



REGULATORY INTERPRETATION 1999-RI-10

Date: April 7, 1999

Subject: Sequential Participations

Request Summary:

The Federal Home Loan Bank of New York (FHLBank) has requested that the Federal Housing Finance Board (Finance Board) determine whether a proposed FHLBank product called Sequential Participation to be offered under the FHLBank's Community Mortgage Asset (CMA) program is consistent with the CMA authority already granted to the FHLBank by Resolution Number 96-44, dated July 3, 1996.

Background:

According to the FHLBank, Sequential Participation allows the FHLBank to purchase participation interests in single-family mortgage pools created by members and divided into three tranches. The first tranche would be comprised of shorter cashflows, the second tranche would consist of longer cashflows while the third tranche is considered the credit support segment. The first and second tranches would constitute 97 percent of the pool (48.5 percent each) and the third tranche would be comprised of the remaining 3 percent of the pool. The FHLBank would purchase either the first or second tranche (with the member holding the other) and the member would be required to hold the third tranche. This third tranche would act as first loss coverage for the pool, for the life of the pool or until the position is exhausted.

In the proposal, the FHLBank notes that the benefits to members include: (1) providing a liquidity alternative to the secondary market, (2) creating greater member profits from credit risk management expertise and the avoidance of paying guarantee fees to Fannie Mae and Freddie Mac, (3) increasing profits by eliminating securitization costs, and (4) providing another interest rate risk management tool.

Analysis/Interpretation:

Resolution No. 96-44 provides that the FHLBank may acquire under CMA up to \$250 million in participation interests in housing and community development loans originated by members and eligible nonmember mortgagees subject to a number of conditions, including that the FHLBank shall ensure and certify to the existence of appropriate expertise, policies, procedures, and controls prior to program implementation; and that program implementation will be contingent upon confirmation by the Finance Board Office of Supervision that appropriate program policies, procedures, controls and reserves have been established by the FHLBank.

Based on the information provided in the FHLBank proposal, and assuming any additional information provided by the FHLBank to the Finance Board is not substantively different from the proposal, it is the view of Finance Board staff that Sequential Participation as described and set forth in the Proposal is authorized to be undertaken by the FHLBank under the terms of Resolution Number 96-44, subject to the terms and conditions set forth therein.

In accordance with Resolution Number 96-44, prior to implementation of the Proposal, the FHLBank must provide to the Finance Board a supplement to the proposal that (i) sets forth the FHLBank's business plan for Sequential Participation, including any market assessments and including pro forma financial projections for the program, and (ii) explains in detail the FHLBank's operational plan, including any policies, requirements, or limits to be imposed on the formation, pricing, and management of the tranches. This supplementary information will form the basis for the pre-implementation examination to be conducted by the Finance Board Office of Supervision under the terms of Resolution Number 96-44, and is intended to confirm that appropriate expertise, program policies, procedures, controls and reserves have been established by the FHLBank. In addition, the operations of the proposal will be subject to regular examination on an ongoing basis.

If you have any questions concerning the issues raised in this letter, please feel free to contact James L. Bothwell at 202-408-2821.

This is a Finance Board regulatory interpretation within the meaning of the Procedures for Requests and Applications adopted by the Board of Directors of the Finance Board pursuant to Resolution Number 98-51, dated October 28, 1998. The regulatory guidance set forth herein may be relied upon subject to modification or rescission by action of the Board of Directors of the Finance Board.