selling the mortgage loans to [REIT] outright, in order to avoid the transaction costs that would be involved with endorsing every mortgage loan being transferred. Because there are many fewer MBSs than mortgage loans involved in the transaction and because of the complexity of creating participation interests in MBSs, [MEMBER] intends to sell the MBSs to [REIT] outright. According to staff conversations with FHLBank General Counsel, the method by which [MEMBER]'s ownership interests in the assets are transferred to [REIT] would have no bearing upon the tax benefits that [MEMBER] hopes to obtain under the proposed structure.

⁴ According to the FHLBank, if [REIT] distributes as dividends to [HOLDING CO.] all income generated by the loan pools, [REIT] will avoid any state tax liability for such income. [HOLDING CO.] will not be required to pay any state income tax on dividends derived from its [HOLDING CO.] of [REIT] stock because [] law does not impose any tax on passive income earned by a [] Investment Holding Company. In addition, because

The ongoing activities of both [REIT] and [HOLDING CO.] will be funded solely by the revenue generated from their assets. [MEMBER] will not guarantee to [REIT] or [HOLDING CO.] the payment of interest, dividends or principal on their assets in the event of default. These assets will continue to be managed, administered and serviced by the same individuals at [MEMBER] currently performing those responsibilities.

A significant portion of the mortgage loans and MBSs that would be the subject of the above-described transactions qualify as collateral eligible to secure FHLBank advances under section 10(a)(1) of the Bank Act and section 9359(a)(1) of the Finance Board's regulations, 12 U.S.C. § 1430(a)(1); 12 C.F.R. § 935.9(a)(1), and, in fact, currently are pledged as collateral for outstanding FHLBank advances to [MEMBER]. According to the FHLBank, the loans to be transferred to [REIT] that currently are pledged to secure outstanding advances to [MEMBER] will be pooled separately from other assets to be transferred to [REIT] and will be represented by discrete pool certificates.⁵ After the transfer of interests from [MEMBER] through [HOLDING CO.] to [REIT], the FHLBank will enter into G & S Agreements with both [REIT] and [HOLDING CO.], through which both entities will "guarantee and assume an unconditional obligation to repay current and future advances made to [MEMBER]." See Update at 1. In turn, the obligations incurred by [REIT] and [HOLDING CO.] under these Agreements will be secured by a pledge of all of their assets, which, in the case of [REIT], will include the mortgage loan participation interests and MBSs and, in the case of [HOLDING CO.], will include all of the common (voting) stock and 89 percent of the preferred (non-voting) stock of [REIT]. Through its existing Advances Agreement with [MEMBER], the FHLBank also will continue to hold as collateral any remaining legal interest that [MEMBER] may be found to have in the mortgage loans underlying the participation certificates that it will transfer to [REIT].⁶ In addition, the FHLBank intends to obtain from [MEMBER] a pledge of all of the stock of [HOLDING CO.].

Prior to consenting to [MEMBER]'s proposed plan, the FHLBank is seeking OGC's concurrence with the FHLBank's opinion, as expressed in the [FHLBank General Counsel] Letter, that the participation certificates to be pledged indirectly by [REIT] under the above-described scenario would constitute collateral eligible to secure advances made by the FHLBank to [MEMBER] under both the Bank Act and Finance Board regulations. The FHLBank argues that a 100 percent undivided participation interest in a pool of whole mortgage loans is "the functional (and legal) equivalent to owning the whole loans" because "[a]ll of the incidents of ownership (right to the income and the risk of loss) are transferred by contract to the new owner." See [FHLBank General Counsel] Letter at 4-5.

these earnings will be retained by [HOLDING CO.] and will not be passed through as dividends to [MEMBER], [MEMBER] will not be required to pay the [] Mutual Thrift Shares tax on the earnings, despite being the sole shareholder of [HOLDING CO.].

⁵ This is not mentioned in the [FHLBank General Counsel] Letter, but was conveyed to Finance Board staff by FHLBank General Counsel [] in a January 15, 1998 telephone conversation.

⁶ According to conversations with [FHLBank General Counsel], [MEMBER] does not have a sufficient amount of other eligible collateral to avoid the need to proceed with the proposed collateral substitution plan.

III. Analysis

A. Authority of the FHLBank to Enter Into a Surety Arrangement, Secured by a Pledge of Eligible Collateral, With Nonmembers [REIT] and [HOLDING CO.] as a Means to Secure FHLBank Advances to a Member. [MEMBER]

1. Under the Bank Act and Advances Regulation, the FHLBank May Enter Into a Surety Arrangement, Secured by a Pledge of Eligible Collateral, With [REIT] and [HOLDING CO.], Affiliates of MEMBER, [MEMBER], to Secure Advances to [MEMBER]

Section 10(a) of the Bank Act states, in pertinent part:

Each [FHL]Bank is authorized to make secured advances to its members upon collateral sufficient, in the judgment of the [FHL]Bank, to fully secure advances obtained from the [FHL]Bank. . . . A [FHL]Bank, at the time of origination or renewal of a loan or advance, shall obtain and maintain a security interest in collateral eligible pursuant to one or more of the following categories:

(1) Fully disbursed, whole first mortgages on improved residential property (not more than 90 days delinquent), or securities representing a whole interest in such mortgages. . . .

See 12 U.S.C. § 1430(a). In discussions with Finance Board staff, the FHLBank has indicated that the collateral now held by [MEMBER] and to be transferred to [REIT] is eligible only under paragraph (1) of section 10(a).⁷ Section 935.9(a)(1) of the Finance Board's Advances Regulation generally repeats the collateral requirements of section 10(a)(1) of the Bank Act by permitting FHLBanks to accept as collateral (i) "[fully disbursed, whole first mortgage loans on improved residential real property not more than 90 days delinquent," or (ii) certain privately-issued MBSs. See 12 C.F.R. § 935.9(a)(1)(i), (ii).

According to conversations with [FHLBank General Counsel], the G & S Agreements into which both [REIT] and [HOLDING CO.] will enter with the FHLBank will render both entities unconditionally liable to the FHLBank as sureties for current and future advances to [MEMBER].* As such, the G & S Agreements would appear to place both [REIT] and [HOLDING CO.] in the position of joint and several obligors with [MEMBER] to the FHLBank

⁷ Under paragraphs (2), (3) and (4) of section 10(a), the FHLBanks generally also are permitted to accept as collateral, respectively: federal agency securities; deposits of a FHLBank, and "other real estate related collateral" that has a readily ascertainable value and in which the FHLBank can perfect its security interest (where the aggregate amount of outstanding advances secured by such collateral does not exceed 30 percent of the borrowing member's capital). See 12 U.S.C. § 1430(a)(2) through (4).

⁸ Generally, although a suretyship essentially is indistinguishable from a guarantee, it is legally distinct from a guarantee in that a guarantor has a secondary liability to the creditor, while a surety has a primary and unconditional liability that is not contingent on a default by the principal. See 72 C.J.S. ¶ 7.

for advances made to [MEMBER]. See 72 C.J.S. ¶ 195(b). If this is the case, any collateral pledged by [REIT] or [HOLDING CO.] to secure the G & S Agreements essentially will be securing these entities' joint and several obligations to the FHLBank under the G & S Agreements and, therefore, can be considered to be pledged to secure FHLBank advances to [MEMBER].

Both section 10(d) of the Bank Act and section 935.4(b)(1) of the Advances Regulation, 12 U.S.C. § 1430(d); 12 C.F.R. § 935.4(b)(1), require that members applying for advances enter into a primary and unconditional obligation to repay the advance. By requiring the member receiving the advance to be primarily obligated for repayment of the advance, the language of the Bank Act appears to contemplate the existence of obligors other than the member itself on advances notes. The Bank Act does not expressly prohibit a non-member third party from acting as guarantor or surety for repayment of an advance made to a member. Thus, as long as the member receiving the advance is primarily and unconditionally responsible for repayment of the advance, it would appear to be permissible under the Bank Act and the Advances Regulation for a non-member to assume joint and several liability with the member under an advances note.

In addition, although both section 10(a) of the Bank Act and section 935.9(a) of the Advances Regulation authorize FHLBanks to make secured advances to members and specify the types of collateral that a FHLBank may accept as security for such advances, neither section explicitly requires that the collateral for an advance come solely from the member receiving the advance.⁹ In fact, the Bank Act and Advances Regulation, in setting forth the priority for certain secured interests, refer to a security interest granted to a FHLBank by any member of any FHLBank "or any affiliate of any such member." See 12 U.S.C. § 1430(e); 12 C.F.R. § 935.10(a). These provisions suggest that a non-member affiliate could pledge collateral to support a FHLBank advance to a member.¹⁰

Although [MEMBER] will not own the stock of [REIT] directly, it will control [REIT] by owning 100 percent of the stock of [HOLDING CO.], which, in turn, will own 100 percent of the voting stock of [REIT]. Accordingly, both [HOLDING CO.] and [REIT] may be considered to be "affiliates" of [MEMBER]. Therefore, the FHLBank may accept a pledge of eligible collateral from both [REIT] and [HOLDING CO.] to secure FHLBank advances to [MEMBER].

In sum, upon the condition that the G & S Agreements to be entered into by [REIT] and [HOLDING CO.] are secured by pledges of eligible collateral and place both [REIT] and [HOLDING CO.] in the position of joint and several obligors with [MEMBER] for FHLBank advances to [MEMBER], OGC believes that the FHLBank may enter into the G & S

⁹ See 12 U.S.C. § 1430(a); 12 C.F.R. § 935.9(a); Letter from Paul J. Drolet, Finance Board General Counsel, to Martin D. Eakes, Chief Executive Officer, Self-Help Credit Union (Jan. 5, 1996) (attachment 3).

¹⁰ In the context of FHLBank director eligibility, the Finance Board regulations define the term "affiliate" to include any "company which . . . is controlled by . . . a member," see 12 C.F.R. § 931.14, and define the word "control" to mean "[t]o own, control, or hold with the power to vote . . . ten (10) percent or more of the voting shares or rights of a company." See *id.* § 931.18. The term has not been defined in the Bank Act or the Advances Regulation.

Agreements, secured by a pledge of eligible collateral, with [REIT] and [HOLDING CO.] to secure advances to [MEMBER] under the Bank Act and the Advances Regulation.

2. Authority of [REIT] and [HOLDING CO.] Under [] Law to Act as Surety for, or Pledge Their Assets to Secure, Borrowings of [MEMBER].

The FHLBank has provided the Finance Board with a legal opinion of outside counsel which concludes that, so long as its governing instrument does not provide otherwise, both a [] Business Trust (i.e., [REIT]) and a [] corporation (i.e., [HOLDING CO.]) have the authority to act as surety, and to pledge their assets to secure, for debt obligations of an affiliated company, regardless of whether such an undertaking would benefit the entity acting as surety. ¹¹ The [OUTSIDE COUNSEL] Memo states further that, as a matter of contract law, the G & S Agreements to be entered into by both [REIT] and [HOLDING CO.], secured by a pledge of their assets, would need to be supported by consideration independent of that which supported the: original advances obligation between the FHLBank and [MEMBER]. The [OUTSIDE COUNSEL] Memo opines that the consideration need not flow directly to [REIT] if a benefit is shown to flow to [MEMBER], or if the FHLBank incurs detriment, deprivation or inconvenience. The [OUTSIDE COUNSEL] Memo suggests that the consideration could be viewed as: (1) the benefit that flows to [MEMBER] (tax savings) as a result of its ability to transfer the collateral; (2) the benefit that flows to [REIT] in the form of a transfer of the collateral; and (3) the FHLBank's waiver of one of its contractual rights under the advance agreement with [MEMBER] (i.e., the right to have [MEMBER] itself pledge collateral to secure its advances without the involvement of third parties). See [OUTSIDE COUNSEL] Memo at 4. Although not mentioned explicitly in the [OUTSIDE COUNSEL] Memo, the foregoing analysis would appear to apply also to a G & S Agreement between the FHLBank and [HOLDING CO.] that is secured by a pledge of [HOLDING CO.]'s stock in [REIT].

OGC has undertaken no independent verification of the conclusions reached in the [OUTSIDE COUNSEL] Memo and here expresses no opinion as to their correctness. However, in reliance upon [OUTSIDE COUNSEL]'s opinion of counsel that both a corporation and business trust are permitted under [] law to act as surety for, and to pledge collateral to secure the debt of, a parent company under the circumstances contemplated, that the governing instruments of [REIT] and [HOLDING CO.] are drafted so as to permit such a suretyship agreement and pledge, and that there is independent consideration for each suretyship agreement and pledge, it is the opinion of OGC that, under the Bank Act, both [REIT] and [HOLDING CO.]

¹¹ See Memorandum from [OUTSIDE COUNSEL] to [FHLBank General Counsel] at 3-4 (Feb. 4, 1998) ([OUTSIDE COUNSEL] Memo) (attachment 4); see also [] (1997) (stating that a [] corporation may "make contracts of guaranty and suretyship which are necessary or convenient to the conduct, promotion or attainment of the business of. . . a corporation which owns, directly or indirectly, all of the outstanding stock of the contracting corporation"); [] (stating that the governing instrument of a [] business trust "may contain any provision relating to the management of the business and affairs of the business trust . . . and, without limitation . . . may provide for the . . . sale, lease, exchange, transfer, pledge or other disposition of all or any part of the assets of the business trust . . ."). The term "contract of suretyship" does not appear to be defined under [] law. However, Black's Law Dictionary defines the term to include "a contract whereby one person engages to be answerable for the debt, default, or miscarriage of another." Black's Law Dictionary at 1293 (5th ed. 1979).

could enter into G & S Agreements with the FHLBank, under which they would pledge collateral to secure the FHLBank advances to [MEMBER].

B. Under the Proposed Plan, the FHLBank May Be Considered to Have an Interest in Collateral Eligible to Secure Advances Under Section 10(a)(1) of the Bank Act and Section 935.9(a)(1) of the Finance Board's Advances Regulation

The question presented by the FHLBank is whether a pledge by [REIT], through its G & S Agreement with the FHLBank, of its participation interests in the pool of whole mortgage loans, as opposed to a pledge of an interest in the underlying whole mortgage loans themselves, constitutes a pledge of collateral eligible to secure advances under section 10(a) of the Bank Act.¹²

1. The FHLBank May Be Considered to Have an Interest in Eligible Collateral Under Section 10(a) of the Bank Act and Section 935.9(a)(1)(i) of the Advances Regulation Because, Under the Proposed Plan, the FHLBank Will Have a Complete Security Interest in the Whole First Mortgage Loans Through the Pledges of [MEMBER], [REIT] and [HOLDING CO.]

Through the transfer to [REIT] of participation interests in the pools of whole mortgage loans, [MEMBER] will transfer all of its beneficial interests in the underlying whole mortgage loans to [REIT], but will retain legal title to the loans.¹³ The FHLBank intends, through its G & S Agreement with [REIT], to have a security interest in the participation certificates held by [REIT]. In addition, the FHLBank intends to have security interests in [MEMBER]'s remaining legal interest in the mortgage collateral, in the stock of [HOLDING CO.] held by [MEMBER] and in the stock of [REIT] held by [HOLDING CO.] (89 percent of the non-voting preferred stock and 100 percent of the voting common stock) -- all of which represent indirect ownership of the mortgage assets to be held by [REIT]. Given these precautions, it appears that the FHLBank will continue to have security interests in the mortgage loans via every possible avenue and that, in the aggregate, these security interests preserve for the FHLBank all the rights that currently exist in connection with its security interests in the mortgage loans of [MEMBER]. Therefore, in reliance upon the opinions of the FHLBank's counsel and assuming FHLBank compliance with the conditions stated herein, we concur in the FHLBank's conclusion that, under the proposed plan, the FHLBank may be considered to have an interest in collateral eligible to secure advances pursuant to section 10(a)(1) of the Bank Act and 935.9(a)(1)(i) of the Advances Regulation. This conclusion is conditioned upon Finance Board review of the underlying agreements and other documents.

¹² **Because** [MEMBER] intends to undertake an outright sale of the MBSs to [REIT], and because MBSs are eligible collateral to secure advances under section 10(a)(1) of the Bank Act, [REIT] clearly may pledge MBSs to secure FHLBank advances to [MEMBER].

¹³ A "beneficial interest" is the "[p]rofit, benefit, or advantage resulting from a contract, or the ownership of an estate as distinct from the legal ownership or control," while a "legal interest" is a "claim cognizable at law in contrast to an equitable *interest*." Black's Law Dictionary at 142,805 (5th ed. 1979).

2. In the Alternative, a Security Interest in [REIT]'s Participation Certificates Arguably Is the Functional Equivalent of a Security Interest in the Underlying Mortgage Loans, and Therefore Constitutes Eligible Collateral Under Section 10(a)(1) of the Bank Act and Section 935.9(a)(1)(i) of the Advances Regulation

The FHLBank asserts that a 100 percent undivided participation interest in a pool of whole mortgage loans is eligible collateral because it is "the functional (and legal) equivalent to owning the whole loans" in that "[a]ll of the incidents of ownership (right to the income and the risk: of loss) are transferred by contract to the new owner." [FHLBank General Counsel] Letter at 4-5. In support of its position, the FHLBank has provided the Finance Board with a memorandum from the Office of the Comptroller of the Currency (OCC) to the FHLBank stating that, for regulatory purposes, "[a] purchaser of a 100 percent undivided participation in a pool of mortgage loans would receive the exact same asset as if it would have purchased each individual loan in the pool."¹⁴

The FHLBank has not provided, and OGC has not found independently, any decisions under [] law that contain such a definitive conclusion.¹⁵ However, review of several federal decisions suggests that the beneficial owner of a loan generally is considered to possess all (elements of the loan that are capable of being subjected to a security interest.¹⁶ Therefore, if the proposed plan is a true transfer of beneficial interests in the whole mortgage loans from [MEMBER] to [REIT], and not in reality a secured loan from [MEMBER] to [REIT],¹⁷ a court following these holdings would be likely to consider the FHLBank's security interest in the participation certificates held by [REIT] to be the functional equivalent of a security interest in the underlying mortgage loans.

As described in the [FHLBank General Counsel] Letter, the revenue stream of [REIT] will be derived solely from the payments made on the mortgage loans underlying the participation interests and the MBSs that are to be transferred to [REIT] by [MEMBER]. That [MEMBER] has not guaranteed a return on the loan participations indicates that [MEMBER]

¹⁴ See Memorandum from Laurie Sears, Senior Attorney, OCC, to [FHLBank General Counsel] (Jan. 16,1998).

¹⁵ Although both [REIT] and [HOLDING CO.] will be chartered in [], both of these entities, as well as [MEMBER], will operate in [the state in which the FHLBank is located]. Because the FHLBank also is located in [the state in which the FHLBank is located], the law of [the state in which the FHLBank is located] will govern transactions between [MEMBER] and its subsidiaries and between [MEMBER] or its subsidiaries and the FHLBank.

¹⁶ See *McVay v. Western Plains Serv. Corp.*, 823 F.2d 1395, 1400 (10th Cir. 1987); *In re Southern Indus. Banking Corp.*, 45 B.R. 97,99-100 (Bankr. E.D. Term. 1984) (stating that the holder of bare legal title to loans has no remaining interest susceptible to garnishment).

¹⁷ Factors that federal courts have looked to in determining that the transfer of a participation interest is a true transfer of a beneficial interest, as opposed to a secured loan, include: that the participation agreement clearly reflects the parties' intent to effect a sale; and that the participant is subject to the normal risks of ownership and is not guaranteed a return by the originator. See *McVay*, 823 F.2d at 1398-99; *In re the Woodson Co.*, 813 F.2d 266, 271-72 (9th Cir. 1986); *In re Southern Indus.*, 45 B.R. at 99-100.

may be considered to have transferred beneficial ownership of the loans -- that is, the tangible value of the loans -- to [REIT], and that [MEMBER] will retain only bare legal title to the mortgage loans. Therefore, so long as the participation agreement makes clear that [MEMBER] intends to transfer to [R&IT], through [HOLDING CO.], the beneficial interest in the underlying mortgage loans, an argument can be made that the FHLBank's security interest in the participation certificates is the functional equivalent of a security interest in the underlying mortgage loans and, therefore, qualifies as eligible collateral under section 10(a)(1) of the Bank Act and section 935.9(a)(1)(i) of the Advances Regulation. However, because OGC has not received or found independently any definitive statement of [] law on these issues, OGC does not base its conclusions in this memorandum solely on the above-described analysis.

C. Perfectibility of the Participation Certificates and the Stock Collateral Pledged by [MEMBER] and [HOLDING CO.], as Required by Section 935.4(c)(3) of the Advances Regulation

Section 935.4(c)(3) of the Advances Regulation requires that a FHLBank's security interest in eligible collateral be "perfectible." See 12 C.F.R. § 935.4(c)(3). The [FHLBank General Counsel] Letter states that, under [the state in which the FHLBank is located] law," a participation certificate is considered to be either an "instrument" or a "general intangible" and that, therefore, the FHLBank may perfect its security interest in the collateral by taking possession of the participation agreement and the participation certificates and by filing a form UCC-1. See [FHLBank General Counsel] Letter at 6. OGC has not verified independently this conclusion and relies solely on the representations of the FHLBank with regard to this issue. In addition, while it appears that a security interest in the stock of [REIT] and [HOLDING CO.] would be perfectible under [the state in which the FHLBank is located] law, see [] (1997), OGC has not confirmed this conclusion with the FHLBank. Accordingly, OGC's conclusion that the proposed transaction complies with the terms of the Advances Regulation is contingent upon the participation interests and the stock of [REIT] and [HOLDING CO.] being perfectible under the law of [the state in which the FHLBank is located].

IV. Conclusion

Under the Bank Act and the Finance Board's Advances Regulation, the FHLBank may enter into the G & S Agreements, secured by a pledge of eligible collateral, with [REIT] and [HOLDING CO.] to secure advances to [MEMBER]. Collateral pledged by [REIT] and [HOLDING CO.] to secure the G & S Agreements essentially will be securing these entities' joint and several obligations under the G & S Agreements and, therefore, can be considered to be pledged to secure FHLBank advances to [MEMBER]. Under [] law, both [REIT], a [] business trust, and [HOLDING CO.], a [] corporation, have authority to act as surety for, and to pledge assets to secure, the repayment of the debts of their affiliate, [MEMBER]. Under the proposed plan, the FHLBank may be considered to have a security interest in eligible collateral because, through the pledges of [MEMBER], [REIT] and [HOLDING CO.] to the FHLBank, the FHLBank will have a complete security interest in the

¹⁸ See, *supra*, note 15.

pool of whole first mortgage loans and will continue to have all the rights that currently exist in connection with its security interests in the mortgage loans of [MEMBER].

In the alternative, an argument could be made that the FHLBank would have a security interest in eligible collateral under section 10(a)(1) of the Bank Act and section 935.9(a)(1)(i) of the Advances Regulation on the theory that [REIT]'s 100 percent undivided participation interests in the pool of whole mortgage loans are the functional equivalent of an ownership interest in the underlying loans. However, OGC need not adopt this theory to conclude that, under the proposed plan, the FHLBank will hold a security interest in whole mortgage loans as required by section 10(a)(1) of the Bank Act.

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