

foreign banks, required reserves are computed by applying the reserve requirement ratios below to net

transaction accounts, nonpersonal time deposits, and Eurocurrency liabilities of

the institution during the computation period.

Reservable liability	Reserve requirement
Net Transaction Accounts:	
\$0 to reserve requirement exemption amount (\$15.5 million) .....	0 percent of amount.
Over reserve requirement exemption amount (\$15.5 million) and up to low reserve tranche (\$115.1 million).	3 percent of amount.
Over low reserve tranche (\$115.1 million) .....	\$2,988,000 plus 10 percent of amount over \$115.1 million.
Nonpersonal time deposits .....	0 percent.
Eurocurrency liabilities .....	0 percent.

By order of the Board of Governors of the Federal Reserve System, acting through the Director of the Division of Monetary Affairs under delegated authority, October 26, 2016.

**Robert deV. Frierson,**  
*Secretary of the Board.*

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**FEDERAL HOUSING FINANCE BOARD**

**12 CFR Part 955**

**FEDERAL HOUSING FINANCE AGENCY**

**12 CFR Parts 1201, 1267, 1268, and 1281**

**RIN 2590-AA69**

**Acquired Member Assets**

**AGENCY:** Federal Housing Finance Board; Federal Housing Finance Agency.

**ACTION:** Final rule.

**SUMMARY:** The Federal Housing Finance Agency (FHFA) is issuing this final rule to reorganize and relocate the current regulation governing the Federal Home Loan Banks' (Banks) Acquired Member Asset (AMA) programs. More significantly, as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), it removes and replaces references in the current regulation to, and requirements based on, ratings issued by a Nationally Recognized Statistical Ratings Organization (NRSRO). It also provides a Bank greater flexibility in choosing the model it can use to estimate the credit enhancement required for AMA loans. Additionally, the final rule adds a provision allowing a Bank to authorize the transfer of mortgage servicing rights on AMA loans to any institution, including a nonmember of the Federal Home Loan Bank System (Bank System). The final rule allows the Banks to acquire mortgage loans that exceed the conforming loan limits if they are guaranteed or insured by a department

or agency of the U.S. government. The final rule excludes a proposed provision that would have eliminated the use of private, loan-level, supplemental mortgage insurance (SMI) in the member credit enhancement structure required by the AMA regulation, but does require Banks to establish financial and operational standards that insurers must meet to be qualified to provide insurance on AMA loans. Finally, the final rule deletes some obsolete provisions from the current regulation, and clarifies certain other provisions.

**DATES:** The final rule is effective January 18, 2017.

**FOR FURTHER INFORMATION CONTACT:** Christina Muradian, Principal Financial Analyst, *Christina.Muradian@fhfa.gov*, 202-649-3323, Division of Bank Regulation; or Neil R. Crowley, Deputy General Counsel, *Neil.Crowley@FHFA.gov*, 202-649-3055 (these are not toll-free numbers), Office of General Counsel, Federal Housing Finance Agency, 400 Seventh Street SW., Washington, DC 20219. The telephone number for the Telecommunications Device for the Hearing Impaired is 800-877-8339.

**SUPPLEMENTARY INFORMATION:**

**I. Background**

*A. The Bank System*

The eleven Banks are wholesale financial institutions organized under the Federal Home Loan Bank Act (Bank Act).<sup>1</sup> The Banks are cooperatives; only members of a Bank may purchase the capital stock of a Bank, and only members or certain eligible housing associates (such as state housing finance agencies) may obtain access to secured loans, known as advances, or other products provided by a Bank.<sup>2</sup> Each Bank serves the public interest by enhancing the availability of residential credit through its member institutions. Any eligible institution (generally, a federally insured depository institution

or state-regulated insurance company) may become a member of a Bank if it satisfies certain criteria and purchases a specified amount of the Bank's capital stock.<sup>3</sup> As government-sponsored enterprises (GSEs), the Banks have certain privileges under federal law, which allow them to borrow funds at spreads over the rates on U.S. Treasury securities of comparable maturity that are narrower than those available to corporate borrowers generally. The Banks pass along a portion of their funding advantage to their members and housing associates—and ultimately to consumers—by providing advances<sup>4</sup> and other financial services at rates that would not otherwise be available to their members. Among those financial services are the Banks' AMA programs, under which the Banks provide financing for members' housing finance activities by purchasing mortgage loans that meet the requirements of the AMA regulation.

*B. Overview of the Existing AMA Regulation*

The current AMA regulation has been in effect since July 2000. It authorizes the Banks to acquire certain assets (principally, conforming residential mortgage loans) from their members and housing associates as a means of advancing their housing finance mission, and prescribes the parameters within which the Banks may do so.

The core of the current AMA regulation is a three-part test, which establishes the requirements for a mortgage loan or other asset to qualify as AMA. The three-part test embodies the underlying policy regarding the acquisition of mortgages and other eligible AMA assets by the Banks. First, the asset requirement establishes that assets must be whole conforming mortgage loans, certain interests in such loans, whole loans secured by

<sup>3</sup> See 12 U.S.C. 1424; 12 CFR part 1263.

<sup>4</sup> Members are required to pledge specific collateral, mainly mortgages or other real estate related assets, to secure any advance taken down from a Bank. See 12 CFR 1266.7.

<sup>1</sup> See 12 U.S.C. 1423, 1432(a).

<sup>2</sup> See 12 U.S.C. 1426(a)(4), 1430(a), 1430b.

manufactured housing, certain state and local housing finance agency (HFA) bonds, and certain other assets that qualify as eligible collateral for a Bank advance. Second, assets must meet a member nexus requirement, meaning that a Bank must acquire the AMA assets from a member or housing associate that is a participating financial institution<sup>5</sup> in the Bank's AMA program or that of another Bank. In either case, the assets acquired by a Bank must be originated or held for a valid business purpose by a participating financial institution (or an affiliate thereof). Finally, to meet the credit risk-sharing requirement, a Bank must structure its AMA products such that a substantial portion of the associated credit risk of the acquired asset is borne by a participating financial institution.

### C. The Proposed Rule

The Federal Housing Finance Board (Finance Board)<sup>6</sup> adopted the current AMA regulation in July 2000, and neither the Finance Board nor FHFA subsequently has amended the regulation. FHFA issued the proposed rule in part to incorporate the AMA provisions into its own regulations and in part to give effect to section 939A of the Dodd-Frank Act, which requires federal agencies to remove from their regulations all references to, or requirements based on, ratings issued by NRSROs.<sup>7</sup> To comply with the Dodd-Frank Act requirements, the proposed rule would have eliminated the existing requirement for the Banks' members to credit enhance the AMA assets to specific NRSRO rating levels. Instead, the proposal would have required the Banks to establish a level of credit enhancement for each AMA product, using models and methodologies of their own choosing.

The proposed rule also contemplated making a number of other substantive changes, which would have: (1) Added several credit enhancement model-related provisions; (2) allowed for the transfer of servicing on AMA loans to

nonmembers, so long as the transfer did not cause the associated mortgage loan to cease to comply with the requirements of the AMA rule; (3) allowed for federal insurance or guarantees to provide the required credit enhancement, and eliminated the requirement for a member to bear the risk of loss from unreimbursed servicing expenses; (4) removed the provisions that allow for the use of SMI or pool insurance as part of the credit enhancement structure; (5) generally prohibited Banks from acquiring loans made to any insiders of the Bank or of the selling institution; and (6) added a new "grandfather" provision to allow a Bank to continue to hold AMA loans acquired as AMA products that the Finance Board or FHFA previously authorized.

Additionally, FHFA asked for comments relating to three specific issues. First, FHFA asked whether the regulation should continue to limit the size of AMA loans to those that meet the conforming loan limits and, more broadly, on any issues related to a Bank's purchase of AMA loans on properties located in designated high-cost areas. Second, FHFA asked whether FHFA should continue to authorize the purchase of AMA loans on manufactured housing that were deemed to be chattel loans under state law. Third, FHFA asked for comments related to the use and importance of SMI and pool insurance in credit enhancement structures that were acceptable under the regulation. FHFA specifically asked what type of standards should replace those in the current AMA regulation, which are based on an insurer's NRSRO rating, and how a Bank might evaluate the claims-paying ability of an insurer in the absence of a specific NRSRO credit rating requirement. FHFA also requested comments on whether, if it were to adopt specific requirements in the rule for SMI providers, such requirements also should apply to private mortgage insurance (PMI) providers.

In developing the proposed rule, FHFA retained the key policies underlying the original AMA regulation, which the Finance Board adopted in 2000, after the courts had upheld the authority of the Finance Board to permit the Banks to engage in this activity.<sup>8</sup> More specifically, the proposed rule retained the Finance Board's determination that the acquisition of AMA loans is the functional equivalent

of making advances such that it: (1) Allows the member or housing associate to use its eligible assets to access liquidity for further mission-related lending; and (2) requires all, or a material portion of, the credit risk attached to the mortgage assets to be borne by the member or housing associate.

FHFA also carried forward in the proposed rule the basic tenet of the current AMA regulation, which is that the Banks and their members each take advantage of their respective core competencies. As such, current AMA requirements allow members to do what they do best (manage their customer relationship) and for the Banks to do what they do best (manage the interest rate risk associated with those loans).<sup>9</sup> The proposed rule also maintained the basic AMA credit risk-sharing structure of the current regulation, which the Finance Board purposefully designed to mirror the risk allocation of advances. Specifically, when a Bank extends an advance to a member, the member is exposed to the credit risk (on the housing assets that the advances ultimately support), and the Bank is exposed to the interest rate risk associated with funding the advance. Under the current AMA regulation, the Bank and its member similarly allocate the interest rate risk and credit risk associated with funding and holding mortgage loans whenever a member sells the Bank an AMA loan.<sup>10</sup>

The current AMA rule's "three-part test" also embodies additional underlying policy determinations related to the acquisition of mortgage assets by Banks. The asset requirement, *i.e.*, limiting AMA to loans that do not exceed the conforming loan limit, addresses mission issues and establishes a level playing field among the Banks, Federal National Mortgage Association (Fannie Mae), and Federal Home Loan Mortgage Corporation (Freddie Mac) with respect to the types of residential mortgages loans eligible for purchase. The member or housing associate nexus requirement, *i.e.*, limiting the potential sellers of AMA to a Bank member or housing associate, ensures that the Banks do not extend the benefits of their GSE status to institutions that are not part of the Bank System, thus aligning

<sup>5</sup> A participating financial institution is a member or housing associate approved by a Bank to sell mortgage loans to the Bank or otherwise participate in its AMA program.

<sup>6</sup> The Finance Board was regulator for the Bank System prior to the creation of FHFA in 2008, at which time supervisory and oversight responsibilities for the Bank System were transferred to FHFA. By statute, the Finance Board regulations, including the existing AMA regulations, remain in effect until such time as FHFA acts to modify or supersede them. See 12 U.S.C. 4511 note.

<sup>7</sup> See 15 U.S.C. 78o-7. Although FHFA cannot include within its regulations requirements based on NRSRO ratings, the Dodd-Frank Act does not prohibit the Banks from using such ratings in conducting their business.

<sup>8</sup> See *Texas Savings and Community Bankers Association v. Federal Housing Finance Board*, 201 F.3d 551 (5th Cir. 2000) (*hereinafter Texas Savings*).

<sup>9</sup> Although the AMA regulation requires the member to bear a significant amount of the credit risk (which may be accomplished through a variety of ways), the Bank remains exposed to some credit risk from those loans.

<sup>10</sup> The advance and AMA risk-allocation structures are different from the risk-allocation structure used by Fannie Mae and Freddie Mac, whereby they are exposed to the credit risk and sell the interest rate risk.

the program with the cooperative structure of the System. The credit risk-sharing requirement encourages members or housing associates to use sound underwriting practices by requiring them to retain a material exposure to the credit risk associated with the mortgage assets sold to the Bank.

The underlying policy considerations embodied in the current and proposed AMA rule are also closely aligned with the legal reasoning that supported the Finance Board's initial authorization of the mortgage loan purchase pilot program, an approval that predated adoption of the AMA regulation. Although the Federal Home Loan Bank Act (Bank Act) does not specifically authorize a Bank to purchase mortgage loans, the Finance Board determined that the authority conferred by section 11(e) of the Bank Act, which authorizes a Bank to carry out activities that are incidental to those specifically authorized by the Bank Act, provided authority for the Banks to purchase mortgage loans from their members.<sup>11</sup> Certain parties challenged the Finance Board's approval of the pilot program, but the Fifth Circuit Court of Appeals agreed with the Finance Board that the incidental powers provision of the Bank Act provided authority for the mortgage purchase program and upheld the Finance Board approval of the program.<sup>12</sup>

In reaching its conclusion, the court considered the Finance Board's determination that a Bank's purchase of mortgages from its members involved an activity that was incidental to the Banks' housing finance mission and represented another method by which the Banks could act as a reservoir of liquidity for members' housing finance lending, albeit in a manner that was "technically more sophisticated than, yet functionally similar to, that which occur[red] when a [Bank] makes an advance."<sup>13</sup> The court also determined that the Finance Board had authority to define the scope of the incidental powers provision, given its ambiguity, and that the Finance Board's construction of that power with regard to the mortgage purchase pilot program was permissible because it was consistent with the structure and purpose of the Bank Act. In particular, the court noted that under the pilot program, the Banks used their access to low-cost funds in capital markets in an effort to improve the level of housing finance. The basic structure and

requirements for the mortgage purchase pilot program reviewed by the court later formed the basis for the specific provisions of the current AMA regulation, including the core three-part test.

#### *D. Overview of Comments on the Proposed Regulation*

The proposed rule provided a comment period of 120 days, which closed on April 15, 2016. FHFA received 65 comment letters on the proposed rule, two of which were not responsive to issues raised by the proposed rule. FHFA reviewed every comment letter and considered all of the comments in developing the final rule.

Approximately three-quarters of the commenter letters came from Bank System members, most of whom filed a substantively similar letter. The eleven Banks filed a joint letter. Eight of the nine Banks that offer the Mortgage Partnership Finance (MPF) program to their members also filed a separate joint letter, which addressed issues beyond those addressed by the joint letter from the eleven Banks. FHFA also received letters from trade associations, including the American Bankers Association, five state banking associations, an association of mortgage insurers, and one mortgage insurance company.

Taken as a whole, the comments requested changes to the proposed rule that would be at odds with the existing policy and legal principles underlying the three-part test. Some commenters suggested that Banks be permitted to purchase loans from institutions that are not Bank System members, which would effectively extend the benefits of membership to institutions that cannot become members and thus cannot receive advances from the Banks. Further, some commenters suggested Banks be permitted to create their own risk-sharing structures under which members would not necessarily be required to retain a meaningful exposure to the credit risk associated with the mortgage loans they sold to the Banks under AMA programs. None of these comments provided a reasoned analysis addressing how their proposed revisions to the proposed rule would be consistent with the legal and policy determinations on which the current regulation is predicated. After considering these comments, FHFA has determined not to alter the basic three-part test for AMA, as set forth in the proposed rule, which remains the most appropriate means of ensuring that the AMA programs operate consistently with the Banks' legal authority and with the policy and safety and soundness

goals established by the Finance Board. These goals include limiting the benefits of GSE funding to those institutions that Congress has authorized for membership or for housing associate status, which is consistent with the cooperative nature of the Bank System, and that members maintain a degree of financial "skin-in-the game" with regard to AMA assets, which helps to ensure that loans are well underwritten, protects the Banks against the expected credit risk associated with the purchased assets, and is consistent with the sharing of financial risks that are present when Banks make advances to their members.

The comments also generally opposed FHFA's proposal to remove the option of allowing SMI or pool insurance as part of the credit enhancement structure, even though no AMA products currently use that option. They further opposed the imposition of any requirements on a Bank's ability to buy loans on which any director, officer, employee, attorney, or agent of a Bank, or of the selling member institution, was the borrower. Several commenters advocated allowing the Banks to buy AMA loans with principal balances that exceed the conforming loan limits applicable to Fannie Mae and Freddie Mac, while others made a number of specific technical suggestions for changes to language of proposed rule provisions.

The primary comments regarding each of the substantive aspects of the proposed rule, as well as FHFA's responses to some of those comments, are discussed below. Comments addressing specific rule provisions are discussed in part II of **SUPPLEMENTARY INFORMATION**, which describes the final rule in detail and the ways in which it differs from the proposed rule.

#### 1. Comments on the Definitions

Commenters recommended that FHFA make a number of technical suggestions to several of the definitions in the proposed rule. Some commenters suggested that FHFA revise the proposed definition of "AMA product" to exclude loans that the Banks acquire and hold temporarily until they aggregate a sufficient number of loans to transfer the loans to another entity, such as is done under certain off-balance sheet programs.

Other comments suggested that FHFA revise the proposed definition of "investment quality" to capture the unique characteristics of the mortgage loans acquired for the AMA program. These Banks pointed out that they acquire AMA loans over time with the expectation that a certain number of

<sup>11</sup> See 12 U.S.C. 1431(e).

<sup>12</sup> See, *Texas Savings*, 201 F.3d at 551.

<sup>13</sup> *Id.* at 554–555.

such loans will become delinquent or go into default. Thus, even if credit enhancements were to allow a Bank to recoup full repayment of principal for a particular loan, the payments received on such a loan may not be “timely” as required by the proposed definition. Moreover, the commenters noted that the models used by the Banks to calculate the credit enhancement and pricing for a particular AMA loan already take into account the expected delinquencies and defaults for the loan pool as a whole.

Commenters also suggested that FHFA revise the proposed definition of “participating financial institution” to reflect that an institution may participate in an AMA program in more than one way, *i.e.*, as a seller, servicer, or credit enhancer of the AMA assets, but not necessarily all of these activities. The proposed definition would have included only those members that the Bank had approved to sell loans into an AMA program and, therefore, would not have captured the full set of potential participating financial institutions.

Commenters further suggested that FHFA change the proposed definition of “pool” to reflect that FHFA has allowed Banks to offer AMA products for which they aggregate loans that have been purchased from different sellers into a single pool. The proposed definition had implied that a pool would include only those loans sold by a single seller under a single master commitment.

## 2. Comments on the Authorization of AMA

Section 1268.2 of the proposed rule would have authorized the Banks to invest in assets that qualify as AMA under the terms of the proposed rule, but also would have added a provision regarding “grandfathered transactions,” meaning those authorized under the current AMA regulation.

Commenters suggested that FHFA expand the proposed grandfather provision to include any purchase of mortgage loans pursuant to any AMA purchase commitment agreements that remained open as of the effective date of any final rule. They suggested that FHFA make this change to address the possibility that any of the previously approved AMA products might not comply with the requirements of the final rule. The commenters, however, did not identify any specific category of current AMA loans or products to which these requested changes could apply, and did not identify which of FHFA’s proposed changes to the rule might conceivably cause any active AMA products or structures to fail to comply with the final rule.

A number of commenters urged FHFA to include within the final rule a provision allowing the Banks to sell AMA loans, or participation interests therein, to other Banks and to Bank members, including members of other Bank districts. They also asked FHFA to allow the sale of AMA loans and pools or interests in such loans or pools to any party—not just members. The commenters noted that any such sales would reduce a Bank’s exposure to market risk and free up resources for additional purchases. Commenters also asked that FHFA allow the Banks the flexibility to design other means to transfer risk associated with AMA purchase to third parties, apart from sales of the loans or interests in the loans. None of these comments provided specific requirements or suggestions for structuring such sales or any analyses of compliance issues that may arise under other regulatory requirements that could apply to such sales, including issues that could arise under federal securities laws or the risk retention rule for asset securitizations.<sup>14</sup> Given the lack of specifics provided, FHFA has not altered the proposed rule in response to any of these comments, but notes that nothing in the current or proposed rule would prevent a Bank from selling AMA loans or developing a program to transfer risk on those loans to third parties. Any such transactions, however, would likely require that the Banks obtain FHFA approval under the new business activity regulation, which would also require that the Banks demonstrate that they have the legal authority under the Bank Act to undertake the proposed activity. Given that an assessment of the legal authority and risks associated with any such proposed transactions is apt to depend significantly on the particular facts of each proposal, FHFA does not believe that it would be appropriate to provide a general authorization for such as part of this rulemaking. Instead, FHFA expects that it would be more appropriate to identify and assess any legal, regulatory, or policy issues associated with such proposals after a Bank has devoted the time and resources to develop a specific structure and identify the market for such transactions.

## 3. Comments on the Asset Requirement

The proposed rule at § 1268.3(a)(1) retained the current prohibition on the Banks acquiring AMA loans that exceed the conforming loan limits. In proposing the rule, FHFA expressly asked for comments regarding loan size, including

any issues related to a Bank’s purchase of loans in designated high-cost areas, as well as whether FHFA should continue to limit the size of AMA loans to those that meet the conforming loan limits.<sup>15</sup> A few commenters supported allowing the Banks to acquire loans that exceed the conforming loan limits, while one commenter opposed that change, and others supported the change, provided that the nonconforming loans were limited to those that are guaranteed or insured by a department or agency of the U.S. government.

The proposed rule would have added new provisions at §§ 1268.3(a)(3) and (b) to restrict the Banks from acquiring as AMA any mortgage loans that had been made to a director, officer, employee, attorney, or agent of the Bank or of the selling institution unless the Bank’s board of directors specifically approved such a purchase and FHFA endorsed the Bank’s resolution. The Bank Act generally prohibits the Banks from accepting such mortgage loans as collateral for advances.<sup>16</sup> FHFA had proposed extending the substance of that provision to the AMA programs, reasoning that a statutory prohibition on taking a security interest in such loans logically should apply as well to the purchase of those same loans because ownership of the loan confers on the Bank a greater interest in the loan, along with the attendant risks, than does the acquisition of a security interest in the same loan. Nearly every comment letter FHFA received requested that FHFA remove the proposed provision from the final rule. Generally, commenters noted that participating financial institutions underwrite loans to such persons to the same standards as all other AMA loans, and, therefore, there is little likelihood that persons employed by the Bank or its members will obtain mortgage loans on favorable terms that might expose the Bank to increased credit risk. Accordingly, those commenters urged FHFA to permit the Banks to purchase the loans without restriction.

The proposed rule at § 1268.3(b) would have continued to authorize the Banks to purchase as AMA manufactured housing loans regardless of whether such housing qualifies as real property under state law, which would include as AMA chattel loans on manufactured housing. FHFA requested specific comments on this provision.<sup>17</sup> A couple of commenters urged FHFA to retain this provision in the final rule, contending that manufactured housing fulfills a need for affordable housing

<sup>15</sup> See Proposed Rule, 80 FR at 78691.

<sup>16</sup> See 12 U.S.C. 1430(b); 12 CFR 1266.7(f).

<sup>17</sup> See Proposed Rule, 80 FR at 78692.

<sup>14</sup> See 12 CFR part 1234.

and that Banks should be able to continue to support their members' determinations about how to meet those needs in their market areas. No commenters opposed the provision.

The proposed rule at § 1268.3(a), which is substantively unchanged from the existing regulation, would have allowed the Banks to acquire as AMA any whole mortgage loans that are eligible to secure advances under FHFA's advances collateral regulation.<sup>18</sup> One commenter contended that the Banks should be able to buy as AMA mortgage loans on multifamily properties, as well as residential land acquisition, development and construction loans, given that these loans also qualify as collateral for advances. FHFA notes that the existing AMA regulation already allows the Banks to buy those types of loans as AMA, given that they may qualify as other real estate-related collateral under the advance collateral regulation. The proposed amendments would not change that authority. Before commencing a program to buy such loans as AMA, however, a Bank likely would have to obtain FHFA approval under the new business activity regulation, and would have to demonstrate that the new AMA product otherwise satisfied all of the requirements of the AMA rule.

#### 4. Comments on the Member or Housing Associate Nexus Requirement

Section 1268.4 of the proposed rule would have retained the member nexus requirement, which requires that AMA assets must have been originated or held for a valid business purpose by a member or housing associate, and must be acquired from a member or housing associate of the acquiring Bank, or from another Bank. As previously discussed, the Finance Board originally adopted this requirement to ensure that the benefits of Bank System membership are not extended to nonmembers. Commenters suggested that FHFA amend the AMA regulation to authorize the Banks to acquire mortgage loans directly from affiliates of their members, which would include nonmember institutions.

#### 5. Comments on the Credit Risk-Sharing Requirement

The Finance Board originally established the credit risk-sharing requirement to ensure that members have a material exposure to the credit risk associated with the AMA assets that they sell to their Banks, which was consistent with the risks undertaken by

members when funding loans for their own portfolios with Bank advances. FHFA received many comments on different aspects of the credit risk-sharing requirement, nearly all of which generally supported loosening the requirement in some fashion. The comments on the individual credit risk-sharing sections, taken together, would have the effect of permitting the Banks to create what they characterized as their own risk-sharing structures, but would not necessarily have required that the Banks structure their AMA products such that the participating financial institution actually continued to have a material exposure to the credit risk associated with the mortgages they sell to the Banks. For example, some commenters asked that the Banks be allowed to transfer the credit enhancement obligation to nonmember institutions, which would have the effect of eliminating the current structure under which members bear the expected losses on the AMA products. Other commenters requested that FHFA permit arrangements under which an affiliate of a member, rather than a member itself, could satisfy any portion of the credit enhancement obligation or that FHFA allow a member to transfer its credit enhancement obligation to any other institution that is willing to assume that obligation.

Some commenters requested that FHFA allow Banks to create an AMA structure that would permit participating financial institutions to accept a price adjustment for the mortgage loans, in lieu of providing a credit enhancement for those loans. Under such an arrangement, the participating financial institution would receive a lesser price from the Bank in return for the Bank agreeing to bear the credit risk, and the price adjustment would vary in proportion to the amount of credit risk the Bank would bear. Other commenters requested that a participating financial institution meet part, or all, of its credit enhancement obligation simply by pledging collateral. Those commenters, however, did not explain how such an arrangement would work or how it would differ from the current enhancement approach used under the Mortgage Partnership Finance (MPF) program, in which a participating financial institution pledges collateral to secure its obligation to absorb a specified amount of the credit losses on mortgage loans sold to the Bank.

The proposed rule also would have carried over the timing requirements of the current regulation regarding the date by which a Bank must calculate a member's total credit enhancement obligation. Thus, the proposal would

have required that a Bank make that determination at the earlier of 270 days from the time a Bank acquires a loan from the member for a particular pool or when the pool reaches \$100 million. Commenters asked that the final rule allow the timing of determining the final credit enhancement vary based on the structure of the particular product. For example, commenters noted that under products where the member pre-funds the credit obligation the Banks should be able to calculate the required credit enhancement at the time the pool closes.

The proposed rule would have added several model-related requirements at § 1268.5(e). Specifically, the proposed rule would have required a Bank to: (1) Validate its model and methodology at least annually and make the results available to FHFA upon request; (2) institute and maintain a process for monitoring model performance that would include tracking, back-testing, benchmarking, and stress testing the model and methodology; (3) inform FHFA prior to making any material changes to the model and methodology, and (4) promptly change its model and methodology as directed by FHFA. Commenters generally requested that the final rule provide general guidance regarding models and methodologies, rather than the specific provisions proposed in the rule, described above.

The proposed rule would have eliminated the option of allowing members to use SMI and/or pool insurance to meet a part of their credit enhancement for AMA assets. The current AMA regulation allows the use of SMI as part of the credit enhancement if the insurance provider has obtained a rating from an NRSRO of no lower than the second highest investment grade. The regulation also allowed pool insurance if the insurance were used to enhance against geographic concentration or pool size risk.

FHFA proposed to remove the option of using SMI and pool insurance in the credit enhancement structure in part based on the experience during the financial crisis, when no private mortgage insurance company was able to maintain an NRSRO credit rating at the minimum level required by the current AMA regulation, and on concerns that other private mono-line insurers could face similar problems in the future. Further, FHFA considered that the Banks have in place alternate AMA structures and products that do not rely on SMI and that eliminating the use of SMI from authorized credit enhancement structures would remain consistent with the intent of the AMA regulation to require participating

<sup>18</sup> See 12 CFR 1266.7.

financial institutions to bear the direct economic consequences of the credit risk associated with AMA assets and not transfer such risk to third parties.<sup>19</sup> Finally, because the current AMA regulation relies on an NRSRO rating to define eligible insurers, FHFA must change or delete that provision in order to comply with section 939A of the Dodd-Frank Act, which bars federal regulatory agencies from incorporating NRSRO ratings requirements into their regulations.

In the preamble to the proposed rule, FHFA specifically requested comments regarding the use and importance of SMI or pool insurance as part of an allowable credit enhancement structure.<sup>20</sup> In particular, FHFA solicited comments on what type of requirements could replace the specific credit rating requirement for insurance providers if it were to retain these insurance options as part of the credit enhancement structure. Further, FHFA requested comments on how a Bank might evaluate the claims-paying ability of an insurer in the absence of a specific credit rating requirement. Finally, FHFA requested comments on whether, if it were to adopt in the AMA regulation specific minimum requirements of SMI and pool insurance, such requirements also should apply to PMI providers.

No commenters responded to the specific questions FHFA posed in the proposed rule regarding these topics, but many comments opposed the elimination of a provision that would authorize the use of SMI and pool insurance as part of the credit enhancement structure, and no commenters supported the removal of this option. Commenters generally argued that FHFA did not articulate a sound reason for removing the insurance option from the rule and that FHFA's focus on credit ratings for mortgage insurers ignored the actual claims paying abilities of these firms. They also pointed out that mortgage insurance providers, including those in run-off, have paid all "valid" claims, with 96 percent of claims paid in cash and the remainder due over time.<sup>21</sup> Commenters also noted that mortgage insurers and their regulators have taken steps to enhance the financial strength of the insurers, improve regulatory oversight, and increase clarity and

reduce ambiguity in master insurance policies. At least one commenter noted that using insurance in the credit enhancement structure did not undermine the incentive to sell quality loans under the AMA regulation because lower insurance premiums would be associated with lower-risk mortgages.

Commenters also noted that use of SMI and pool insurance provided important economic benefits to members that sell AMA loans to the Banks, by reducing capital charges on the retained credit enhancement and transferring risk associated with the enhancement to third parties. A number of commenters stated that the Banks could develop internal ratings for SMI and pool insurance providers and pointed to the Enterprises' Private Mortgage Insurer Eligibility Requirements (PMIERS) recently adopted by Fannie Mae and Freddie Mac as an example of acceptable standards, although some commenters said that PMIERS should not be the only standard used for qualifying insurance providers. These commenters suggested that FHFA could condition use of such internal standards on a Bank demonstrating the effectiveness of its approach prior to introducing products that use SMI or pool insurance. Some comments also suggested that the rule not restrict insurance providers to mono-line mortgage insurers, although the current AMA regulation only requires that insurance be provided by an insurer. Thus, the AMA regulation already allows multiline insurers to provide SMI or pool insurance if they meet the other requirements in the regulation.

A number of commenters stated that FHFA should not impose specific requirements in the regulation on providers of borrower-financed PMI and instead should continue current practice of letting the Banks identify acceptable providers. Other commenters said that if FHFA wished to add such a requirement, it should require the PMI provider to meet PMIERS. Still other commenters urged FHFA to consider a broader range of insurance products as part of the credit enhancement structure and allow a member to rely on insurance to cover the entire credit enhancement obligation rather than just the amount in excess of the member required direct enhancement, as under the current regulation.

#### 6. Comments on Mortgage Servicing Rights

No commenter objected to FHFA's proposal to allow a participating financial institution to transfer servicing

rights on AMA loans to any institution approved by the Bank, regardless of whether it was a member. Some commenters objected to a related change that would have relieved a participating financial institution of the responsibility for paying the unreimbursed servicing expenses on loans guaranteed or insured by a federal department or agency as a means of meeting its credit enhancement obligation for such loans. FHFA had proposed that change in order to facilitate the transfer of mortgage servicing rights on federally insured or guaranteed AMA loans to a nonmember institution, because for such loans the responsibility for unreimbursed servicing expenses transfers with servicing rights. The commenters disagreed with FHFA's statement that requiring a member to retain exposure to unreimbursed servicing expenses on loans guaranteed or insured by a department or agency of the U.S. government was unlikely to substantially affect the underwriting for such loans, given the requirements and standards already imposed by the provider of the federal guarantee or insurance. They believed that the proposed change would alter the underlying premise for AMA in the case of such federally guaranteed or insured loans—namely that members needed to have "skin in the game" for loans sold to the Banks. The commenters did not address why continuing to allow SMI or pool insurance would not similarly be contrary to this aspect of the AMA program.

#### 7. Comments on Administrative Transactions and Agreements Between Banks

Section 1268.8 of the proposed rule addressed the delegation of administrative AMA program duties (*i.e.*, back-office operations) and the ability to terminate AMA agreements between Banks. FHFA made no substantive changes to this section of the rule when it proposed the amendment. Commenters asked FHFA to make two changes to this section. First, commenters asked to add regulatory language to the delegation of administrative duties provisions to allow a Bank to contract with other parties (including other Banks) to provide services related to administration of its own or its delegated AMA program without having to disclose such delegation to participating financial institutions. Second, commenters asked to add regulatory language to the delegation of pricing provision to allow Banks to specify that a Bank that has delegated its AMA pricing function to another Bank

<sup>19</sup> See Proposed Rule, 80 FR at 78694–95.

<sup>20</sup> See *id.*

<sup>21</sup> Payments "due over time" represent obligations of indefinite duration issued by insurers that they will pay the remainder of any amounts owed under a claim at some point in the future. In many cases, troubled insurers paid only part of what was owed under a claim (*e.g.*, 50 cents on the dollar) with the remaining amount due over time.

may retain its right to refuse to acquire AMA at certain prices pursuant to contractual provisions among the parties.

#### 8. Comments on Other FHFA Regulations

FHFA received comments requesting that it consider two other regulations—those pertaining to Bank housing goals and new business activities—as part of its review of the AMA rule, even though FHFA had not proposed to address either of those matters as part of this rulemaking. FHFA believes that the issues raised by commenters pertain to matters that are beyond the scope of this rulemaking and are best considered as part of FHFA rulemakings related to the other regulations.

As to the matter of Bank housing goals, these commenters called on FHFA to align the AMA regulation and the new housing goals regulation. Without providing specific examples, the commenters suggested that the AMA regulation should provide flexibility for the Banks to offer AMA products and purchase AMA loans as one means to satisfy the housing goals regulation requirements. FHFA also received many comments asking it to address FHFA's current new business activity regulation, as it may be applied to the Banks' AMA programs. The majority of commenters believed that the new business activity filings were burdensome and resulted in significant delays to the Banks' ability to improve their programs. More specifically, they sought to exclude from the new business activity review process certain types of modifications or expansions to existing AMA programs and products. These suggestions are much the same as those received in response to a separate rulemaking in which FHFA had proposed certain amendments to the existing new business activity regulation, and which FHFA will consider as part of that rulemaking.

## II. Section-by-Section Analysis of the Final Rule

### A. Definitions—§ 1268.1

The proposed rule included definitions for four new terms to be used in the AMA regulation, which are: “AMA product,” “AMA program,” “participating financial institution,” and “pool.” FHFA intended for these terms to help simplify and clarify other provisions in the regulation and, with the exception of revisions made in response to certain comments, as discussed below, is adopting those definitions as proposed. FHFA has expanded the proposed definition of

“participating financial institution” to reflect the fact that a participating financial institution may be approved to sell AMA loans to a Bank, but also could be approved (either in conjunction with or apart from its role as a seller of loans) to service those loans, or provide a credit enhancement for them. FHFA has also clarified the wording for the definition of “pool” to reflect the fact that FHFA has authorized some Banks to aggregate AMA pools, which requires that the definition make clear that a pool may contain loans sold by more than one member or other source.

FHFA has also modified somewhat the proposed definition of “AMA product” to make clear that while each Bank may develop and establish different AMA products and structures, all such products and structures must comply with the provisions of the AMA regulation. This change was based on language suggested by the comments. FHFA did not, however, alter the definition to specifically exclude loans held by a Bank on its balance sheet for a short time prior to transferring them to another entity, as some commenters requested. Generally speaking, mortgage loans purchased under the Banks' off-balance sheet programs are not intended to qualify as AMA, and thus do not have all of the features that are necessary for a mortgage loan to qualify as AMA. Therefore, such loans would not come within the new definition of “AMA product”, which specifically includes only those loans that comply with all of the requirements of the AMA regulation.<sup>22</sup> In light of that fact, there is no need to specifically exclude these loans from the definition.

In response to issues raised by the commenters, FHFA is also adding new definitions in the final rule for the terms “AMA investment grade” and “qualified insurer.” The term “AMA investment grade” modifies and replaces the proposed definition of “investment quality.” FHFA developed the definition of “AMA investment grade” based on comments received on the proposed definition of “investment quality.” The term “qualified insurer” is used in provisions that FHFA is adding back to § 1268.5, which will allow Banks to use pool and loan-level insurance as part of an eligible credit

<sup>22</sup> In approving most of these off-balance sheet products, FHFA specifically recognized that the loans did not qualify as AMA loans. The one exception was the MPF Government MBS product. However, in that case, part of FHFA's reasoning for approving the product was that the Bank would purchase loans that qualified as AMA and would treat the loans as AMA loans while it accumulated them on its balance sheet.

enhancement structure for AMA products. FHFA addresses these new definitions in more detail below, in its discussion of § 1268.5 of the final rule. FHFA is also adopting, without further change, its proposed amendments to the definitions of “expected losses” and “acquired member assets” in 12 CFR part 1201.<sup>23</sup>

### B. Authorization for Acquired Member Assets—§ 1268.2

FHFA is adopting § 1268.2 as proposed.<sup>24</sup> This section generally authorizes the Banks to invest in AMA, subject to the requirements of FHFA's AMA and new business activity regulations. This section also includes a “grandfather” provision that authorizes a Bank to continue to hold as AMA any loans that FHFA or the Finance Board previously authorized for purchase, even if the loan would not meet one or more of the requirements of the final rule. The grandfather provision covers all loans that were previously authorized for purchase by any regulation, order, or other agency action, such as waiver of particular requirements that allowed a Bank to purchase the loan.<sup>25</sup> The grandfather provision at § 1268.2(b), however, does not allow a Bank to continue to purchase new loans that do not meet the requirements of the final rule after the rule becomes effective.

One commenter requested that FHFA expand the grandfather provision to include any purchase of mortgage loans pursuant to any open commitment as of the effective date of the final rule. The commenter stated that this would assure the Banks could fulfill any existing commitments to purchase loans if any of the existing Bank AMA products did not meet the requirements of the final rule. FHFA noted in proposing the rule, however, that it believed that all currently active AMA products would

<sup>23</sup> See Proposed Rule, 80 FR at 78690–91. FHFA also made non-substantive changes to the wording of the definition of “expected losses” to clarify the meaning of the term, but these changes were not intended to alter the scope of the proposed definition.

<sup>24</sup> Section 1268.2 carries over the substance of the general Bank authority to purchase and hold AMA now found at 12 CFR 955.2. As part of the final rule, however, FHFA is moving the loan type, member nexus, and credit-enhancement requirements also now found in current 12 CFR 955.2 to §§ 1268.3, 1268.4, and 1268.5. FHFA is also making other changes to these provisions.

<sup>25</sup> For example, on August 5, 2011, FHFA waived the ratings requirement for SMI providers in the current regulation to allow Banks to continue to buy loans that used SMI as part of the credit enhancement structure, even though no SMI provider met the ratings requirement. This grandfather provision would allow the Banks that bought loans pursuant to that waiver to continue to hold those loans.

meet the requirements of the proposed rule.<sup>26</sup> The commenter did not provide an example of an active AMA product that would not meet the requirements of the proposed rule. As a consequence, FHFA has not revised the proposed grandfather provision in response to the comment. In the unlikely event that a Bank determines that an existing AMA product would not meet all of the requirements under this final rule, FHFA would allow the Bank to continue to honor any contractual obligations it had entered into under a commitment that had been entered into prior to the effective date of this rule and that complied in all respects with the requirements of the existing AMA regulation.

### C. Asset Requirement—§ 1268.3

#### 1. Asset Types

Section 1268.3 of the final rule sets forth the four categories of asset types that are eligible for purchase as AMA. As adopted, it closely follows current 12 CFR 955.2(a), although the final rule also incorporates specific authority for Banks to acquire as AMA certain certificates representing interests in AMA-qualified whole loans, which is based on a Finance Board approval of a similar transaction in 2002. The first of these categories allows a Bank to acquire as AMA any whole loans that are eligible to secure advances to members under FHFA's advances regulation, at 12 CFR 1266.7. These assets include: (1) Fully disbursed, whole first mortgage loans on improved residential real property not more than 90 days delinquent; (2) mortgages or other loans, regardless of delinquency status, to the extent that they are insured or guaranteed by the United States or any agency thereof, and such insurance or guarantee is for the direct benefit of the holder of the mortgage or loan; (3) loans that qualify as "other real estate-related collateral," which requires that such loans also have a readily ascertainable value, can be reliably discounted to account for liquidation and other risks, can be liquidated in due course, and in which the Bank can perfect a security interest; and (4) loans acquired from community financial institution (CFI) members or their affiliates, for small business, small farm, small agri-business, or community development purposes, and which are fully secured by collateral other than real estate, or securities representing a whole interest in such secured loans. Such CFI collateral also must have a readily ascertainable value, be able to be

reliably discounted to account for liquidation and other risks, and be able to be liquidated in due course.

As under current 12 CFR 955.2(a), § 1268.3 of the final rule authorizes a Bank to purchase as AMA manufactured housing loans regardless of whether such housing constitutes real property under state law. FHFA specifically requested comment on whether it should continue to authorize the purchase of manufactured housing loans as AMA if relevant state law considers the loans to be chattel loans. FHFA received only a few comments in response to this request, which supported retaining the current regulatory text, citing, among other things, the importance of manufactured housing in meeting affordable housing needs in certain markets. As a result, FHFA has determined not to change the scope of existing authority and the final rule will continue to allow Banks to purchase as AMA manufactured housing loans regardless of whether state law considers them to be real property or chattel loans. The third category of asset types is state and local housing finance agency bonds, which is unchanged from the corresponding provision of the current regulation. FHFA received no comments advocating for changes to this provision.

The fourth category of asset types pertains to certain certificates that represent interests in loans that qualify as AMA. This category of assets is not addressed by the current regulation, but the Finance Board had previously approved a Bank's request to acquire such assets as AMA. The effect of including this provision in the final rule is to codify the previous Finance Board determination that such assets may qualify as AMA. When the Finance Board adopted the current AMA regulation, it noted, in response to comments, that the rule would allow the Banks to buy structured products as AMA, provided the products met certain identified conditions.<sup>27</sup> Section 1268.3(d) incorporates these conditions, which require that any such certificate must: (i) Be backed by loans that themselves qualify as AMA and that meet the member nexus requirement; (ii) Meet the requirement that the certificate is enhanced to AMA investment grade; (iii) Be issued

<sup>27</sup> Currently, this authority is set forth in a discussion in the **SUPPLEMENTARY INFORMATION** of the **Federal Register** release originally adopting the AMA regulation. See Final Rule: Federal Home Loan Bank Acquired Member Assets, Core Mission Activities, Investments and Advances, 65 FR at 43974, 43977 (July 17, 2000) (*hereinafter* 2000 Final AMA Rule). The Finance Board approved one AMA product under this authority (in December 2002), which is now inactive.

pursuant to an agreement between the Bank and the participating financial institution under which the participating financial institution shares credit risk as required by the regulation; and (iv) Are acquired substantially by the initiating Bank or Banks.

By incorporating the substance of the Finance Board's earlier approval into the regulatory text, FHFA would clarify that such programs are possible under the amended regulation and would bring all relevant authority into a single provision within the regulatory text. FHFA would interpret the provisions of § 1268.3(d) of the final rule to permit the use of a third party to securitize the whole loans, as that arrangement would merely represent the use of a vehicle to invest in certain types of AMA under more favorable terms. However, if any such certificates were to have been created as a security that initially was available to investors generally, they would not qualify as AMA under this provision.<sup>28</sup>

#### 2. Restrictions on Certain Loans

Although, as discussed above, whole loans eligible to secure advances may qualify as AMA, both the current regulation and the proposed rule explicitly excluded from AMA any single-family home mortgage loans that exceed the conforming loan limits and any loans made to an entity, or secured by property, that is not located in a state. The final rule carries over without change the existing exclusion for loans not located in a state, and modifies the conforming loan provision, as described below. In proposing the rule, FHFA specifically requested comments on whether the final rule should continue to limit AMA loans to those that meet the conforming loan limits more generally.<sup>29</sup> Some commenters suggested that FHFA remove the limits for all loans, while other commenters suggested loans that are guaranteed or insured by a department or agency of the U.S. government be allowed to exceed the conforming loan limits.

After considering the comments, FHFA has decided that it would be appropriate to allow the Banks to acquire as AMA loans guaranteed or insured by a department or agency of the U.S. government without regard to the conforming loan limit, while continuing to apply the limit to other types of loans. FHFA considers the conforming loan limit, which is a statutory requirement, to be an appropriate public policy guide in determining how the GSE subsidy that

<sup>28</sup> *Id.*

<sup>29</sup> See Proposed Rule, 80 FR at 78691.

<sup>26</sup> See Proposed Rule, 80 FR at 78691.

accrues to the Banks should be used to support the housing finance efforts of their members when making loans without any federal guarantee or insurance. Because other federal statutes separately authorize certain agencies or departments of the U.S. government to insure or guarantee mortgage loans that exceed the conforming loan limit, FHFA views those provisions as evidence that public policy would favor allowing the Banks to also support those market segments, and to do so in a manner that is consistent with the limits of those programs. Accordingly, § 1268.3(a)(1) of the final rule will carry forward the existing AMA rule provision that excludes from AMA those single-family mortgages where the loan amount exceeds the conforming loan limits established pursuant to 12 U.S.C. 1717(b)(2), but will also exempt from that prohibition loans that are insured or guaranteed by a department or agency of the U.S. government.<sup>30</sup>

As discussed earlier, the proposed rule would have barred a Bank from purchasing as AMA any home mortgage loans on which a director, officer, employee, attorney, or agent of a Bank or of the selling member institution was the borrower, unless the board of directors of the Bank specifically approved such purchase.<sup>31</sup> As commenters point out, in the current mortgage market any loans made to such “insiders” should meet the same AMA underwriting standards that the member or other originator would apply to all of AMA-eligible loans and thus would not have a different risk profile from those other loans. Commenters also contended that such a requirement would present significant operational difficulties. For example, because of the breadth of the proposal, it would effectively require the Banks to screen out of their AMA pools not only those loans that had been made to a member’s executives, but also to any of its rank and file employees. FHFA is persuaded that the costs to the Banks of implementing this provision would likely outweigh whatever benefits might accrue from it. FHFA also recognizes that the statutory language to which FHFA looked in proposing this provision was likely intended to address the risks associated with particular practices that are less of a concern in

today’s mortgage marketplace. The original statutory provision, which pertains only to the acceptance of such loans as collateral and dates to the original Bank Act, likely was intended to prevent the Banks from accepting as collateral mortgage loans that savings and loan association members had made to their “insiders” and which may not have been underwritten as rigorously as their other loans. Given that today’s mortgage markets are much more uniform, in terms of underwriting practices, than was the case in the 1930s, it is unlikely that removing the prohibition would create any significant risks for the Banks.

While the final rule adopts or retains specific restrictions on certain loans, it does not limit the total amount of AMA assets a Bank may acquire. Nevertheless, FHFA expects each Bank’s board of directors to establish a prudential limit on its maximum holdings of AMA, which should be governed by the Bank’s ability to manage the risks inherent in funding and holding such mortgage loans.

#### *D. Member or Housing Associate Nexus Requirement—§ 1268.4*

Section 1268.4 of the proposed rule would have carried forward without substantive change the member nexus requirement of the current AMA regulation, found at 12 CFR 955.2(b). After considering the issues raised by the commenters, described below, FHFA has decided to adopt this provision of the final rule without any substantive differences from the proposed rule. Under this “member nexus” provision, an asset may be eligible for purchase as AMA only if the participating financial institution has originated or issued the assets or has held it for a valid business purpose. The “valid business purpose” provision was intended to recognize the fact that some members may conduct their mortgage lending operations through both the origination and purchase of mortgage loans, which may include the acquisition of loans from nonmember institutions as part of the normal course of business, and may then wish to sell both categories of loans to their Bank. The Finance Board and FHFA have interpreted this provision as excluding any loans that merely pass from a nonmember through a member to a Bank, because such arrangements would have the effect of extending the benefits of membership to the nonmember.<sup>32</sup>

<sup>32</sup> See Proposed Rule: Federal Home Loan Bank Acquired Member Assets, Core Mission Activities, Investments and Advances, 65 FR 25676, 25681 (May 3, 2000) (*hereinafter* 2000 Proposed AMA Rule).

Commenters suggested that FHFA amend the AMA rule to allow Banks to acquire loans directly from the affiliates of a Bank member, which they contend would streamline the process of acquiring loans. The Banks believe that the current requirement is inefficient because it requires the use of a two-step process whereby a nonmember affiliate that originates a mortgage loan must first assign the loan to its affiliated member prior to the member is able to sell the loan to the Bank. FHFA acknowledges that the current process may be inefficient for such members, but believes that the Finance Board struck an appropriate balance when it first adopted the AMA rule between the need for operational efficiency and the need to ensure that the benefits of Bank membership are made available only to institutions that are eligible for membership. Accordingly, FHFA decided to adopt the provision generally as proposed.

The reference in § 1268.4(a) of the final rule to assets issued “through, or on behalf of the participating financial institution” carries over from the current regulation, and is intended to address the terms under which HFA bonds may qualify as AMA. As under the current regulation, this provision allows HFA bonds issued by an underwriter for the participating financial institution, *i.e.*, a housing finance agency that has become a housing associate of the Bank, to qualify as AMA.<sup>33</sup> In § 1268.4(b), FHFA is also carrying over without substantive change the provisions of the current regulations that address the process through which a Bank may purchase HFA bonds as AMA from a housing associate of another Bank. Under this provision, a Bank may acquire initial-offering taxable HFA bonds from out-of-district associates, provided the Bank in whose district the HFA is located (local Bank) has a right of first refusal to purchase, or negotiate the terms of, a particular bond issue. If the local Bank refuses, or does not respond within three business days, the HFA may then offer the bonds to an out-of-district Bank.

#### *E. Credit Risk-Sharing Requirement—§ 1268.5*

##### 1. Overview

FHFA proposed to reorganize the current credit risk-sharing requirements from two provisions of the Finance Board regulations, 12 CFR 955.2(c) and 955.3, into a single provision of the final rule, § 1268.5. The proposed rule would

<sup>33</sup> *Id.* at 25681.

<sup>30</sup> For loans not guaranteed or insured by a department or agency of the U.S. government, the rule allows loans on properties located in designated “high-cost areas,” where the conforming loan limit is adjusted in accordance with the criteria established in 12 U.S.C. 1717(b)(2), to remain eligible for purchase as AMA as long as the loan value is within the adjusted conforming loan limit.

<sup>31</sup> See Proposed Rule, 80 FR at 78691–92.

have carried over several of the credit risk-sharing provisions without substantive changes, including the requirement that all AMA loans carry a credit enhancement and the design requirement for the credit enhancement structure to ensure that the participating financial institution retained a material economic incentive to reduce actual losses on any AMA loans.<sup>34</sup> To comply with Dodd-Frank Act mandates that generally bar regulatory agencies from incorporating NRSRO credit rating requirements into their regulations, FHFA also proposed to amend those provisions of the current AMA regulation that were based on or referenced NRSRO ratings, including allowing the Banks flexibility to use a non-NRSRO methodology and model for calculating the credit enhancement obligation. Finally, FHFA had proposed to delete existing provisions that authorize the use of private SMI or pool insurance as part of the credit enhancement structure and, as a consequence, also remove provisions from the current regulation requiring eligible SMI providers to maintain specific NRSRO ratings.

FHFA has made several changes to the credit enhancement provisions of the proposed rule in response to comments, including restoring to the rule provisions allowing the use of SMI or pool insurance as part of the credit enhancement structure. Related to that provision, and as addressed in more detail below, FHFA is also adding to the final rule a requirement that a Bank must develop and maintain written financial and operational standards under which it will review and approve insurers as eligible to provide mortgage insurance on AMA loans. This requirement replaces the provisions of the current regulation, which had required the Banks to use NRSRO ratings for evaluating mortgage insurers. The final rule will carry over from the current rule the requirements that all AMA loans be covered by a member-provided credit enhancement, and that such credit enhancement on loans other than those loans covered by a federal guarantee or insurance bear the direct economic consequences of losses from the first dollar up to expected losses, or immediately following expected losses but in an amount that is equal to or exceeding the expected losses.<sup>35</sup>

## 2. Determining Credit Enhancements on AMA pools

Section 1268.5(b)(1) of the final rule sets forth the general requirements for how a Bank is to determine the total credit enhancement that a participating financial institution must provide for an asset or pool to qualify as AMA. Unlike under the current rule, the final rule does not require that Banks calculate the credit enhancement for AMA using NRSRO models and methodologies, or that the credit enhancement raises the credit quality of an asset or pool to a level that is equivalent to a specific NRSRO-determined rating. Instead, the final rule requires the Banks to determine and document that AMA assets are enhanced at least to “AMA investment grade.” The rule defines “AMA investment grade” as:

... a determination made by the Bank with respect to an asset or pool, based on documented analysis, including consideration of applicable insurance, credit enhancements, and other sources for repayment on the asset or pool, that the Bank has a high degree of confidence that it will be paid principal and interest in all material respects, even under reasonably likely adverse changes to expected economic conditions.

The term “AMA investment grade,” as well as its definition, represents a change from the proposed rule that FHFA made in response to comments received on the proposal. The proposed rule would have required that the enhancement on AMA assets raise them to at least “investment quality,” which would have been defined by reference to the definition of that term that is used in the Bank investment regulation, at 12 CFR 1267.1. Commenters pointed out, however, that the term “investment quality” as used in the investment regulation generally applies to debt securities and that, unlike when Banks purchase debt securities, Banks buy AMA assets with the knowledge and expectation that some of those assets will default, and become delinquent.<sup>36</sup> Thus, as commenters further noted, the fact that the definition of “investment quality” in the Bank investment rule references expectations of “full and timely payment of principal and interest” means the definition cannot be readily applied to individual mortgages or mortgage pools purchased as AMA.

game,” the rule provides them an incentive to sell high-quality loans to the Banks and the opportunity to benefit financially from good underwriting practices. See Proposed Rule, 80 FR at 78693.

<sup>36</sup> The Banks take account of these expected defaults and delinquencies and related losses when determining pricing for their purchases of AMA loans and in structuring the AMA products.

FHFA agrees with the comments and has revised the proposed definition to address those commenters’ concerns. In particular, the definition of “AMA investment grade” that is adopted in the final rule replaces the references to expectations that a Bank will receive “full and timely payment of principal and interest” with language suggested by commenters, *i.e.*, that a Bank has a high degree of confidence that “it will be paid principal and interest in all material respects.” The change recognizes that Banks will, upon purchase of the AMA asset, expect certain levels of payment defaults and delinquencies. The final definition continues to require that the Bank’s analysis of the possibility for repayment take account of adverse stress to future expected economic conditions and that the Bank should consider such adverse stresses in their analysis, to the extent that such adverse changes could reasonably occur given current economic conditions and outlooks.

While the proposed rule would not have changed the existing requirement that a Bank determine the necessary credit enhancement on a pool at the earlier of 270 days from the date of the Bank’s acquisition of the first loan in a pool or the date at which the pool reaches \$100 million in assets, § 1268.5(b)(1) of the final rule has revised those provisions such that a Bank now must determine the total credit enhancement obligation no later than 30 calendar days after a pool closes or the Bank completes the purchase of an AMA asset.<sup>37</sup> FHFA made this change based on comments that the rule should allow a Bank to calculate the credit enhancement in a manner that is consistent with the terms of specific loan funding commitments. Commenters provided as an example the Mortgage Partnership Program (MPP) for which calculating the credit enhancement at the time the pool closes would bring more certainty to participating financial institutions as to their ongoing financial obligations. FHFA believes that the change in the final rule will provide Banks sufficient flexibility to meet the concerns raised by commenters while still ensuring that all AMA pools are enhanced to levels

<sup>37</sup> As FHFA previously noted, some AMA eligible assets would be in the form of a security or certificate, such as an HFA bond or a certificate of security representing interest in a pool of whole loans. For those AMA products that involve a Bank’s purchase of a single security or instrument, and not the purchase of a pool of individual loans, the relevant date for applying this provision would be the date the purchase of the instrument is completed.

<sup>34</sup> See 2000 Final AMA Rule, 65 FR at 43976–77.

<sup>35</sup> As FHFA noted in proposing the new AMA rule, the credit risk-sharing requirements provide that participating financial institutions selling mortgages must retain a substantial portion of the credit risk, given their expertise in underwriting mortgages. In requiring the participating financial institution to have such financial “skin in the

consistent with the terms and conditions of the specific AMA product.

Under § 1268.5(b)(1), the Bank could continue to specify, as part of the terms and conditions for a particular AMA product, that a participating financial institution must provide a credit enhancement greater than that needed to enhance the asset or pool to AMA investment grade. The final rule further provides that a Bank must make its credit enhancement determinations using a model and methodology of the Bank's choosing, subject to the requirements of § 1268.5(f), which requires the Banks to provide information about their model and methodology to FHFA upon request, and which reserves FHFA's right to require changes to a Bank's model or methodology. As FHFA noted in the proposed rule, a Bank may continue to use the same NRSRO model it currently uses for making credit enhancement determinations under the final rule, and in such a case, would not need to alter the credit enhancement levels it currently requires, unless FHFA directs it to do so or its estimated enhancement levels otherwise do not comply with the rule.<sup>38</sup> For example, a Bank would need to increase credit enhancement levels if it determined that the credit enhancement currently estimated by its NRSRO model was not sufficient for an asset or pool to be AMA investment grade under the definition of that term.

FHFA is adopting as proposed the requirement that a Bank document the basis for its conclusion that the contractual credit enhancement required for a particular pool is sufficient to meet the required credit enhancement obligation for a particular AMA product, given the Bank's chosen model's relevant stress scenarios.<sup>39</sup> This provision is located at § 1268.5(b)(2) of the final rule, and that information will help FHFA monitor the Banks' use of their models and the adequacy of the specific credit enhancement structures used in each AMA product.

Section 1268.5(c) of the final rule addresses the credit risk-sharing structure for AMA products. As is the case under existing regulations, this provision generally requires that the participating financial institution providing the credit enhancement bear

the direct economic consequences of actual credit losses on the assets from the first dollar of loss up to expected losses, or immediately following expected losses in an amount equal to or exceeding expected losses.<sup>40</sup> This requirement would not apply to federally insured or guaranteed mortgage loans.<sup>41</sup>

As noted previously by the Finance Board, this requirement helps ensure that a participating financial institution bears the direct consequences of the credit quality of the asset or pool, and thereby has the incentive to maintain high underwriting standards for any AMA loans sold to a Bank.<sup>42</sup> The participating financial institution cannot transfer this responsibility to an affiliate or nonmember entity.

While the current regulation defines "expected losses" as the base loss scenario in the methodology of an NRSRO applicable to a particular AMA asset, the final rule amends this definition to refer to the loss on the particular AMA asset or pool given the expected future economic and market conditions in the model or methodology used by the Bank to calculate the credit enhancement for an AMA product. This change results from the fact that the final rule no longer requires a Bank to use an NRSRO model, and also accommodates the potential for a Bank to adopt a model that applies a methodology that differs from that used in the Banks' current models. Otherwise, FHFA believes that this change does not alter the substance of what is currently required by the AMA rule; nor is it intended to alter how a Bank would calculate "expected losses" if the Bank continues to use its current model.

Section 1268.5(c) also continues to require that the credit enhancement remain in place at all times, *i.e.*, for the

<sup>40</sup> The economic responsibility of the expected credit losses may be borne by the member or housing associate in a variety of ways. For instance, under the product developed by the Chicago Bank known as MPF 100, a Bank establishes an account to absorb credit losses. As the Bank incurs losses, the member reimburses the Bank through the reduction of credit enhancement fees paid to the member by the Bank and, therefore, is exposed to the credit risk of the loans starting with the first dollar of loss. Essentially, the fees paid to the member are contingent upon the performance of the asset. Also, the rule allows for a member-provided credit enhancement to be positioned after expected losses. Authorizing this structure in the rule allows for the existing MPF Original product.

<sup>41</sup> As is discussed below, FHFA is amending the requirement that for government insured or guaranteed loans the members or housing associates must bear responsibility for unreimbursed servicing expenses up to the amount of expected losses for the loan to qualify as AMA.

<sup>42</sup> See 2000 Proposed AMA Rule, 65 FR at 25683; *see also*, 2000 Final AMA Rule, 65 FR at 43976.

life of the asset or pool.<sup>43</sup> This requirement effectively prohibits the Banks from using structures, for example, that comply with the credit rating requirement during in the first year, but that then scale back the amount of the member's credit enhancement in subsequent years so that the pool would no longer be credit enhanced to a level that is consistent with the terms and conditions of the AMA product.<sup>44</sup>

Section 1268.5(c)(1)(ii) of the final rule also will retain the existing requirement that a participating financial institution must secure fully its credit enhancement obligation, and that it do so in the same manner that a member must secure its obligation to repay an advance under part 1266 of the FHFA advances regulations. This provision is intended to prevent a Bank from being exposed to any additional credit risk as a result of a member's failure to comply with its contractual obligation to absorb a specified portion of the credit losses on its AMA loans. While some commenters asked FHFA to delete this requirement so that the Banks could have added flexibility in designing different types of credit enhancement structures, FHFA believes that the collateral requirement provides a necessary level of protection for the Banks should a participating financial institution be unable to fulfill its credit enhancement obligation, and also is consistent with the legal rationale for the AMA programs, which views the acquisition of AMA loans as being functionally equivalent to the extension of credit via an advance, which members must fully secure with eligible collateral.

### 3. Transfer of Credit Enhancement Obligation

The final rule will carry over, with some modifications, the provisions of the existing regulations that establish alternative means by which a member may provide the credit enhancement for its AMA loans, including a transfer of the enhancement obligation to certain parties, subject to certain limitations. The revised provision would be located at § 1268.5(c)(2) of the final rule. The use of these structures requires the approval of the Bank, which could do so either by establishing the required form of credit enhancement in the terms of a particular AMA product, or by

<sup>43</sup> Where the Bank returns the credit enhancement to a participating financial institution, it would only do so if the credit quality of the asset or pool continues to meet the terms and conditions of the AMA product.

<sup>44</sup> See 2000 Final Rule, 65 FR at 43976.

<sup>38</sup> See Proposed Rule, 80 FR at 78693.

<sup>39</sup> This requirement replaces 12 CFR 955.3(b) and (c) which state that a Bank had to obtain the NRSRO verifications with regard to the adequacy of the credit enhancement structure and Bank's use of the NRSRO model for estimating the required enhancement in each AMA product. Given that under the amendments made by this final rule, FHFA no longer requires a Bank to use NRSRO models, the NRSRO verification requirements are obsolete, and FHFA has removed them.

providing specific approval for the transfer.

Specifically, § 1268.5(c)(2)(i) authorizes a participating financial institution to transfer its credit enhancement obligation to its insurance affiliate, but only where the insurance provided by the affiliate is positioned after the participating financial institution bears the financial losses on the AMA loan in an amount at least equal to the expected losses. Similarly, the final rule carries over the substance of two provisions of the current regulations, which allow a participating financial institution to transfer its credit enhancement obligation to another participating financial institution, which may be either a member of the same Bank or, subject to certain conditions, a member of another Bank. Those provisions are located at § 1268.5(c)(2)(iv) and (v) of the final rule. These provisions remain consistent with the existing regulations, as well as with current Bank practice with regard to AMA product structures and permissible transfers of the credit enhancement obligations.

As already discussed, FHFA had proposed eliminating provisions of the existing regulation that allow a participating financial institution to meet part of its credit enhancement obligation through the purchase of loan-level SMI or pool insurance. After considering the comments on this issue, however, FHFA has determined to retain those provisions, which are located at § 1268.5(c)(2)(ii) and (iii) of the final rule. Thus, a participating financial institution can continue to provide part of its credit enhancement obligation by purchasing loan-level SMI, but only if the SMI is positioned in the credit enhancement structure to cover losses remaining after the participating financial institution has borne the direct economic consequences of the actual credit losses, as required by § 1268.5(c)(1)(i). Similarly, the participating financial institution can continue to purchase pool insurance, but only where such insurance covers that portion of the credit enhancement obligation attributable to the geographic concentration or size of the pool and is positioned last in the credit enhancement structure.

The provisions pertaining to the use of SMI or pool insurance generally carry over the substance of the existing regulations, with one significant exception related to the rating requirement for insurance providers. The existing AMA regulations require that insurance be maintained at all times with an insurer that has been assigned a rating from an NRSRO that is

at least equal to the second highest investment grade NRSRO rating. Because the Dodd-Frank Act requires that FHFA remove such ratings-based provisions from its regulations, FHFA is replacing this requirement with a requirement that the participating financial institution may obtain its SMI or pool insurance only from an institution that at all times is a “qualified insurer,” as defined by the final rule.<sup>45</sup> To implement this “qualified insurer” requirement, FHFA is adopting as part of the final rule a new provision, to be located at § 1268.5(e)(1), which directs a Bank to develop and maintain a written financial and operational standards that it will apply in approving an entity as a “qualified insurer.” That provision also makes clear that a Bank can rely on another provision of the final rule, § 1268.8, to delegate to another Bank or group of Banks the responsibility for developing and applying these standards. The provision will allow a group of Banks to develop a common policy and common list of qualified insurers for AMA programs if they choose.

The rule allows a Bank one year to develop these new insurance provider standards. The FHFA expects that Banks will develop the new standards and qualify under these standards any mortgage insurers with which the Banks intend to do business under their AMA programs within this one-year timeframe. Until the end of this one-year grace period, Banks can continue to do business with the insurance counterparties that it currently allows to provide insurance on AMA assets or can add new insurance counterparties based on existing standards that the Banks may have in place.<sup>46</sup> Once the new standards are in place, § 1268.5(e)(1) also requires that a Bank review qualified insurers at least once every two years and verify that they continue to meet the Bank’s standards.<sup>47</sup>

<sup>45</sup> FHFA also has adopted in § 1268.1 a definition for “qualified insurer,” which includes any insurance company that a Bank approves in accordance with § 1268.5(e) to provide any form of mortgage insurance on assets and pools purchased under an AMA program. Consistent with suggestions by commenters, this definition does not restrict potential qualified insurers just to mono-line mortgage insurance providers, but could include any insurance company.

<sup>46</sup> The grandfather provision in § 1268.2(b) allows a Bank to continue to hold loans purchased prior to the end of the phase-in period for adopting the qualified insurer standards even if the PMI or other insurance on those loans is provided by an entity that does not meet the Bank’s new standards.

<sup>47</sup> Section 1268.8 of the final rule allows a Bank to delegate the administration of its AMA program to another Bank, which would allow a Bank to delegate the responsibility for conducting this

FHFA expects that any standards a Bank adopts under § 1268.5(e)(1) will be rigorous and will set minimum financial and operating standards that an insurer must meet to help ensure that the insurer will have the financial resources to fulfill its obligations under insurance policies on AMA assets. While the rule does not provide specific requirements that the Banks must meet in developing these standards, FHFA notes that the PMIERS recently implemented by the Enterprises represent a good model of the type of analytical approach that FHFA would expect of the Banks’ standards under this provision. FHFA expects to review a Bank’s qualified insurer standards as part of its regular supervisory examination and off-site monitoring of Bank activities. FHFA also expects Banks periodically to review their qualified insurer standards, and to revise them as appropriate.

In order to ensure a degree of uniformity with respect to the financial condition of entities that may provide insurance in connection with the AMA programs, FHFA is also adopting new § 1268.5(e)(2), which will allow only those entities that are “qualified insurers” to provide either the loan-level or pool insurance policies allowed as part of the credit enhancement structure under § 1268.5(c)(2)(ii) and (iii) or the private mortgage insurance on loans purchased as AMA. In proposing this rule, FHFA specifically requested comments on whether any eligibility requirements for providers of SMI or pool insurance should also apply to PMI providers.<sup>48</sup> Few commenters responded to this request, but the commenters generally expressed the view that FHFA should not impose specific requirements on PMI providers and, instead, should continue to allow Banks to adopt their own standards for those providers. One of the commenters noted, however, that if the FHFA did impose requirements, PMI providers should be required to meet PMIERS. After consideration of these comments, FHFA has determined to apply the “qualified insurer” requirements of § 1268.5(e)(1) to providers of PMI, SMI and pool insurance. By requiring that providers of all types of mortgage insurance used in AMA products meet rigorous financial and operational standards, this provision helps assure that Banks engage in sound counterparty risk management and maintain strong safety and soundness measures for their AMA programs. Moreover, given that § 1268.5(e)

required periodic review to another Bank or Banks should it so wish.

<sup>48</sup> See Proposed Rule, 80 FR at 78695.

provides the Banks with latitude to develop their own standards for what constitutes a “qualified insurer,” the application of this provision to PMI providers should not represent a significant change from the existing approach.

#### 4. Loans Guaranteed or Insured by a Department or Agency of the U.S. Government

Section 1268.5(d) of the final rule addresses the purchase of federally insured or guaranteed mortgage loans as AMA. The existing regulatory text allows a portion of the credit enhancement to be provided through the purchase of loan-level insurance, including insurance provided by a federal mortgage insurance or guarantee program. Although the federal insurance or guarantee generally eliminates the credit risk to the member selling mortgage loans to its Bank, the Finance Board had determined that the member’s potential liability to bear the unreimbursed servicing expenses on such loans served the same purpose of providing an economic incentive for the member to sell only well-underwritten loans to the Bank. The final rule carries over much of the substance of current agency policy, and simply states that a participating financial institution may provide the required credit enhancement by purchasing loan-level guarantees or insurance from departments or agencies of the U.S. government, provided that the guarantee or insurance remains in effect for however long the Bank owns the loan. The requirement that the guarantee or insurance remain in effect does not require that the Bank member be the party that maintains the guarantee or insurance for that period, which would allow any other entity servicing the loan to maintain the guarantee or insurance. The final rule differs from the existing regulations, however, in that it does not require loans guaranteed or insured by a department or agency of the U.S. government to meet the specific credit enhancement structure requirements, *i.e.*, wherein the member must bear the first dollar of losses for a loan or pool up to the amount of expected losses or must bear losses immediately following the expected losses in an amount that equals or exceeds expected losses.<sup>49</sup> Even under this new provision, however, the federal guarantee or insurance must be sufficient so that the underlying asset or pool meets the required credit enhancement specified as part of the terms and conditions that

the Bank has established for the relevant AMA product.

As already noted, the Finance Board has described the purpose of the AMA credit enhancement structure requirement as being to ensure that participating financial institutions, “when responsible for such losses, [had] incentive to seek ways to achieve better than expected performance [for the loans sold as AMA].”<sup>50</sup> As the Finance Board explained, for a participating financial institution to meet this structure requirement with respect to federally guaranteed or insured loans, given that losses eventually would be covered by the guarantee or insurance, the participating financial institution would have to bear the economic responsibility of all unreimbursed servicing expenses associated with those loans, up to the amount of the expected losses.<sup>51</sup> As a result, under the current regulation the member’s credit enhancement obligation for AMA government loans is tied closely to its servicing obligations. An unintended consequence of tying the credit enhancement obligation to the servicing obligation is that such a requirement effectively limits a participating financial institution’s ability to transfer the mortgage-servicing rights for any AMA government loans to non-participating financial institutions. In addition, as FHFA noted in proposing the rule, after having had the opportunity to review the Banks’ AMA programs since 2000, FHFA has come to the conclusion that requiring a member to retain an obligation to cover unreimbursed servicing expenses for AMA government loans provides no meaningful additional incentive to improve underwriting to achieve better than expected loan performance.<sup>52</sup>

A small number of commenters objected to this proposed revision. These comments noted that the proposed change would have altered one of the key underlying premises for AMA with regard to government loans, namely that the members need to have “skin in the game” to assure high quality underwriting. After considering these comments in light of its own experience in monitoring the Banks’ AMA programs, FHFA has concluded that, with regard to federally guaranteed or insured loans, the underwriting standards imposed by the relevant

government department or agency address the same policy objective of the credit enhancement requirements, which is to encourage the members to underwrite the loans to a high level. Therefore, FHFA finds that requiring the participating financial institution to also remain responsible for unreimbursed servicing expenses would add little, if any, incentive to underwrite its mortgage loans to a materially different level above the already high level required by the federal guarantor or insurer. At the same time, FHFA believes that the ability to transfer the servicing rights on federally insured or guaranteed loans is important in the current marketplace. Thus by carrying over to the final rule a provision that would prevent participating financial institutions from transferring servicing rights on such loans FHFA could negatively affect members’ ability to use the AMA program to obtain liquidity to support this segment of the mortgage market.<sup>53</sup> FHFA, therefore, is adopting § 1268.5(d), as proposed.

#### 5. Model and Methodology

Section 1268.5(f) of the final rule addresses the model and methodology that a Bank uses to estimate the required credit enhancement, and has been simplified in response to certain recommendations from the commenters. The final rule requires a Bank to establish a model and methodology for estimating the required member credit enhancements for AMA loans that a participating financial institution sells to a Bank.<sup>54</sup> The new provision, consistent with the Dodd-Frank Act requirements, no longer requires a Bank to use an NRSRO model.<sup>55</sup> The final rule does require a Bank to provide to FHFA upon request any information about the Bank’s model and methodology including results of any model runs and testing performed by the Bank. While the final rule does not require that FHFA approve the model

<sup>49</sup> As FHFA noted when it proposed this rule, the flexibility allowed in transferring mortgage-servicing rights under the amended provision would prove beneficial for many smaller or medium sized members. These members, in particular, might wish to sell their AMA government loans into AMA government products but may lack the ability to perform the servicing obligations, as now required by the AMA regulation. In addition, given changes in the mortgage industry, Banks may find it increasingly difficult to find member institutions willing to take on the servicing obligations for AMA government loans. *Id.*

<sup>50</sup> The provision was proposed as § 1268.5(e). *See* Proposed Rule, 80 FR at 78698.

<sup>51</sup> Nothing in the final rule, however, prohibits a Bank from continuing to use an NRSRO model to estimate the credit enhancement requirement, provided that the Bank otherwise complies with § 1268.5(f).

<sup>52</sup> 2000 Final AMA Rule, 65 FR at 43977.

<sup>53</sup> *Id.* In the supplementary information section of the original rule, the Finance Board explained how loans guaranteed or insured by a department or agency of the U.S. government would meet the credit enhancement requirements of the original AMA rule.

<sup>54</sup> Proposed Rule, 80 FR at 78695.

<sup>49</sup> FHFA is readopting these requirements as § 1268.5(c)(1) of this final rule.

and methodology that a Bank uses to estimate the required credit enhancement, it specifically reserves to FHFA the right to direct a Bank to make changes to its model and methodology and further requires that a Bank promptly implement any such changes once FHFA directs it to do so.

As noted above, FHFA has altered the final version of § 1268.5(f) from what it proposed based on the comments received, a number of which thought that the proposed provision was too prescriptive and would hinder the Banks' ability to adjust their models and methodologies in response to advances in technologies and methods. These commenters believed that it would be more appropriate for the final rule to provide only general guidance relating to the models and methodologies, and rely on advisory bulletins and other forms of supervisory guidance with regard to specific practices on evaluating and monitoring performance. The commenters also noted that FHFA generally follows their suggested approach with regard to Banks' use of models in other areas.

FHFA agrees with the comments, and has note included as part of the final rule the proposed requirements related to a Bank's validation and monitoring of its model, or that requiring a Bank to inform FHFA prior to making any material changes to its model and methodology. Instead, FHFA will address these items through its supervisory process, and will issue guidance to the Banks on these topics as the need arises. FHFA, however, continues to expect a Bank to have risk management policies and procedures commensurate with the complexity of the model and methodology. Effective model risk management should entail a comprehensive approach in identifying risk throughout the model lifecycle and should be consistent with any applicable FHFA guidance.

#### F. Servicing of AMA Loans—§ 1268.6

Section 1268.6 of the final rule addresses the servicing of AMA loans, which FHFA is adopting as proposed. This provision incorporates current FHFA positions, as set forth in a recent regulatory interpretation, on the rights of the Banks to allow for the transfer of mortgage servicing rights from the participating financial institution that originally sold the AMA loans to the Bank.<sup>56</sup> FHFA received no comments on this provision.<sup>57</sup>

Thus, § 1268.6 allows for the transfer of servicing rights on AMA loans, including federally guaranteed or insured loans, to any institution, including a non-Bank System member. The provision specifically provides that any such transfer cannot result in the AMA loan failing to meet any other AMA requirement, including the credit enhancement requirement.<sup>58</sup> Section 1268.6 also requires the approval of each Bank that has any ownership interest in the underlying loans, no matter how small that interest may be, prior to the transfer of the servicing obligation. Finally, § 1268.6 states that the Banks must have policies and procedures that ensure the transfer of servicing would not negatively affect the credit enhancement on the underlying loans or substantially increase the Bank's exposure to risk. As it noted when proposing the rule, FHFA expects such policies and procedures specifically to address transfers to non-Bank System member servicers and provide contingency plans to address a case in which a large servicer fails or is otherwise unable to continue to service a Bank's AMA portfolio.<sup>59</sup>

#### G. Administrative Arrangements Between Banks—§ 1268.8

Proposed § 1268.8 would have carried over without substantive change the provisions of § 955.5 of the current regulation, which addresses administrative transactions and agreements between Banks involving AMA. This provision allows Banks to delegate to another Bank the administration of its AMA program, but requires the delegating Bank to disclose to a participating financial institution the existence of the delegation or the possibility of such delegation, in its AMA-related agreements with the participating financial institution.

Commenters requested technical changes to the proposed rule to clarify that Banks can contract with third parties, including another Bank, to provide services for their AMA programs separate and apart from the administrative delegation contemplated in this provision without triggering additional disclosure obligations. They

eliminate the requirement that members bear the unreimbursed servicing expenses for U.S. government insured loans as part of their AMA credit enhancement obligation. These comments were addressed in the section above addressing credit enhancement requirements.

<sup>58</sup> As FHFA noted in proposing the rule, this means that a member cannot transfer any part of the credit enhancement obligation on a non-U.S. government insured loan to a non-member institution as part of the transfer of servicing rights. See Proposed Rule, 80 FR at 78696.

<sup>59</sup> *Id.*

also suggested a change in wording to make clear that a Bank may, by contract, define specific parameters on its delegation of pricing authority for its AMA program to another Bank. FHFA agrees that the suggested changes appropriately clarify the scope of the requirements in § 1268.8 and raise no safety and soundness or other concerns. Therefore, FHFA has incorporated the Banks' suggested language into the final rule. Otherwise, proposed § 1268.8 is adopted as final without further changes.

#### H. Other Provisions—§ 1268.7

As proposed, FHFA is carrying over without change the current rule's data reporting requirements for AMA, which would be located at § 1268.7. FHFA received no comments on that provision. Also as proposed, FHFA is deleting from the AMA rule the provision that had established risk-based capital requirements for AMA, which has been superseded by the statutory risk-based capital requirement and thus has no continuing applicability.<sup>60</sup> FHFA received no comments on its proposal to delete this provision.

### III. Consideration of Differences Between the Banks and the Enterprises

When promulgating regulations relating to the Banks, section 1313(f) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 requires the Director to consider the differences among the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation (together, the Enterprises) and the Banks with respect to the Banks' cooperative ownership structure; mission of providing liquidity to members; affordable housing and community development mission; capital structure; and joint and several liability.<sup>61</sup> The amendments made by this rulemaking apply exclusively to the Banks. In preparing the proposed and final rules the Director considered the differences between the Banks and the Enterprises as they relate to the above factors, and the proposed rule requested public comments on the extent to which the rule might implicate any of the statutory factors. FHFA received a comment suggesting that the continued use of the conforming loan limit for Bank AMA purchases would not appropriately take into account the differences between the Banks and the Enterprises. As already discussed above, in connection with the section of the

<sup>60</sup> *Id.*

<sup>61</sup> See 12 U.S.C. 4513(f).

<sup>56</sup> See Regulatory Interpretation, 2015-RI-01 (June 23, 2015).

<sup>57</sup> As discussed previously, FHFA received comments objecting to amendments that would

final rule relating to the conforming loan limits, the Director has considered this comment and has determined that it is appropriate to continue to refer to the conforming loan limit as a policy guide for establishing reasonable limits on the use of the Banks' GSE subsidy in connection with their purchase of non-federally insured or guaranteed mortgage loans.

**IV. Paperwork Reduction Act**

The information collection, entitled "Federal Home Loan Bank Acquired Member Assets, Core Mission Activities, Investments and Advances" contained in current 12 CFR part 955 of the regulations that is transferred to 12 CFR part 1268 by this final rule has been assigned control number 2590-0008 by the Office of Management and Budget (OMB). The final rule does not substantively or materially modify the current, approved information collection.

**V. Regulatory Flexibility Act**

The Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) requires that a regulation that has a significant economic impact on a substantial number of small entities, small businesses, or small organizations must include an initial regulatory flexibility analysis describing the regulation's impact on small entities. FHFA need not undertake such an analysis if the agency has certified the regulation will not have a significant economic impact on a substantial number of small entities. 5 U.S.C. 605(b). FHFA has considered the impact of the final rule under the Regulatory Flexibility Act.

FHFA certifies that the final rule will not have a significant economic impact on a substantial number of small entities because the regulation is applicable only to the Banks, which are not small entities for purposes of the Regulatory Flexibility Act.

**List of Subjects**

*12 CFR Part 955*

Community development, Credit, Federal home loan banks, Housing, Reporting and recordkeeping requirements.

*12 CFR Part 1201*

Administrative practice and procedure, Federal home loan banks, Government-sponsored enterprises, Office of Finance, Regulated entities.

*12 CFR Part 1267*

Community development, Credit, Federal home loan bank, Housing, Reporting and recordkeeping requirements.

*12 CFR Part 1268*

Acquired member assets, Credit, Federal home loan bank, Housing, Nationally recognized statistical rating agency.

*12 CFR Part 1281*

Credit, Federal home loan banks, Housing, Mortgages, Reporting and recordkeeping requirements.

**Authority and Issuance**

For reasons stated in the **SUPPLEMENTARY INFORMATION**, and under the authority of 12 U.S.C. 1430, 1430b, 1431, 4511, 4513, 4526, FHFA is amending subchapter G of chapter IX and subchapters A, D, and E of chapter XII of title 12 of the Code of Federal Regulations as follows:

**CHAPTER IX—FEDERAL HOUSING FINANCE BOARD**

**Subchapter G—[Removed and Reserved]**

- 1. Subchapter G, consisting of part 955, is removed and reserved.

**CHAPTER XII—FEDERAL HOUSING FINANCE AGENCY**

**Subchapter A—Organization and Operations**

**PART 1201—GENERAL DEFINITIONS APPLYING TO ALL FEDERAL HOUSING FINANCE AGENCY REGULATIONS**

- 2. The authority citation for part 1201 continues to read as follows:

**Authority:** 12 U.S.C. 4511(b), 4513(a), 4513(b).

- 3. Amend § 1201.1 by revising the definition of "Acquired member assets" to read as follows:

**§ 1201.1 Definitions.**

\* \* \* \* \*

*Acquired member assets* or *AMA* means assets acquired in accordance with, and satisfying the applicable requirements of, part 1268 of this chapter.

\* \* \* \* \*

**Subchapter D—Federal Home Loan Banks**

**PART 1267—FEDERAL HOME LOAN BANK INVESTMENTS**

- 4. The authority citation for part 1267 continues to read as follows:

**Authority:** 12 U.S.C. 1429, 1430, 1430b, 1431, 1436, 4511, 4513, 4526.

**§ 1267.2 [Amended]**

- 5. Amend § 1267.2 in paragraph (a) by removing "955 of this title" and adding in its place "1268 of this chapter".

- 6. Part 1268 is added to subchapter D to read as follows:

**PART 1268—ACQUIRED MEMBER ASSETS**

Sec.

- 1268.1 Definitions.
- 1268.2 Authorization for acquired member assets.
- 1268.3 Asset requirement.
- 1268.4 Member or housing associate nexus requirement.
- 1268.5 Credit risk-sharing requirement.
- 1268.6 Servicing of AMA loans.
- 1268.7 Reporting requirements for acquired member assets.
- 1268.8 Administrative transactions and agreements between Banks.

**Authority:** 12 U.S.C. 1430, 1430b, 1431, 4511, 4513, 4526.

**§ 1268.1 Definitions.**

As used in this part:  
*Affiliate* means any business entity that controls, is controlled by, or is under common control with, a member.

*AMA investment grade* means a determination made by the Bank with respect to an asset or pool, based on documented analysis, including consideration of applicable insurance, credit enhancements, and other sources for repayment on the asset or pool, that the Bank has a high degree of confidence that it will be paid principal and interest in all material respects, even under reasonably likely adverse changes to expected economic conditions.

*AMA product* means a structure that is defined by a specific set of terms and conditions that comply with this part 1268 and that is established by a Bank for purposes of governing the Bank's purchase of AMA-eligible loans.

*AMA program* means a Bank-established program to buy mortgage loans that meet the requirements of this part, which may comprise multiple AMA products.

*Expected losses* means the loss on the asset or pool given the expected future economic and market conditions in the model or methodology used by the Bank under § 1268.5 and applicable to an AMA product.

*Participating financial institution* means a member or housing associate of a Bank that is authorized to sell, credit enhance, or service mortgage loans to or for its own Bank through an AMA program, or a member or housing associate of another Bank that has been authorized to sell, credit enhance, or service mortgage loans to or for the other Bank pursuant to an agreement between the Bank acquiring the AMA product and the Bank of which the selling institution is a member or housing associate.

*Pool* means a group of loans acquired under one or more loan funding

commitments, contractual agreements, or similar arrangements.

*Qualified insurer* means an insurer that a Bank approves in accordance with § 1268.5(e)(1) to provide any form of mortgage insurance coverage on assets and pools purchased under an AMA program.

*Residential real property* has the meaning set forth in § 1266.1 of this chapter.

**§ 1268.2 Authorization for acquired member assets.**

(a) *General.* Each Bank is authorized to invest in assets that qualify as AMA, subject to the requirements of this part and part 1272 of this chapter.

(b) *Grandfathered transactions.* Notwithstanding paragraph (a), a Bank may continue to hold as AMA assets that were previously authorized by the Federal Housing Finance Board or FHFA for purchase as AMA, provided that the assets were purchased, and continue to be held, in compliance with that authorization.

**§ 1268.3 Asset requirement.**

Assets that qualify as AMA shall be limited to the following:

(a) Whole loans that are eligible to secure advances under § 1266.7(a)(1)(i),

(a)(2)(ii), (a)(4), or (b)(1) of this chapter, excluding:

(1) Single-family mortgage loans where the loan amount exceeds the limits established pursuant to 12 U.S.C. 1717(b)(2), unless the loan is guaranteed or insured by an agency or department of the U.S. government, in which case the limits in 12 U.S.C. 1717(b)(2) do not apply; and

(2) Loans made to an entity, or secured by property, not located in a state;

(b) Whole loans secured by manufactured housing, regardless of whether such housing qualifies as residential real property under applicable state law;

(c) State and local housing finance agency bonds; or

(d) Certificates representing interests in whole loans if:

(1) The loans qualify as AMA under paragraphs (a) or (b) of this section and meet the nexus requirement of § 1268.4; and

(2) The certificates:

(i) Meet the credit enhancement requirements of § 1268.5;

(ii) Are issued pursuant to an agreement between the Bank and a participating financial institution to share risks consistent with the requirements of this part; and

(iii) Are acquired substantially by the initiating Bank or Banks.

**§ 1268.4 Member or housing associate nexus requirement.**

(a) *General provision.* To qualify as AMA, any assets described in § 1268.3 must be acquired in a purchase or funding transaction only from:

(1) A participating financial institution, provided that the asset was:

(i) Originated or issued by, through, or on behalf of the participating financial institution, or an affiliate thereof; or

(ii) Held for a valid business purpose by the participating financial institution, or an affiliate thereof, prior to acquisition by the Bank; or

(2) Another Bank, provided that the asset was originally acquired by the selling Bank consistent with this section.

(b) *Special provision for housing finance agency bonds.* In the case of housing finance agency bonds acquired by a Bank from a housing associate located in the district of another Bank (local Bank), the arrangement required by the definition of “participating financial institution” in § 1268.1 between the acquiring Bank and the local Bank may be reached in accordance with the following process:

(1) The housing finance agency shall first offer the local Bank right of first refusal to purchase, or negotiate the terms of, its proposed bond offering;

(2) If the local Bank indicates, within three business days, it will negotiate in good faith to purchase the bonds, the housing finance agency may not offer to sell or negotiate the terms of a purchase with another Bank; and

(3) If the local Bank declines the offer, or has failed to respond within three business days, the acquiring Bank will be considered to have an arrangement with the local Bank for purposes of this section and may offer to buy or negotiate the terms of a bond sale with the housing finance agency.

**§ 1268.5 Credit risk-sharing requirement.**

(a) *General credit risk-sharing requirement.* For each AMA product, the Bank shall implement and have in place at all times, a credit risk-sharing structure that:

(1) Requires a participating financial institution to provide the credit enhancement necessary to enhance an eligible asset or pool to the credit quality specified by the terms and conditions of the AMA product, provided, however, that such credit enhancement results in the eligible asset or pool being at least AMA investment grade, as defined in § 1268.1; and

(2) Meets the requirements of this section.

(b) *Determination of necessary credit enhancement.* (1) No later than 30

calendar days after the purchase of the asset or after a pool closes, the Bank shall determine the total credit enhancement necessary to enhance the asset or pool to at least AMA investment grade and to be consistent with the terms and conditions of a specific AMA product. The enhancement shall be for the life of the asset or pool. The Bank shall make this determination for each AMA product using a model and methodology that the Bank deems appropriate, subject to paragraph (f) of this section.

(2) A Bank shall document its basis for concluding that the contractual credit enhancement required from each participating financial institution with regard to a particular asset or pool will equal or exceed the credit enhancement level specified in the terms and conditions of the AMA product and determined in accordance with paragraph (b)(1) of this section.

(c) *Credit risk-sharing structure.* Under any credit risk-sharing structure, the credit enhancement provided by the participating financial institution shall at all times meet the following requirements:

(1) The participating financial institution that is providing the credit enhancement required under this paragraph (c) shall in all cases:

(i) Bear the direct economic consequences of actual credit losses on the asset or pool:

(A) From the first dollar of loss up to the amount of expected losses; or

(B) Immediately following expected losses, but in an amount equal to or exceeding the amount of expected losses; and

(ii) Fully secure its direct credit enhancement obligation in accordance with § 1266.7; and

(2) The participating financial institution also may provide all or a portion of the credit enhancement, with the approval of the Bank, by:

(i) Contracting with an insurance affiliate of that participating financial institution to provide an enhancement, but only where such insurance is positioned in the credit risk-sharing structure so as to cover only losses remaining after the participating financial institution has borne losses as required under paragraph (c)(1)(i) of this section;

(ii) Purchasing loan-level insurance only where:

(A) The participating financial institution is legally obligated at all times to maintain such insurance with a qualified insurer; and

(B) Such insurance is positioned in the credit enhancement structure so as to cover only losses remaining after the

participating financial institution has borne losses as required under paragraph (c)(1)(i) of this section;

(iii) Purchasing pool-level insurance only where:

(A) The participating financial institution is legally obligated at all times to maintain such insurance with a qualified insurer;

(B) Such insurance insures that portion of the required credit enhancement attributable to the geographic concentration and size of the pool; and

(C) Such insurance is positioned last in the credit enhancement structure so as to cover only those losses remaining after all other elements of the credit enhancement structure have been exhausted;

(iv) Contracting with another participating financial institution in the Bank's district to provide a credit enhancement consistent with this section, in return for compensation; or

(v) Contracting with a participating financial institution in another Bank's district, pursuant to an arrangement between the two Banks, to provide a credit enhancement consistent with this section, in return for compensation.

(d) *Loans guaranteed or insured by a department or agency of the U.S. government.* Instead of the structure set forth in paragraph (c) of this section, a participating financial institution also may provide the required credit enhancement through loan-level insurance that is issued by an agency or department of the U.S. government or is a guarantee from an agency or department of the U.S. government, provided that the government insurance or guarantee remains in place for as long as the Bank owns the loan.

(e) *Qualified insurers.* (1) Within one year of January 18, 2017, each Bank must develop, and subsequently maintain, written financial and operational standards that an insurer must meet for the Bank to approve it as a qualified insurer. A Bank shall review qualified insurers at least once every two years to determine whether they still meet the financial and operational standards set by the Bank. A Bank may delegate responsibility for development of these standards and approval of qualified insurers to another Bank or group of Banks pursuant to § 1268.8.

(2) Only qualified insurers may provide private loan insurance on AMA eligible assets or the loan or pool insurance allowed as part of the credit enhancement structure for AMA products under paragraphs (c)(2)(ii) or (iii) of this section.

(f) *Appropriate methodology for calculating credit enhancement.* A Bank

shall use a model and methodology for estimating the amount of credit enhancement for an asset or pool. A Bank shall provide to FHFA upon request information about the model and methodology, including and without limitation results of any model runs and the results of any tests of the model performed by the Bank. FHFA reserves the right to direct a Bank to make changes to its model and methodology, and a Bank promptly shall institute any such FHFA-directed changes.

**§ 1268.6 Servicing of AMA loans.**

(a) Servicing of AMA loans may be performed by or transferred to any institution, including an institution that is not a member of the Bank System, provided that the loans, after such transfer, continue to meet all requirements to qualify as AMA under §§ 1268.3, 1268.4, and 1268.5.

(b) The transfer of mortgage servicing rights and responsibilities must be approved by the Bank or Banks that own the loan or a participation interest in the loan.

(c) A Bank shall have in place policies and procedures to ensure that the transfer of mortgage servicing rights does not negatively affect the credit enhancement on the loans in question or substantially increase the Bank's exposure to the credit risk for the asset or pool.

**§ 1268.7 Reporting requirements for acquired member assets.**

Each Bank shall report information related to AMA in accordance with the instructions provided in the Data Reporting Manual issued by FHFA, as amended from time to time.

**§ 1268.8 Administrative transactions and agreements between Banks.**

(a) *Delegation of administrative duties.* A Bank may delegate the administration of an AMA program to another Bank whose administrative office has been examined and approved by FHFA, or previously examined and approved by the Federal Housing Finance Board, to process AMA transactions. The existence of such a delegation, or the possibility that such a delegation may be made, must be disclosed to any potential participating financial institution as part of any AMA-related agreements signed with that participating financial institution. A Bank may contract with one or more parties, including without limitation another Bank, to provide services related to the administration of its own AMA program or the AMA program of another Bank for which it has been

delegated administrative responsibility, without the necessity for further disclosure to the participating financial institutions.

(b) *Termination of agreements.* Any agreement made between two or more Banks in connection with the administration of any AMA program may be terminated by any party after a reasonable notice period.

(c) *Delegation of pricing authority.* A Bank that has delegated its AMA pricing function to another Bank shall retain a right to refuse to acquire AMA at prices it does not consider appropriate, pursuant to contractual provisions among the parties.

**Subchapter E—Housing Goals and Mission**

**PART 1281—FEDERAL HOME LOAN BANK HOUSING GOALS**

■ 7. The authority citation for part 1281 continues to read as follows:

**Authority:** 12 U.S.C. 1430c.

■ 8. Amend § 1281.1 by revising the definitions of “Acquired Member Assets (AMA) program” and “AMA-approved mortgage” to read as follows:

**§ 1281.1 Definitions.**

\* \* \* \* \*

*Acquired Member Assets (AMA) program* means a program that authorizes a Bank to hold assets acquired from or through Bank members or housing associates by means of either a purchase or funding transaction, subject to the requirements of parts 1268 and 1272 of this chapter.

*AMA-approved mortgage* means a mortgage that meets the requirements of an AMA program at part 1268 of this chapter, which program has been approved to be implemented under part 1272 of this chapter.

\* \* \* \* \*

Dated: December 9, 2016.

**Melvin L. Watt,**  
*Director, Federal Housing Finance Agency.*  
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**FEDERAL HOUSING FINANCE AGENCY**

**12 CFR Part 1272**

**RIN 2590-AA84**

**Federal Home Loan Bank New Business Activities**

**AGENCY:** Federal Housing Finance Agency.

**ACTION:** Final rule.