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**FEDERAL HOUSING FINANCE AGENCY**

[No. 2009-N-03]

**FHFA Study of Securitization of Acquired Member Assets****AGENCY:** Federal Housing Finance Agency.**ACTION:** Notice of Concept Release; request for comments.

**SUMMARY:** The Federal Housing Regulatory Reform Act (Act), Division A of the Housing and Economic Recovery Act of 2008 (HERA), requires the Federal Housing Finance Agency (FHFA) to conduct a study on the securitization of home mortgage loans purchased or to be purchased from Federal Home Loan Bank (Bank) System member financial institutions under the Acquired Member Assets (AMA) programs. FHFA is seeking public comment and hopes that the responses to this request for comments will constitute an important source of information that will assist it in its preparation of the study. FHFA urges commenters to analyze, in light of current market conditions, the benefits and risks associated with securitization, the potential impact of securitization upon liquidity and competitiveness in the mortgage and broader credit markets, the ability of the Banks to manage the risks associated with a securitization program, and the effect of a securitization program on the Banks' existing activities, as well as on the joint and several liability of the Banks and the cooperative structure of the Bank System. This release in no way alters current requirements, restrictions or prohibitions on the Banks with respect to the purchase or sale of mortgages or to the AMA programs.

**DATES:** Comments on the Concept Release must be received on or before April 28, 2009. For additional information, see **SUPPLEMENTARY INFORMATION**.

**ADDRESSES:** You may submit your comments on this Concept Release, identified by a subject line of "Securitization Study" by any of the following methods:

- *U.S. Mail, United Parcel Post, Federal Express, or Other Mail Service:* The mailing address for comments is: Alfred M. Pollard, General Counsel and Christopher T. Curtis, Senior Deputy General Counsel and Managing Counsel, Attention: Comments/Securitization

Study, Federal Housing Finance Agency, Fourth Floor, 1700 G Street, NW., Washington, DC 20552.

- *Hand Delivered/Courier:* The hand delivery address is: Alfred M. Pollard, General Counsel and Christopher T. Curtis, Senior Deputy General Counsel and Managing Counsel, Attention: Comments/Securitization Study, Federal Housing Finance Agency, Fourth Floor, 1700 G Street, NW., Washington, DC 20552. The package should be logged at the Guard Desk, First Floor, on business days between 9 a.m. and 5 p.m.

- *E-mail:* Comments to Alfred M. Pollard, General Counsel and Christopher T. Curtis, Senior Deputy General Counsel and Managing Counsel, may be sent by e-mail at [RegComments@FHFA.gov](mailto:RegComments@FHFA.gov). Please include "Securitization Study" in the subject line of the message.

- *Federal eRulemaking Portal:* <http://www.regulations.gov>. Follow the instructions for submitting comments.

**FOR FURTHER INFORMATION CONTACT:**

George G. Korenko, Senior Economist, (202) 408-2543 or Christina Muradian, Senior Financial Analyst, (202) 408-2584, Division of Federal Home Loan Bank Regulation; or Thomas E. Joseph, Senior Attorney-Advisor, Office of General Counsel for Federal Home Loan Bank Supervision, (202) 408-2512, Federal Housing Finance Agency, 1625 Eye Street, NW., Washington, DC 20006. The telephone number for the Telecommunications Device for the Deaf is (800) 877-8339.

**SUPPLEMENTARY INFORMATION:****I. Comments**

The Federal Housing Finance Agency (FHFA) invites comments on all aspects of the Concept Release and will consider all comments before issuing a report to Congress. FHFA requests that comments submitted in hard copy also be accompanied by the electronic version in Microsoft® Word or in portable document format (PDF) on CD-ROM.

Copies of all comments will be posted on the internet web site at <https://www.fhfa.gov>. In addition, copies of all comments received will be available for examination by the public on business days between the hours of 10 a.m. and 3 p.m., at the Federal Housing Finance Agency, Fourth Floor, 1700 G Street, NW., Washington, DC 20552. To make an appointment to inspect comments, please call the Office of General Counsel at (202) 414-3751.

**II. Purpose of Release**

Effective July 30, 2008, the Act, Public Law 110-289, 122 Stat. 2654 (2008),

transferred the supervisory and oversight responsibilities of the Office of Federal Housing Enterprise Oversight (OFHEO) over the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) (collectively, Enterprises), and the oversight responsibilities of the Federal Housing Finance Board (FHFB) over the Banks and the Office of Finance (which acts as the Banks' fiscal agent) to FHFA, a new independent executive branch agency. FHFA is responsible for ensuring that the Enterprises and the Banks operate in a safe and sound manner, that they maintain adequate capital and internal controls, that their activities foster liquid, efficient, competitive and resilient national housing finance markets, and that they carry out their public policy missions through authorized activities. See § 1102, Public Law 110-289, 122 Stat. 2663-64. The Enterprises and the Banks continue to operate under regulations promulgated by OFHEO and the FHFB until FHFA issues its own regulations. See *id.* at §§ 1302, 1313, 122 Stat. 2795, 2798.

Section 1215 of the Act requires the Director of FHFA to conduct a study on securitization of home mortgage loans purchased or to be purchased from Bank member financial institutions under the AMA programs.<sup>1</sup> See *id.* at § 1215, 122 Stat. 2791. The Act requires FHFA to submit a report to Congress by July 30, 2009, detailing the results of the study. The report must include policy recommendations based on the Director's analysis of the feasibility of the Banks, either individually or collectively, issuing mortgage-backed securities (MBS), and the benefits and risks associated with such a program.

The Act stipulates that the study address the benefits and risks associated with securitization of AMA; the potential impact of securitization upon liquidity in the mortgage and broader credit markets; the ability of the Banks to manage the risks associated with such a program; the impact of such a program on the existing activities of the Banks, including their mortgage portfolios and advances; and the effects of securitization on joint and several liability of the Banks and the cooperative structure of the Bank System. The Act further requires that in conducting the study, the Director

<sup>1</sup> As explained more fully in this release, AMA is the name given to conforming mortgage loans that the Banks purchase from their members pursuant to part 955 of current regulations. 12 CFR part 955. The transactions through which the Banks purchase AMA must meet a number of conditions set forth in the regulations. These conditions are explained more fully below.

consult with the Banks, the Office of Finance, representatives of the mortgage lending industry, practitioners in the field of structured finance, and other experts as needed. The Director also must establish a process for the formal submission of comments on the study. The purpose of this release is to solicit such comments regarding a potential Bank securitization program.

### III. Background

#### A. The Bank System

The twelve Banks are instrumentalities of the United States organized under the Federal Home Loan Bank Act (Bank Act). *See* 12 U.S.C. 1423, 1432(a). The Banks are cooperatives; only members of a Bank may own the capital stock of a Bank and only members or certain eligible housing associates (such as state housing finance agencies) may obtain access to the products provided by a Bank. *See* 12 U.S.C. 1426, 1430(a), 1430b. Each Bank is managed by its own board of directors and serves the public by enhancing the availability of residential mortgage and community lending credit through its member institutions. *See* 12 U.S.C. 1427. Any eligible institution (typically, thrifts, Federally insured depository institutions or state-regulated insurance companies) may become a member of a Bank by satisfying certain criteria and by purchasing a specified amount of the Bank's capital stock. *See* 12 U.S.C. 1424, 1426; 12 CFR part 931.

As government sponsored enterprises (GSEs), the Banks are able to borrow funds in the capital markets on terms more favorable than could be obtained by most other entities. Typically, the Bank System can borrow funds at a modest spread over the rates on U.S. Treasury securities of comparable maturity, although under recent market conditions spreads to U.S. Treasuries have widened considerably. The Banks can pass along their GSE funding advantage to their members—and ultimately to consumers—by providing advances (secured loans) and other financial services at rates that would not otherwise be available to their members. Some of the Banks also have AMA programs whereby they acquire fixed-rate, single-family mortgage loans from participating member institutions.

Consolidated obligations, consisting of bonds and discount notes, are the principal source for the Banks to fund advances, AMA programs, and investments. The Office of Finance issues all consolidated obligations on behalf of the twelve Banks. Although each Bank is primarily liable for the

portion of consolidated obligations corresponding to the proceeds received by that Bank, each Bank is also jointly and severally liable with the other eleven Banks for the payment of principal of, and interest on, all consolidated obligations. *See* 12 CFR 966.9.

#### B. AMA Regulation

In July 2000, the Board of Directors of the Finance Board adopted a final regulation governing AMA activities. *See* Final Rule: Federal Home Loan Bank Acquired Member Assets, Core Mission Activities, Investments and Advances, 65 FR 43969 (July 17, 2000) (hereinafter Final AMA Rule). The rule, contained in Part 955 of the Finance Board's regulations, remains in effect today. To date, two separate mortgage programs are authorized under Part 955—the Mortgage Partnership Finance (MPF) program and the Mortgage Purchase Program (MPP).

The AMA products are structured such that the Banks acquire, through either a purchase or funding transaction, whole, single-family mortgage loans from their members. Products exist for both conventional and government-guaranteed/-insured loans. The risks associated with the mortgages are such that the Bank manages the interest-rate risk and the member manages a substantial portion of the risks associated with originating the mortgage, including a substantial portion of the credit risk. Part 955 requires that the member provide a credit enhancement sufficient to enhance the credit quality of the assets to an equivalent of an instrument rated at least investment grade (e.g., BBB), although all approved AMA programs require members to enhance the loans to the second highest investment grade (e.g., AA). The member may provide this credit enhancement through various means.

In order for a Bank to acquire a mortgage loan as AMA, the loan must meet the requirements set forth under a three-part test established by regulation. *See* 12 CFR 955.2. The three-part test consists of a loan type requirement; a member or housing associate nexus requirement; and a credit risk-sharing requirement.

The loan type requirement establishes the types of assets that could be considered as AMA-eligible. Assets acquired by a Bank must fall within three certain categories. The assets may be whole loans eligible to secure advances that do not exceed the conforming loan limits that apply to the Enterprises. Further, the loans must be

secured by property located in a state.<sup>2</sup> The assets also may be whole loans secured by manufactured housing, regardless of whether such housing qualifies as residential real property. Finally, state and local housing finance agency (HFA) bonds are AMA-eligible. Interests in whole loans backed by mortgages that meet the previously noted asset type requirements are also eligible for purchase under AMA.<sup>3</sup>

The second part of the three-part test is the member or housing associate nexus requirement. The nexus requirement was established to ensure that the assets acquired by the Banks have some connection to a System member or housing associate. In order for an asset to be considered AMA-eligible, the asset must be originated (if a loan) or issued (if a bond) by, through, or on behalf of a Bank System member, housing associate, or affiliate thereof; or held for a "valid business purpose" by a Bank System member or housing associate prior to the acquisition by the Bank. In addition, the asset must be acquired from either a member or housing associate of the acquiring Bank; a member or housing associate of another Bank, but only pursuant to an arrangement between the Banks; or another Bank.

The final part of the three-part test is the credit risk-sharing requirement. The risk-sharing requirement was established to emphasize the cooperative nature of the Bank System by ensuring that the member or housing associate shares with the Bank the credit risks associated with the asset. *See* Final AMA Rule, 65 FR at 43975–78. While the first and second parts of the three-part test focus on asset eligibility, the third part focuses on the transactions through which the Bank acquires AMA. In general, the credit risk-sharing requirements prescribe the manner in which AMA products must be structured in order to ensure that the member bears the economic costs associated with enhancing AMA pools to at least a BBB level. The AMA regulation provides detailed credit risk-sharing structure requirements. *See* 12 CFR 955.3. Essentially, these

<sup>2</sup> As defined by regulation, "state" means a state of the United States, American Samoa, the Commonwealth of the Northern Mariana Islands, the District of Columbia, Guam, Puerto Rico, or the United States Virgin Islands. *See* 12 CFR 900.3.

<sup>3</sup> In fact, the Banks purchase whole, single-family mortgage loans under the AMA programs. The Chicago, Pittsburgh and Des Moines Banks have also purchased securities that represented senior interests in pools of AMA-qualified single-family mortgage loans under the MPF Shared Funding Program, but this program is not active. Banks have not purchased any manufactured housing loans or HFA bonds under the AMA programs.

requirements provide that AMA products must be structured such that the member provides a credit enhancement sufficient to bring a pool up to the equivalent of an instrument rated at least the BBB level or such higher level required by the Bank. The member must have direct economic responsibility for the credit enhancement that covers expected losses (*i.e.*, the member must be in the first loss position). For the portion of the credit enhancement beyond expected losses, the credit enhancement may be provided by a member's insurance affiliate; loan-level insurance (which includes U.S. Government insurance or guarantee) provided that the insurer is rated at least the second highest investment grade rating established by a Nationally Recognized Statistical Rating Organization (NRSRO); pool insurance, but only to cover the portion of the credit enhancement attributable to pool size; or another member. A member's credit enhancement obligation must be secured fully in parallel with the requirements for securing advances under Part 950 of the Finance Board's regulations.

### C. Mortgage Programs

Two AMA programs have been authorized by the Finance Board, MPF and MPP, under the AMA regulation. Additionally, two programs, MPF Xtra and Global Mortgage Alliance Program (GMAP), were authorized under the Banks' incidental authority. Prior to offering these programs to its members, each FHLBank underwent an application process with the Finance Board or FHFA, as appropriate. This application process included a safety and soundness examination to verify that the Banks had in place adequate policies, procedures, and controls to manage the risks presented by these programs.

As already noted, the AMA programs are designed, pursuant to regulation, such that members are responsible for a substantial portion of the credit risk while the Banks manage the interest rate, prepayment, and funding risks. The exact method through which the member assumes responsibility for the credit risk varies depending upon the structure of the AMA product. For example, the "MPF-Plus" and "MPP-Conventional" products both rely on supplemental mortgage insurance purchased by the member to credit enhance the mortgage pools to the equivalent of an AA-rating. The "MPF-Government" and "MPP-FHA" products rely on government insurance or guarantee to meet the credit-risk sharing requirements of the AMA

regulation. For other MPF products, members provide the amount of credit enhancement necessary to enhance the mortgage pools to achieve a putative rating of the second highest investment grade rating. The Banks determine the amount of the required credit enhancement by using methodologies verified by an NRSRO. The AMA programs allow members to receive compensation for providing the credit enhancement to the loans sold. The structure of this compensation varies both between MPF and MPP and among the various products offered under the MPF program.

The Banks that currently offer MPF to their members (MPF-Banks) are Boston, New York, Pittsburgh, Chicago, Des Moines, Dallas, and Topeka. The "MPP-Banks" are Atlanta, Cincinnati, and Indianapolis. Outstanding mortgages in the Bank System totaled \$87.9 billion as of September 30, 2008. Mortgage loans comprised 6 percent of total Bank System assets while advances (*i.e.*, loans made to member institutions) represented 71 percent of total assets.

In May 2007, the Finance Board approved the Atlanta Bank's request to offer GMAP under which it would facilitate the sale of certain qualified conforming mortgage loans from eligible members to another of its members, which would then securitize those loans. To date, no transactions have occurred under GMAP. In September 2008, FHFA approved the Chicago Bank's request to engage in the MPF Xtra program, under which it would buy certain qualified, conforming mortgages from eligible members for immediate onward sale to Fannie Mae. Neither MPF Xtra nor GMAP are AMA programs authorized under part 955 of the Finance Board rules. Since September 2008, five additional Banks requested and received approval to engage in MPF Xtra through the Chicago Bank. In both the GMAP and MPF Xtra programs, the mortgages are not held by the Banks and are not assets of the Banks. Instead, the participating Banks receive a fee for their role in the program.

### D. Securitization

In its most basic form, securitization of mortgages involves the sale of pools of mortgages from the holder of those instruments to a special purpose vehicle (SPV). The SPV would be organized to be legally distinct from the entity selling the mortgages and would be structured so that it would not be affected by problems associated with or bankruptcy of the original seller of the mortgages. The SPV often is structured as a trust. The SPV would in turn issue securities—generally referred to as

mortgage-backed securities (MBS)—that are backed by the pool of mortgages held by the SPV and represent an interest in the payments generated from that pool of mortgages. These securities themselves may be pooled together and new securities issued representing various claims to the underlying cash flows.

There are alternate formats for securitizing loans. For example, a simple form of an MBS is a mortgage pass-through, whereby all principal and interest payments (excluding a servicing fee) from the pool of mortgages are proportionately passed directly to investors each month. Thus, a holder of the MBS has an undivided, *pro rata* interest in the underlying pool of loans. By contrast, a collateralized mortgage obligation (CMO) is another type of MBS. Unlike a pass-through, a CMO has different classes of securities where net cash flows are divided differently among each class or tranche. The tranches are structured to have different risk characteristics and maturity ranges. Examples of differing structures are sequential pay, interest-only (IO), principal only (PO), and z-bonds. CMOs can be created directly based on an underlying pool of mortgages, but they are often created by pooling pass-through MBS and dividing the underlying cash flows from those securities into the various tranches. For tax purposes, transactions creating the CMOs generally are structured to qualify as Real Estate Mortgage Investment Conduits (REMICs) under the Internal Revenue Code. See 26 U.S.C. 860A–860G.

In securitizing loans, the Banks could also consider adding a guarantee that principal and interest on the MBS created under a Bank securitization program will be paid. The holders of the MBS, therefore, would not assume the credit risk associated with the pool of loans but would retain the market, interest rate, and prepayment risk. Essentially, the Enterprises currently operate in this way. They purchase conforming mortgage loans, use those loans to back the MBS they issue, and add a guarantee that the principal and interest on these securities will be paid in return for a fee that is paid by the seller of the loans. Banks could also have the option of securitizing loans directly or selling loans on to a third party and allowing that party to undertake the actual securitization.

#### IV. Policy and Safety and Soundness Considerations

##### A. Securitization of AMA

Certain characteristics of the AMA program make the securitization of the Bank's existing mortgage holdings more difficult than the securitization of new mortgages that may be acquired. For example, members enter into master commitments with the Banks participating in the MPF program. These master commitments define the terms under which loan sales to the Bank will take place, including the amount of the first-loss account, amount of the credit-enhancement fees paid to the participating financial institution, and the amount of the credit enhancement obligation. In addition, Banks have engaged in "participations," whereby one Bank has acquired an interest in the AMA holdings of another Bank. These two features leave the responsibility for losses, the credit enhancement responsibilities, and the ownership of some of the AMA, fragmented throughout the Bank System. To securitize the existing loans, the Banks may have to negotiate termination of these provisions.

To avoid these issues arising with newly purchased loans, the AMA regulation could be amended to make buying loans for securitization less complicated. For example, the credit risk sharing requirement could be waived for loans that would be securitized. In this way, their mortgage purchases would be similar to those of Fannie Mae and Freddie Mac. When purchasing mortgages, the Enterprises must, for example, purchase "conforming" loans and abide by any limits on the size of their overall portfolio that are imposed by FHFA. The conforming loan requirements include loan-to-value ratio limits, documentation requirements, and maximum loan size. For a securitization program, the Banks could follow existing loan-type requirements of the AMA program, including the purchase of only conforming loans, or they could be allowed to purchase mortgages from a more or less expansive pool of loans. In addition, some Banks have had difficulty managing the risks associated with their AMA portfolios. Thus, it may be prudent to limit the size and the growth of the AMA portfolio at the Bank level and/or at the System level.

With respect to securitization, we are seeking comment on the following:

A.1. Should the Banks be authorized to securitize loans? If so, should the Banks be authorized to continue their existing AMA programs in addition to being authorized to securitize loans?

Would a pass-through program such as MPF Xtra provide a better alternative to a direct securitization program?

A.2. Should individual Banks be authorized to securitize loans or should the securitization be conducted by the Bank System as a whole?

A.3. Should any limitations be imposed on the Banks with respect to the mortgages purchased either under the AMA program as it currently exists or under a modified AMA program? If so, what types of limitations should be imposed?

A.4. What are the ways that the master commitment obligations and participations between Banks can be unwound so that the existing AMA mortgages could be securitized and sold?

##### B. Credit Enhancement on MBS

One potentially critical feature of any MBS that the Banks securitize is the level of credit enhancement. For example, the Enterprises provide a guarantee of interest and principal payments on their MBS. If the Banks were to securitize mortgages, it may be beneficial to the program for them to provide a similar guarantee. The guarantee could be the joint and several obligation of all the Banks in the System or by a subset of the Banks if not all Banks are participating in the program. Alternatively, the Banks could securitize the AMA in a CMO structure, providing tranches, some with more protection against credit losses and some with less. The Banks could also purchase credit enhancement in the form of an insurance "wrap" provided by a highly rated private mortgage insurer.

With respect to credit enhancements, we are seeking comments on the following:

B.1. If the Banks securitize mortgages, should they guarantee the resulting MBS?

B.2. Given the Banks' joint and several liability for consolidated obligations, would it be reasonable for only a sub-set of the Banks to guarantee MBS?

B.3. If the Banks did not provide a guarantee, would other types of credit enhancement be economically viable or more efficient?

B.4. Would there be a viable market for MBS issued by the Banks or the Bank System?

B.5. How would the market in which these securities would trade be affected by the level and type of credit enhancement?

B.6. Would these securities be likely to trade similarly to Private Label MBS or Agency MBS, and if so, how might

such a program affect these markets? Alternatively, would such securities constitute a new market? How large would this program need to be to achieve a liquid market?

##### C. Benefits and Risks of Securitization

An important consideration in the establishment of a securitization program is an evaluation of the potential benefits and risks of such a program. If a securitization program were allowed, the potential benefits of such a program would need to be weighed against possible risks. Potentially, benefits could include increased liquidity and competition in the markets and greater access to smaller member financial institutions to sell mortgage loans. When the AMA programs were introduced, a primary goal was to provide participating member financial institutions with an alternative avenue to sell single-family mortgage loans with the risks aligned to the competencies of the members and the Banks. A securitization program could also help the Banks manage some of the risks such as interest rate risk associated with holding mortgages on their balance sheet. Difficulty in managing the interest rate risks associated with the AMA program has caused financial problems for some Banks.

The benefits of securitization would need to be weighed against the risks. For example, the Banks currently classify their AMA portfolios as held-in-portfolio. This classification is available to the Banks since they can demonstrate the intent and ability to hold these assets to maturity, and can insulate them from some changes in the market value of the assets. Mortgages acquired for a securitization program would likely be classified as held-for-sale, and fluctuations in the values of these assets would need to be reflected on the Banks' financial statements, potentially affecting earnings—and therefore, affect contributions to the Affordable Housing Program (AHP)<sup>4</sup>—and economic and regulatory capital. In addition, a successful program may require the Banks to build portfolios of mortgages that are substantially larger than those they are currently holding. While these mortgages are held in the portfolio and not yet securitized, the Banks may assume substantial market and credit

<sup>4</sup> Each Bank is required to allocate at least 10 percent of its prior year's net income to fund the AHP. Under the terms of the AHP, a member may submit an application to its Bank for funds to finance the purchase, construction or rehabilitation of housing for very low-, low-, and moderate-income households. See 12 CFR part 951.

risk, depending on the terms under which the mortgages are acquired.

With respect to the potential benefits and risks of a securitization program to the Banks, their members and housing markets more generally, we are seeking comment on the following:

C.1. Would the Bank's securitization of mortgages provide added liquidity and competition to the housing finance market?

C.2. What are the benefits to Bank System members?

C.3. Would the benefits be different for large and small members?

C.4. How would this activity further the public purpose of the Banks and promote the cooperative nature of the System? How would it affect the availability and affordability of mortgage credit, especially for low- and moderate-income households and first-time homebuyers?

C.5. How could the Banks' joint and several liability be affected?

C.6. What types of risk would the Banks face under a securitization program?

C.7. Do the Banks have the ability to manage these risks? What activities would the Banks need to undertake to mitigate and manage any such risks?

C.8. What prudential principles are needed and what prudential rules, limitations, and constraints would FHFA need impose on the Banks to ensure that securitization is conducted in a safe and sound manner?

#### D. Capital Requirements

The Bank Act states that each Bank must hold total capital equal to at least 5 percent of its total assets, provided that in determining compliance with this ratio, a Bank's total capital shall be calculated by multiplying its permanent capital by 1.5 and adding to this product any other component of total capital.<sup>5</sup> See 12 U.S.C. 1426(a)(2) and 12 CFR 932.2(b). The Bank Act also requires that when total capital is calculated without application of the

multiplier of 1.5, a Bank's total capital must equal at least 4 percent of its total assets. See 12 U.S.C. 1426(a)(2)(B) and 12 CFR 932.2(a). A Bank also must hold sufficient permanent capital to meet its market, credit and operations risk, as measured under current regulations. See 12 U.S.C. 1426(a)(3) and 12 CFR 932.3.

Under current capital requirements, loans purchased for securitization would be subject to the same capital requirements as AMA for the period of time a Bank held the loan, assuming the loans were purchased with a member credit enhancement. If the loans the Bank intended to securitize were purchased without a member credit enhancement, however, credit risk charges under the risk-based capital rules would likely be higher than for AMA because the credit quality of the unenhanced loans would be lower.<sup>6</sup> See 12 CFR 932.4.

If the Banks were to guarantee any mortgages that they sold for securitization against default, the current risk based capital rules would likely require the Banks to treat those mortgages as "Asset sales with recourse where the credit risk remains with the Bank." See *id.* and Table 2 of 12 CFR part 932. Under this provision, a Bank would have to treat the pools of loans underlying the guaranteed MBS as if it owned the loans and apply a credit risk charge appropriate for the credit rating of those loans. Such capital charges could prove prohibitive to a securitization program, especially if the loans did not retain a credit enhancement from the member after securitization. Banks may also need to modify their market risk models to assure that the models would calculate an appropriate market risk capital charge associated with the guarantees. See 12 CFR 932.5.

With respect to capital requirements, we are seeking comments on the following:

D.1. What, if any changes, to the current capital requirements may be necessary if the Banks were to undertake a securitization program?

D.2. Would the current rules need to be changed to account for credit or other risks associated with mortgage loan guarantees, if the Banks were to provide a guarantee, as part of the securitization program?

D.3. What are the risks related to mortgage loans and associated hedging

instruments that would be in a securitization pipeline?

D.4. How should the potential increased exposure to operational risk associated with a securitization program be captured by the risk based capital rules?

#### E. Financial Viability

For any securitization program to be a viable business line for the Banks, the program would need to generate an adequate return. The outlook for generating such a return can be affected by many factors including market conditions, economies of scale, and the form of the securitization program (*e.g.*, whether the Banks provide a guarantee on the securitized mortgages).

With respect to financial viability, we are seeking comments on the following:

E.1. What conditions, resources, and capabilities, including technological capabilities, would be necessary for the Banks to implement a viable securitization program?

E.2. What are the key factors for launching and operating a successful securitization program in the foreseeable future? What scale of operations would be necessary to operate a successful securitization operation?

E.3. Given the Banks' capabilities, what are the feasible strategic alternatives for competing in the securitization market?

E.4. How might the Banks achieve a comparative advantage over existing competitors in the market?

E.5. What segment of the market for MBS would the Banks serve? How would the Banks differentiate their MBS product from existing competitors in that market? Would there be sufficient demand for product securitized by the Banks?

E.6. Would the Banks be able to earn a sufficient return if the current structure of the AMA programs in which members provide the credit enhancement were carried over to the securitized products? Would a Bank guarantee of the mortgages be necessary to assure an adequate return for the Banks and/or the success of the program?

E.7. How would the Banks' advances programs (and returns from the advances business) be affected if the Banks also bought mortgages from members to securitize? Could a securitization program affect other Bank products, such as MPF Xtra?

E.8. How would the development of a market for covered bonds affect the feasibility of launching a securitization program?

<sup>5</sup> The Bank Act defines "permanent capital" as the amounts paid for Class B stock by members plus the Bank's retained earnings as determined in accordance with generally accepted accounting principles (GAAP), and defines "total capital" as permanent capital plus the amounts paid by members for Class A stock, any general allowances for losses held by a Bank under GAAP (but not any allowances or reserves held against specific assets) and any other amounts from sources available to absorb losses that are determined by regulation to be appropriate to include in total capital. See 12 U.S.C. 1426(a)(5). However, because the Banks have no general allowances for losses (not held against specific classes of assets) and no additional sources have been determined to be appropriate to include in total capital, a Bank's total capital currently consists of its permanent capital plus the amounts, if any, paid by its members for Class A stock.

<sup>6</sup> Current regulations would not allow the Banks to purchase and accumulate mortgage loans for securitization unless they were credit enhanced to investment grade by the member. The regulations would need to be amended before the Banks could purchase loans that were not credit enhanced. See 12 CFR 956.3(a)(4).

### F. Accounting Issues

Currently, the mortgages purchased under the mortgage purchase programs are designated by the Banks as Held-in-portfolio. Therefore, short-term market gains and losses on their purchased mortgage portfolios are not recognized in financial statements. If the Banks developed a securitization program, mortgage loans that they purchased for securitization would have to be designated as held-for-sale. Fluctuations in current market values of these loans would be recognized through current income while the loans are held by the Bank. Allowing a mortgage securitization program, therefore, could in theory create greater volatility in Banks' reported income, although such possibility must be weighed against the longer terms effects on income that might arise from not needing to hold purchased mortgages on their books for the life of the loans. The Banks could also be expected to implement hedging strategies that could mitigate the effects of market value changes in the mortgages held for securitization on their income.

Accounting considerations may also affect a Bank's decision as to whether it would securitize loans that it previously purchased with the intent to hold them to maturity. If a Bank determined that it wanted to securitize any of these loans, the Bank would need to identify which loans that it would likely securitize, and designate such loans as held-for-sale. It would also have to recognize immediately current market value gains and losses in current income and continue to recognize future changes in market value through income until the loans actually are securitized. Given that the mortgages portfolio for most Banks currently show market value losses, such immediate recognition of the losses initially could negatively affect a Bank's reported income.

If the Banks were to guarantee the payment of principal and interest on the MBS they issue, they would also have to record the guarantee on their balance sheets. Guarantees generally would appear to meet the definitions of derivatives under Statement of Financial Accounting Standard 133, but may qualify for the exemption provided for financial guarantee contracts in that statement. In any case, the use of a guarantee as part of the securitization program would affect the timing and the amounts of the Banks' reported income.

In September 2008, the Financial Accounting Standards Board (FASB) issued Exposure Drafts requesting public comment on a proposed amendment to Interpretation No. 46

(revised December 2003), *Consolidation of Variable Interest Entities* (FIN 46(R)) as well as to FASB Statement No. 140, *Accounting for Transfers of Financial Assets*. These amendments could significantly affect financial reporting for securitizations and associated guarantees. Therefore, the amendments could present challenges for the Banks in implementing a securitization program.

F.1. Would accounting considerations, including, but not limited to amendments to FIN 46(R) and FASB 140, present a major obstacle to the Banks' implementing a securitization program?

### G. Legal Issues

The Banks currently purchase mortgages under the incidental authority in sections 11(a) and 11(e)(1) of the Bank Act. 12 U.S.C. 1431(a) and (e)(1). In approving the initial mortgage purchase programs, the Finance Board noted that the programs were a way for the Banks to channel funds into residential housing finance in a manner that was functionally similar but technically more sophisticated than the advances programs. For that reason, it saw the activity as incidental to the dominant statutory purpose of the Banks to make advances. See Fin. Brd. Res. No. 96-111 (Dec. 23, 1996). See also, Office of General Counsel Opinion, 1996-GC-10 (Fin. Brd. Dec. 18, 1996).

The Finance Board's decision to allow the Banks to purchase mortgages was challenged in court, but it was eventually upheld by the Fifth Circuit Court of Appeals. See *Texas Savings v. Fed. Housing Fin. Brd.*, 201 F.3d 551 (5th Cir. 2000). In upholding the Finance Board's action, the court concluded that the Finance Board's interpretation of the Bank's incidental authority was "permissible \* \* \* because it is consistent with the structure and purpose of the \* \* \* Bank Act, i.e., to use the FHLBanks' access to low-cost funds in the securities markets in an effort to improve the level of housing finance." *Id.* at 556. While major amendments were made to the Bank Act in 1999 by the Gramm-Leach-Bliley Act and more recently by HERA, the Banks' central mission remains providing funding for housing finance so that the underlying reasoning in *Texas Savings* is still applicable. See 12

U.S.C. 1430. See also, § 1313, Public Law 110-289 (amending 12 U.S.C. 4513(a)(1)(B)(ii)).

Securitization would go beyond the Banks' current mortgage purchase programs. It would provide the Banks an additional means to manage the risks of these programs by allowing them to package and sell the loans that they purchase. The underlying purpose of the mortgage purchase programs—to channel funding into housing finance—would not be altered, however, by a securitization program. Thus, the underlying legal reasoning applicable to the mortgage programs might apply to a securitization program so that the Banks should be able to undertake such a program without additional changes to their authorizing statutes. This would especially appear to be true if the Banks do not also guarantee the payment of principal and interest for the MBS as part of the securitization program.

In fact, in 1999, the Finance Board approved a program for the New York Bank that allowed it to buy certain conforming mortgages and community development loans originated by members, pool the loans and create credit support and other tranches from those pools, and sell those interests back to its members. See Fin. Brd. Res. 1999-43 (Aug. 18, 1999) (approving modifications to Community Mortgage Asset Activities Program). See also Office of General Counsel Opinion, 1999-GC-03 (Fin. Brd. Aug. 12, 1999). The program required that the member that originated the loans buy the credit support tranche from the Bank, and that the loans sold by the member meet certain other requirements. The Bank was not authorized to guarantee payments on the pooled loans.

This program was approved under the Banks' incidental powers, as were the other mortgage purchase programs. See Fin. Brd. Res. 1999-43, and 1999-GC-03. In analyzing the program, the Finance Board's Office of General Counsel reasoned that the securitization of the loans in question both would be a means to help members control the risks of their housing and community development lending<sup>8</sup> and would be a means for the Bank itself to manage the risk of its investment portfolio so that the program would be "convenient and useful" in carrying out the Bank's express investment powers. See 1999-

<sup>7</sup> The court determined that it was sufficient that the Banks had authority to purchase mortgages as an activity incidental to their housing finance mission, and it did not find it necessary to consider the Banks' investment authority or the Finance Board's construction of the investment authority provision of the Bank Act. See *Texas Savings*, 201 F.3d at 551 n.5.

<sup>8</sup> The Opinion noted that one of the underlying purposes of amendments to the incidental power provisions of the Bank Act made by Federal Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) was to permit the Banks to assist members in controlling their costs, and the interest and credit risks arising from their activities. See 1999-GC-03 at 4-5.

GC-03 at 5. Although the Bank in question never implemented this program, so no loans were securitized under it, the legal reasoning remains valid given that the incidental powers provisions have not been amended since the program was approved. The same legal reasoning could be extended to a more general securitization program for the Banks.

With respect to legal issues, we are specifically seeking comment on the following:

G.1. Do the incidental authorities in section 11(a) and 11(e)(1) of the Bank Act provide a sufficient basis to authorize a securitization program, especially if the Banks are allowed to guarantee the securitized mortgages?

G.2. Are there other laws, such as the Government Corporation Control Act or specific tax provisions, which could create obstacles to a Bank securitization program?<sup>9</sup>

G.3. Given that different formats for securitization could be adopted by the Banks, would some formats present more legal obstacles to a program than others?

## V. Summary of Request for Comment

In anticipation of presenting a report to Congress by July 30, 2009, FHFA is seeking public comment with respect to a possible securitization program in the Bank System. Some of the policy and safety and soundness issues that FHFA would need to address in the study are described in this notice. FHFA anticipates that responses to the questions raised in this notice will constitute an important source of relevant data and analysis. In addition to responses on the specific questions raised, commenters should provide other information that they believe may be useful in our analysis and preparation of the FHFA report to Congress.

Dated: February 23, 2009.

**James B. Lockhart III,**

*Director, Federal Housing Finance Agency.*  
[FR Doc. E9-4262 Filed 2-26-09; 8:45 am]

**BILLING CODE 8070-01-P**

<sup>9</sup>For example, if the Banks were to issue CMOs as part of the program, the Banks would want such interests to qualify for the tax treatment provided to REMICs. The Banks, however, because they are not subject to Federal taxes, would most likely be considered a "disqualified organization" under the REMIC tax provisions and therefore could not hold any residual interests that were created by the securitization. See 26 U.S.C. 860E.

## FEDERAL RESERVE SYSTEM

### Change in Bank Control Notices; Acquisition of Shares of Bank or Bank Holding Companies

The notificants listed below have applied under the Change in Bank Control Act (12 U.S.C. 1817(j)) and § 225.41 of the Board's Regulation Y (12 CFR 225.41) to acquire a bank or bank holding company. The factors that are considered in acting on the notices are set forth in paragraph 7 of the Act (12 U.S.C. 1817(j)(7)).

The notices are available for immediate inspection at the Federal Reserve Bank indicated. The notices also will be available for inspection at the office of the Board of Governors. Interested persons may express their views in writing to the Reserve Bank indicated for that notice or to the offices of the Board of Governors. Comments must be received not later than March 16, 2009.

**A. Federal Reserve Bank of Minneapolis** (Jacqueline G. King, Community Affairs Officer) 90 Hennepin Avenue, Minneapolis, Minnesota 55480-0291:

1. *Gary Ihry; Mary Ihry; Wade Ihry; Marilyn Ihry; Keith Ihry; Brenda Ihry*, all of Hope, North Dakota, and *Reed Ihry*, of Devils Lake, North Dakota, to acquire voting shares of Quality Bankshares, Inc., and thereby indirectly acquire voting shares of Quality Bank, both of Fingal, North Dakota.

Board of Governors of the Federal Reserve System, February 24, 2009.

**Robert deV. Frierson,**

*Deputy Secretary of the Board.*

[FR Doc. E9-4206 Filed 2-26-09; 8:45 am]

**BILLING CODE 6210-01-S**

## FEDERAL RESERVE SYSTEM

### Notice of Proposals to Engage in Permissible Nonbanking Activities or To Acquire Companies That Are Engaged in Permissible Nonbanking Activities

The companies listed in this notice have given notice under section 4 of the Bank Holding Company Act (12 U.S.C. 1843) (BHC Act) and Regulation Y (12 CFR Part 225) to engage *de novo*, or to acquire or control voting securities or assets of a company, including the companies listed below, that engages either directly or through a subsidiary or other company, in a nonbanking activity that is listed in § 225.28 of Regulation Y (12 CFR 225.28) or that the Board has determined by Order to be closely related to banking and permissible for

bank holding companies. Unless otherwise noted, these activities will be conducted throughout the United States.

Each notice is available for inspection at the Federal Reserve Bank indicated. The notice also will be available for inspection at the offices of the Board of Governors. Interested persons may express their views in writing on the question whether the proposal complies with the standards of section 4 of the BHC Act. Additional information on all bank holding companies may be obtained from the National Information Center website at [www.ffiec.gov/nic/](http://www.ffiec.gov/nic/).

Unless otherwise noted, comments regarding the applications must be received at the Reserve Bank indicated or the offices of the Board of Governors not later than March 16, 2009.

**A. Federal Reserve Bank of Atlanta** (Steve Foley, Vice President) 1000 Peachtree Street, N.E., Atlanta, Georgia 30309:

1. *Educational Services of America, Inc. and Educational Funding of the South, Inc.*, both of Knoxville, Tennessee, to engage in community development activities, pursuant to section 225.28(b)(12) of Regulation Y.

Board of Governors of the Federal Reserve System, February 24, 2009.

**Robert deV. Frierson,**

*Deputy Secretary of the Board.*

[FR Doc. E9-4205 Filed 2-26-09; 8:45 am]

**BILLING CODE 6210-01-S**

## DEPARTMENT OF HEALTH AND HUMAN SERVICES

### National Institute for Occupational Safety and Health; Final Effect of Designation of a Class of Employees for Addition to the Special Exposure Cohort

**AGENCY:** Centers for Disease Control and Prevention (CDC), Department of Health and Human Services (HHS).

**ACTION:** Notice.

**SUMMARY:** The Department of Health and Human Services (HHS) gives notice concerning the final effect of the HHS decision to designate a class of employees at Vitro Manufacturing in Canonsburg, Pennsylvania, as an addition to the Special Exposure Cohort (SEC) under the Energy Employees Occupational Illness Compensation Program Act of 2000. On January 16, 2009, as provided for under 42 U.S.C. 7384q(b), the Secretary of HHS designated the following class of employees as an addition to the SEC:

All AWE employees who worked at Vitro Manufacturing in Canonsburg, Pennsylvania,