

producer milk, in product pounds, during the month, combining all plants of a single handler regulated under the same Federal order.

(c) *Forward contract* means an agreement covering the terms and conditions for the sale of milk from a producer defined in §§ 1001.12, 1005.12, 1006.12, 1007.12, 1030.12, 1032.12, 1033.12, 1124.12, 1126.12, 1131.12, and 1135.12, or a cooperative association defined in § 1000.18, and a handler defined in § 1000.9 or 1135.9.

(d) *Contract milk* means the producer milk covered by a forward contract.

(e) *Disclosure statement* means the following statement which must be signed by each producer entering into a forward contract with a handler before the market administrator will recognize the terms and conditions provided in such contract.

#### Disclosure Statement

I am voluntarily entering into a forward contract with \_\_\_\_\_ (handler's name). I have been given a copy of the contract and I have received the USDA's Pilot Program Fact Sheet to which this disclosure statement was attached. By signing this form, I understand that I am forfeiting my right to receive the order's minimum prices for that portion of my milk that is under forward contract for the duration of the contract. I also understand that my milk will be priced in accordance with the terms and conditions of the contract.

Printed Name:

Signature:

Date:

Address:

Producer No:

(f) *Other definitions.* The definition of any term in parts 1000–1135 of this chapter apply to, and are hereby made a part of, this part.

### Subpart B—Rules Governing Forward Contracts

#### § 1140.2 Rules governing forward contracts.

(a) Any handler defined in §§ 1000.9 and 1135.9 may enter into forward contracts with producers or cooperative associations for the handler's eligible milk. Milk under forward contract in compliance with these rules will be exempt from the minimum payment provisions that would apply to such milk pursuant to §§ 1001.73, 1005.73, 1006.73, 1007.73, 1030.73, 1032.73, 1033.73, 1124.73, 1126.73, 1131.73 and 1135.73 for the period of time covered by the contract.

(b) A forward contract with a producer or cooperative association participating for the first time in this pilot program may not exceed 12 months. In no event shall a forward contract executed pursuant to this part extend beyond December 31, 2004.

(c) Forward contracts must be signed and dated by the contracting handler and producer (or cooperative association) prior to the 1st day of the 1st month for which they are to be effective and must be in the possession of the market administrator by the 15th day of that month.<sup>1</sup> The disclosure statement provided in § 1140.1(e) must be signed on the same date as the contract by each producer entering into a forward contract under the pilot program, and this signed disclosure statement must be attached to each contract submitted to the market administrator.

(d) In the event that a handler's contract milk exceeds the handler's eligible milk for any month in which the specified contract price(s) are below the order's minimum prices, the handler must designate which producer milk shall not be contract milk. If the handler does not designate the suppliers of the over-contracted milk, the market administrator shall prorate the over-contracted milk to each producer and cooperative association having a forward contract with the handler.

(e) Payments for milk covered by a forward contract must be made on or before the dates applicable to payments for milk that is not under forward contract under the respective Federal order.

(f) Handlers participating in the pilot program will continue to be required to file all reports that are currently required under the respective marketing orders and will continue to be required to account to the pool for all milk they receive at their respective order's minimum class prices.

(g) Nothing in this part shall impede the contractual arrangements that exist between a cooperative association and its members.

Dated: July 13, 2000.

**Kathleen A. Merrigan,**

*Administrator, Agricultural Marketing Service.*

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### FEDERAL HOUSING FINANCE BOARD

**12 CFR Parts 900, 917, 926, 944, 950, 952, 961 and 980**

[No. 2000–34]

RIN 3069–AA97

#### Federal Home Loan Bank Advances, Eligible Collateral, New Business Activities and Related Matters

**AGENCY:** Federal Housing Finance Board.

**ACTION:** Final rule.

**SUMMARY:** The Federal Housing Finance Board (Finance Board) is amending its Advances Regulation and other regulations to implement the requirements of the Federal Home Loan Bank System Modernization Act of 1999 by: allowing the Federal Home Loan Banks (Banks) to accept from community financial institution (CFI) members new categories of collateral to secure advances; expanding the purposes for which the Banks may make long-term advances to CFI members; and removing the limit on the amount of a member's advances that may be secured by other real estate-related collateral. The Finance Board also is making related and other technical changes to its regulations on General Definitions, Powers and Responsibilities of Bank Boards of Directors and Senior Management, Federal Home Loan Bank Housing Associates, Community Support Requirements, Community Investment Cash Advance Programs and Standby Letters of Credit, and adopting a new regulation on New Business Activities.

**DATES:** The final rule is effective on August 17, 2000.

**FOR FURTHER INFORMATION CONTACT:** James L. Bothwell, Director, (202) 408–2821, Scott L. Smith, Deputy Director, (202) 408–2991, or Julie Paller, Senior Financial Analyst, (202) 408–2842, Office of Policy, Research and Analysis; or Eric E. Berg, Senior Attorney-Advisor, (202) 408–2589, Eric M. Raudenbush, Senior Attorney-Advisor, (202) 408–2932, or Sharon B. Like, (202) 408–2930, Senior Attorney-Advisor, Office of General Counsel, Federal Housing Finance Board, 1777 F Street, N.W., Washington, D.C. 20006.

#### SUPPLEMENTARY INFORMATION:

##### I. Background

##### A. Historical Benefits of Federal Home Loan Bank System

The Federal Home Loan Bank System (Bank System) comprises twelve regional Banks that are instrumentalities

<sup>1</sup> Contracts that have been signed prior to the effective date of these rules are invalid under the pilot program.

of the United States organized under the authority of the Federal Home Loan Bank Act (Bank Act). See 12 U.S.C. 1423, 1432(a). The Banks are cooperatives; only members of a Bank may own the capital stock of a Bank and only members and certain eligible nonmember borrowers (housing associates) (such as state housing finance agencies) may obtain access to the products provided by a Bank. See 12 U.S.C. 1426, 1430(a), 1430b. Each Bank is managed by its own board of directors and serves the public by enhancing the availability of residential housing finance and community lending credit through its members and housing associates. See 12 U.S.C. 1427. Any eligible institution (typically, an insured depository institution) may become a member of a Bank by satisfying certain criteria and by purchasing a specified amount of a Bank's capital stock. See 12 U.S.C. 1424, 1426; 12 CFR part 925.

As government sponsored enterprises (GSEs), the Banks are granted certain privileges that enable them to borrow funds in the capital markets on terms more favorable than could be obtained by private entities, so that the Bank System generally can borrow funds at a modest spread over the rates on U.S. Treasury securities of comparable maturity. The Banks pass along their GSE funding advantage to their members, and ultimately to consumers, by providing secured loans, called advances, and other financial products and services at rates and terms that would not otherwise be available to their members.

The Banks must fully secure advances with eligible collateral. See 12 U.S.C. 1430(a). At the time of origination or renewal of an advance, a Bank must obtain a security interest in collateral eligible under one or more of the collateral categories set forth in the Bank Act. See 12 U.S.C. 1430(a).

Under section 10 of the Bank Act and part 950 of the Finance Board's regulations, the Banks have broad authority to make advances in support of residential housing finance, which includes community lending, defined, in the final rule, as providing financing for economic development projects for targeted beneficiaries and, for CFIs, purchasing or funding small business loans, small farm loans or small agri-business loans. See 12 U.S.C. 1430(a), (i), (j); 12 CFR parts 900, 950. The Banks also are required to offer two programs, the Affordable Housing Program (AHP) and the Community Investment Program (CIP), to provide subsidized or at-cost advances, respectively, in support of unmet housing finance or targeted economic development credit needs.

See 12 U.S.C. 1430(i), (j); 12 CFR parts 951, 952. In addition, section 10(j)(10) of the Bank Act authorizes the Banks to establish additional Community Investment Cash Advance (CICA) Programs for targeted community lending, defined as providing financing for economic development projects for targeted beneficiaries. See 12 U.S.C. 1430(j)(10); 12 CFR part 952.

#### *B. Expanded Access to Bank System Benefits*

On November 12, 1999, the President signed into law the Federal Home Loan Bank System Modernization Act of 1999 (Modernization Act)<sup>1</sup> which, among other things, amended the Bank Act by providing smaller lenders with greater access to membership in the Bank System and greater access to Bank advances. The Modernization Act established a category of members consisting of depository institutions whose deposits are insured by the Federal Deposit Insurance Corporation (FDIC) that have less than \$500,000,000 in average total assets (based on an average of total assets over three years) called community financial institutions (CFIs),<sup>2</sup> and authorized the Banks to make long-term advances to CFI members for the purposes of providing funds for small businesses, small farms and small agri-businesses. See Modernization Act, sections 602, 604(a)(2), 605. The Modernization Act also authorized the Banks to accept from CFI members as security for advances secured loans for small business, agriculture, or securities representing a whole interest in such secured loans. See *id.*, section 604(a)(5)(C).

For all members, the Modernization Act removed the statutory limit on the amount of aggregate outstanding advances that could be secured by "other real estate-related collateral," which had been capped at 30 percent of a member's capital. See *id.*, section 604(a)(5)(B). The Banks, therefore, are now authorized to accept other real estate-related collateral as security for advances to any member as long as the collateral has a readily ascertainable value and the Bank is able to perfect a security interest in that collateral. See 12 U.S.C. 1430(a)(3)(D) (as amended).

<sup>1</sup> The Modernization Act is Title VI of the Gramm-Leach-Bliley Act, Pub. L. No. 106-102, 113 Stat. 1338 (Nov. 12, 1999).

<sup>2</sup> The Finance Board recently adopted an Interim Final Rule that amended the Finance Board's Membership Regulation to implement the Modernization Act amendments regarding membership in the Bank System. See 65 FR 13866 (March 15, 2000). The Finance Board adopted the Interim Final Rule as a Final Rule, with several changes, at its June 23, 2000 Board meeting.

#### *C. Proposed Rule*

On May 8, 2000, the Finance Board issued a notice of proposed rulemaking that proposed amendments to the Finance Board's regulations to implement the new statutory authorities described above. See 65 FR 26518 (May 8, 2000). The public comment period on the proposed rule closed on June 7, 2000. The Finance Board received letters from a total of 64 commenters, including: 11 Banks; 15 financial institution trade associations; 34 Bank members; 1 home builders' association; the Farm Credit System trade association; the Bank's trade association; and a Congressman. Comments as they relate to specific issues raised by the proposed rule are discussed below.

## **II. Analysis of Final Rule**

### *A. Modernization Act Amendments Establishing Newly Eligible Collateral*

#### *1. New CFI-Eligible Collateral*

The Modernization Act amended the Bank Act to allow CFI members to pledge new types of collateral as security for advances, specifically, secured loans for small business or agriculture, or securities representing a whole interest in such secured loans. See Modernization Act, section 604(a)(5)(C). Proposed § 950.7(b)(1) implemented this amendment by authorizing the Banks to accept from CFI members or their affiliates as security for advances, small business loans, small farm loans or small agri-business loans fully secured by collateral other than real estate, or securities representing a whole interest in such loans, provided that: (i) The loans have a readily ascertainable liquidation value and can be freely liquidated in due course; and (ii) the Bank can perfect a security interest in such collateral (CFI-eligible collateral). Proposed § 950.7(b)(1) also required that, prior to accepting any such CFI-eligible collateral, a Bank shall meet the new business activity requirements of proposed part 980. This requirement was intended to ensure that a Bank has the capacity to value, discount and manage the newly eligible collateral prior to making advances secured by such collateral.

Proposed § 950.7(b)(1) excluded loans secured by real estate because these types of loans were included in proposed § 950.7(a)(4).

*a. Types of CFI-eligible collateral—Definitions of "small business loans," "small farm loans" and "small agri-business loans".* Proposed § 950.1 defined the terms "small business

loans,” “small farm loans” and “small agri-business loans” using a loan size approach and an alternative business (or farm) size approach. Specifically, loans below a prescribed aggregate amount—\$1 million for small business loans, and \$500,000 for small farm loans and small agri-business loans—were considered a proxy for business (or farm) size based on the loan size standards established by regulation of the agencies comprising the Federal Financial Institutions Examination Council (FFIEC),<sup>3</sup> and met the proposed definitions. See 57 FR 54235 (Nov. 17, 1992). As discussed in the **SUPPLEMENTARY INFORMATION** section of the proposed rule, these aggregate loan size limits were derived from the FFIEC requirement that financial institutions report to their primary regulators small business loans of up to \$1 million and small farm loans of up to \$500,000. See *id.* Loans above these aggregate loan size limits would not meet the proposed definitions, unless business data specific to the borrowing enterprise (annual gross receipts or number of employees) showed that the borrower met the eligibility standards for a small business (or farm) concern under the Small Business Administrations (SBA) regulations. See 13 CFR part 121.

As discussed in the **SUPPLEMENTARY INFORMATION** section of the proposed rule, the business size approach provides greater accuracy, but may result in costs that deter CFI members from fully employing Banks as a funding source for loans to small businesses and small farms. The loan size approach is less precise, but has the advantage of lower implementation costs, since it involves information already available to Federally regulated financial institutions in the reports they are required to file with their primary federal regulator.

In the **SUPPLEMENTARY INFORMATION** section of the proposed rule, the Finance Board stated that the proposed definitions represented an appropriate compromise between these two approaches that would allow CFI members to use Bank System funding to finance small businesses and small farms, as authorized by the Modernization Act. See Modernization Act, section 604(a)(5)(C). The Finance Board requested comment on whether

there were any other appropriate methods of categorizing or defining small business loans, small farm loans, and small agri-business loans.

Many of the community bank commenters noted that the expansion of eligible collateral to secure advances is critical to their funding needs. Many commenters of all types stated that neither of the alternatives set forth in the proposed definitions would allow CFI members to utilize such loans as a source of funding to the extent intended by Congress. The consensus among commenters was that the aggregate loan size limits set forth in the proposed definitions were too restrictive, and that the alternative documentation requirements for loans above the aggregate loan size limits would be too time-consuming and burdensome to offer a practical alternative. Many commenters recommended instead that the Finance Board adopt a definitional approach tied to the legal “loans to one borrower” (LTOB) limits to which members already are subject. Other commenters variously recommended raising the maximum aggregate loan size limits, making any aggregate loan size limits uniform for all categories of CFI-eligible collateral, providing a mechanism that would adjust the aggregate loan size limits over time for inflation, and reducing documentation requirements. One commenter recommended adopting an aggregate loan size limit based on the standard for small farms developed by the Secretary of Agriculture (less than \$250,000 in annual gross agricultural sales).

Loans and extensions of credit by insured depository institutions are subject to statutory and regulatory LTOB limits. See, e.g., 12 U.S.C. 84(a); 12 CFR part 32 (Office of the Comptroller of the Currency); 12 CFR 560.93 (Office of Thrift Supervision). Generally, the total loans and extensions of credit made by an insured depository institution to any one borrower may not exceed 15 percent of that institution’s total unimpaired capital and unimpaired surplus, with exceptions for, among other things, loans fully secured by high quality and highly liquid collateral. See 12 U.S.C. 84(a)(1), (2), (c). These LTOB limits are intended to protect the safety and soundness of insured depository institutions by prohibiting concentration of lending to any one entity. Commenters pointed out that, in conjunction with the LTOB limits, the size limit on a member’s CFI eligibility of \$500 million in total assets effectively limits the size of the loans the member may pledge for advances. Various commenters calculated the “effective” loan limit resulting from the LTOB

approach to range from \$3.75 million to \$6 million for a \$500 million institution, depending on the institution’s capital level. Several commenters pointed out that the Finance Board adopted a similar approach in amending the definition of “combination business or farm property” in the Advances Regulation in order to permit members with assets of \$500 million and less to pledge combination agriculture/residential loans and business/residential loans as eligible collateral. See 63 FR 35117 (June 29, 1998). The Finance Board noted at that time that by limiting the size of members that could pledge the loans, the Finance Board was indirectly limiting the size of the loans themselves. See *id.* at 35122.

The Finance Board recognizes that the LTOB approach offers certain advantages over the definitions of “small business loans,” “small farm loans,” and “small agri-business loans” set forth in the proposed rule. For example, the aggregate loan size limits in the proposed rule represent static, one-size-fits-all loan amounts. One commenter noted, in this regard, that while the proposed aggregate loan size limits might not impact CFI members with assets of \$100 million or less, the proposed limits could create an impediment for larger CFI members making larger loans. By contrast, the LTOB approach would result in aggregate loan size limits that are relative to the size of each CFI member and arguably more relevant and appropriate. Additionally, since LTOB restrictions are already in place, reliance on this measure would ease administration and limit implementation costs. Further, a CFI member’s LTOB limit would follow the movement of its assets and capital, thereby making adjustments for inflation unnecessary.

The Finance Board also recognizes that LTOB restrictions are not uniform. Legal lending limits for similarly sized CFI members will vary, not only because institutions will hold different amounts of capital and unimpaired surplus, but because LTOB restrictions themselves may vary in form or application among the federal and state regulatory bodies that promulgate and enforce such restrictions. Even within the same regulatory structure, the size of loan a CFI member is permitted to make may vary depending on the extent to which certain exceptions to the general LTOB limit may apply to that particular loan. However, the Finance Board does not believe that these variances, including the potential for higher loan amounts under certain circumstances, would prevent the LTOB approach from

<sup>3</sup> FFIEC is a formal interagency body empowered to prescribe uniform principals, standards, and report forms for the federal examination of financial institutions by the Board of Governors of the Federal Reserve System, the FDIC, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision, and to make recommendations to promote uniformity in the supervision of financial institutions. See 12 U.S.C. 3301 *et seq.*

serving as an appropriate method of categorizing or defining small business loans, small farm loans and small agri-business loans.

On balance, the Finance Board is persuaded that the LTOB approach is the most reasonable and cost efficient means of implementing the Modernization Act in a manner that will facilitate CFI member access to Bank advances for the purpose of funding small businesses, small farms and small agri-businesses. Further, the Finance Board does not believe that the LTOB approach raises any additional safety and soundness concerns that cannot be adequately addressed by the collateral policy requirements in § 917.4 and the new business activities requirements in part 980 discussed below. Accordingly, § 950.1 of the final rule defines "small business loans," "small farm loans," and "small agri-business loans" as loans that are within the legal lending limit of the reporting CFI member and reported on certain regulatory financial reports as specifically provided in § 950.1. To ensure that loan size is effectively limited by the definitions of "small business loans," "small farm loans," and "small agri-business loans," the definitions shall apply only to whole loans and not to loan participations.

As proposed, § 950.7(b)(1) of the final rule does not explicitly refer to secured loans for agriculture, as does the Modernization Act. See Modernization Act, section 604(a)(5)(C). Instead, the Finance Board has interpreted "agriculture loans" to mean small farm loans and small agri-business loans, and substituted these terms, in the text of § 950.7(b)(1). These terms also appear in § 950.3, which sets forth the authorized purposes of long-term Bank advances, so their use in § 950.7(b)(1) is consistent with the Finance Board's general policy of employing uniform terminology in its regulations whenever possible. The Finance Board also stated in the **SUPPLEMENTARY INFORMATION** section of the proposed rule that permitting the Banks to accept as collateral only "small" agriculture loans was consistent with both the Banks' mission of assisting members with community lending and with the Modernization Act's emphasis on small institutions' lending to small enterprises. See Modernization Act, sections 602, 604(a)(3), 604(a)(5)(C).

Many commenters stated that the Finance Board's interpretation of the statutory term "agriculture loans" as small farm loans and small agri-business loans was unnecessarily restrictive, on the basis that the Modernization Act does not explicitly specify an aggregate size limit on secured loans for

agriculture. The Finance Board's adoption of the LTOB approach to loan size definitions in the final rule resolves this issue, since it allows CFI members to pledge as collateral to secure advances farm loans and agri-business loans up to their respective legal lending limits.

*b. Restrictions on acceptance of CFI-eligible collateral.* The primary duty of the Finance Board is to ensure that the Banks operate in a financially safe and sound manner. See 12 U.S.C. 1422a(a)(3)(A). As discussed in the **SUPPLEMENTARY INFORMATION** section of the proposed rule, in view of the potentially greater risks inherent in non-mortgage, CFI-eligible collateral, with which the Banks have limited or no experience, the Finance Board, for safety and soundness reasons, considered whether limits or restrictions should be established on the types of collateral that could secure such loans or securities pledged by a CFI member or affiliate to secure an advance. For example, small business loans secured by accounts receivable or inventory, or small farm loans secured by crops or livestock, which may present greater risks than other types of secured small business or small farm loans, could have been excluded from the types of eligible collateral. The Finance Board chose not to impose limits or restrictions in the proposed rule, but instead to require in proposed § 917.4 that the Banks have policies and capacity to value the collateral, whatever it may be. In addition, proposed part 980 treated the acceptance of CFI-eligible collateral for the first time as a new business activity requiring 60-day notice to the Finance Board before the activity could be undertaken.

The Finance Board requested comment on whether certain types of CFI-eligible collateral should be prohibited as eligible collateral on the basis of risk. Several commenters supported the approach in the proposed rule, stating that no types of CFI-eligible collateral are so inherently risky as to justify a prohibition on their acceptance, and that each Bank should have the discretion to determine risk parameters and eligibility standards for each type of CFI-eligible collateral it chooses to accept.

The Finance Board continues to believe that requiring each Bank to determine the value of collateral in accordance with a member products policy established pursuant to § 917.4 will minimize appropriately the Banks' exposure to risk in accepting CFI-eligible collateral. The Finance Board expects such policies, if properly

developed and implemented, will take the appropriate risk factors into account in their valuation and discounting procedures. Of course, those policies, and the Banks' activities in this regard, would continue to be subject to examination by the Finance Board and to the new business activities requirements of part 980, discussed in section II.B., below. Accordingly, as proposed, the final rule establishes no limits on the types of collateral that may secure such loans or securities pledged by a CFI member or affiliate.

*c. CFI status. (i) Definition of "CFI"—Determination of CFI status based on calculation of three-year total assets average.* The Modernization Act defines a "community financial institution" as an FDIC-insured institution that has, as of the date of the transaction at issue, less than \$500 million in average total assets, based on an average of total assets over the three years preceding that date. See Modernization Act, § 602 (to be codified at 12 U.S.C. 1422(13)). The proposed rule included a definition of "CFI" in § 900.1 that mirrored the statutory definition.

A number of commenters recommended that the Banks be allowed to determine the status of their members by calculating the average total assets of their members on an annual basis, based on calendar year-end financial data available from the institutions' regulatory financial reports filed with their regulators, or, in the alternative, based on data available from the institutions' quarterly regulatory financial reports for the preceding three years. Commenters stated that it would be confusing to determine CFI status on a quarterly or monthly basis when § 925.22(b)(1) of the Membership Regulation requires the Banks to calculate annually each member's minimum capital stock requirement using calendar year-end financial data. Commenters stated that calculation of CFI status on a quarterly or monthly basis would result in unnecessary administrative burdens and expense. Other commenters supported quarterly calculations of average total assets based on the institutions' quarterly regulatory financial reports over the three preceding years. Commenters also stated that calculation of CFI status on a quarterly or monthly basis would cause some members' CFI status to fluctuate more frequently, which, for members approaching the CFI asset cap, could have a negative effect on their reliance on Bank funding secured by CFI-eligible collateral.

The Finance Board finds merit in these comments and believes it would be reasonable and less burdensome for

the Banks to determine their members' CFI status by calculating annually the members' average total assets based on data drawn from the members' regulatory financial reports for the three most recent calendar year-ends. The April 1 effective date adopted in the final rule provides sufficient time for the Banks to use calendar year-end data available from the regulatory financial reports.

The issue of how to calculate the three-year total assets average also arises in the context of the membership application review process regarding the determination of whether an applicant for membership qualifies as a CFI and, therefore, is exempt from the statutory requirement that at least 10 percent of its total assets must be residential mortgage loans. See 12 U.S.C. 1424(a)(2) (1994). Because the calculation of the three-year total assets average affects the determination of CFI status for both membership and advances collateral purposes, consistent with the proposed Advances Collateral Rule, the final rule moves the definition of "CFI" to § 900.1, which contains general definitions applying to all Finance Board regulations. The final rule revises the proposed definition of "CFI" to include the calculation for advances collateral purposes described above, as well as a separate calculation for membership purposes discussed in the **SUPPLEMENTARY INFORMATION** section of the Finance Board's final rule on membership and advances adopted by the Finance Board on June 23, 2000.

(ii) *Change in CFI status.* The proposed rule provided that if a member that previously qualified as a CFI loses its CFI status, the Bank may not accept as security for new advances CFI-eligible collateral from that member. Proposed § 950.7(b)(2) also provided that a Bank shall not require a member that loses its CFI status and has outstanding advances secured by CFI-eligible collateral to repay such advances prior to the stated maturities, or to provide substitute collateral, eligible under paragraphs (a)(1) through (5), based solely on the member's change in CFI status. All of the comments addressing the change in CFI status provisions in proposed § 950.7(b)(2) supported allowing outstanding advances held by members that no longer qualify as CFIs to run to their stated maturities. Accordingly, this provision is adopted without change in § 950.7(b)(2)(i) of the final rule.

Proposed § 950.7(b)(2) also authorized a Bank to allow a member that has lost its CFI status to renew maturing advances secured by CFI-eligible collateral for up to 6 months in order to

provide the member with sufficient time to wind down advances and replace them with other funding in an orderly fashion. The Finance Board requested comment on whether allowing renewals of such advances is appropriate and, if so, whether allowing renewals for up to 6 months would provide sufficient time for members to obtain alternative funding. Some of the commenters stated that the proposed 6-month renewal period for maturing advances was not enough time for members to obtain replacement funding for maturing advances. Alternative suggestions from commenters included a 12-month renewal period, an 18-month renewal period, and allowing members to maintain a permanent maximum eligible collateral limit, based on one-to two-year historical usage. In addition, some of the commenters indicated that it would be difficult to determine which advances are secured by CFI-eligible collateral and which advances are secured by other collateral.

Based on the comments, § 950.7(b)(2) of the final rule has been revised to apply to members that no longer qualify as CFIs and have total advances outstanding that exceed the amount that can be fully secured by collateral under § 950.7(a) (non-CFI-eligible collateral).

While the Finance Board believes that it is inappropriate to allow CFI members that lose their CFI status to continue to pledge CFI-eligible collateral as security for advances indefinitely, it does acknowledge that the proposed 6-month renewal period may not be long enough for members to obtain replacement funding for maturing advances. A 12-month renewal period would appear to be a more reasonable amount of time for transition, especially given that the calculation of CFI status is based on a three-year total assets average and a member, therefore, is likely to be aware of its potential loss of CFI status well before it actually occurs. Accordingly, § 950.7(b)(2)(ii) of the final rule has been revised to provide that maturing advances may be renewed to mature no later than 12 months from the date the Bank determines that a member ceases to qualify as a CFI. Since, as discussed above, § 900.1 of the final rule requires each Bank to perform the CFI calculation of the three-year total assets average on an annual basis effective April 1 of each year, the 12-month renewal period will run from April 1 of the year that a Bank determines that a member no longer qualifies as a CFI to March 31 of the following year.

Section 950.7(b)(2) of the final rule also provides that the total of a member's advances under § 950.7(b)(2)(i) and (ii) shall be fully

secured by collateral set forth in paragraphs (a) and (b) of this section.

*d. Readily ascertainable value.*

Proposed § 950.7(b)(1) authorized the Banks to accept from CFI members or their affiliates as security for advances, CFI-eligible collateral provided that: (i) the loans have a readily ascertainable liquidation value and can be freely liquidated in due course; and (ii) the Bank can perfect a security interest in such collateral. The basis of this standard was the Finance Board's belief that the liquidation value of collateral, and the ability to liquidate the collateral quickly, was an appropriate measure of the value of CFI-eligible collateral securing an advance.

A substantial number of Bank commenters opposed the proposed standard on the grounds that liquidation value is difficult to measure and, therefore, impractical as a standard. The commenters also found the phrase "freely liquidated in due course" to be unclear in terms of when and how frequently such determination would have to be made.

In response to the Banks' concerns, § 950.7(a)(4) is revised in the final rule to provide that CFI-eligible collateral is eligible to secure advances if it has "a readily ascertainable value, can be reliably discounted to account for liquidation and other risks, and can be liquidated in due course." This standard is intended to clarify that the critical factor is the Bank's ability to reliably discount the collateral in question. The phrase "can be liquidated in due course" is intended to mean that there are no known impediments to liquidation at the time the collateral is accepted by the Bank. This change also is made in § 950.7(a)(4)(i)(A) of the final rule with respect to other real estate-related collateral.

**2. Cash or Deposits in a Bank**

Current § 950.9 of the Advances Regulation (redesignated as § 950.7 in the final rule) sets forth the types of eligible collateral that a Bank may accept to secure advances. The Modernization Act revised section 10(a)(3) of the Bank Act to add "cash" to the types of eligible collateral. See Modernization Act, section 604(a)(5)(A). As proposed, § 950.7(a)(3) of the final rule implements this change by adding cash as eligible collateral.

**3. Other Real Estate-Related Collateral**

*a. New business activity notice requirement.* The Modernization Act amended section 10(a)(4) of the Bank Act by removing the limit on the dollar amount of advances that may be secured by other real estate-related collateral,

which had been set at 30 percent of the member's capital. *See* Modernization Act, section 604(a)(5)(B). Section 950.7(a)(4) of the final rule implements this change by removing the 30 percent limitation. As discussed in the **SUPPLEMENTARY INFORMATION** section of the proposed rule, because the Banks have had no or limited experience with accepting other real estate-related collateral, the Banks will need to build capacity and exercise caution in evaluating and accepting such collateral. For this reason, the proposed rule treated the acceptance of other real estate-related collateral as a new business activity, and proposed § 950.7(a)(4)(iii) prohibited a Bank from making total advances to all members secured by other real estate-related collateral in an aggregate amount exceeding 25% of the highest level of advances previously secured by such collateral (125% trigger), until the Bank met the new business activity requirements of proposed part 980. Proposed § 980.3 required a Bank to provide at least 60 days prior notice to the Finance Board to include, among other things, information demonstrating the Bank's capacity, sufficiency of experience and expertise to safely value, discount and manage the risks associated with other real estate-related collateral. Under proposed §§ 980.4 and 980.5, the Bank was permitted to commence acceptance of other real estate-related collateral if, 60 days after receipt by the Finance Board of the notice, the Finance Board had not issued to the Bank a notice of disapproval, a notice instructing the Bank not to commence the new activity pending further consideration by the Finance Board, a notice of intent to examine, or a request for additional information, or if the Finance Board had issued a letter of approval.

The Finance Board requested comment on what the appropriate threshold should be for triggering the new business activity requirement with respect to the use of other real estate-related collateral, and whether there should be any other limits on the use of such collateral to ensure that the Banks' lending against this type of collateral was done in a safe and sound manner. A number of commenters opposed the proposed 125% trigger, stating that it was too severe, and several suggested a higher trigger. Most of the commenters recommended a trigger linked to a percentage or dollar limit per member. Various commenters recommended a trigger of 100% of member capital, 55% of member capital, 55% of Bank capital, and 100% of Bank capital. One

commenter recommended that the final rule establish specific discount rates to be used by the Banks, rather than the Finance Board reviewing each Bank's capacity, sufficiency of experience and expertise to safely discount and manage the risks associated with other real estate-related collateral. Many commenters observed that the Banks had ample experience accepting this type of collateral without limit before the 30 percent cap was imposed by amendment of the Bank Act in 1989 and, thus, already were well qualified to manage and discount this type of collateral.

The Finance Board has reconsidered the 125% trigger in light of the comments, as being more restrictive than may be necessary, and has deleted the trigger from the final rule. However, because other real estate-related collateral has only been accepted by a few Banks in limited amounts since 1989, and because the Bank System's operations were very different prior to 1989, the Finance Board still believes it necessary for the Banks to establish policies and procedures to adequately value and discount this type of collateral. Rather than dictating specific discount rates to be applied by the Banks, which is a management function more appropriately administered by the Banks, which are in the best position to assess their members' underwriting capacity and the quality of loans pledged, § 980.1 of the final rule treats a Bank's acceptance of other real estate-related collateral of any amount as a new business activity, regardless of whether the Bank has accepted such collateral in the past, and § 980.3(b) requires the Bank to file a new business activity notice with the Finance Board prior to accepting such collateral. As stated in the **SUPPLEMENTARY INFORMATION** section of the proposed rule, in evaluating a Bank's notice, the Finance Board intends to encourage conservative discounting of new collateral until the Bank gains experience in valuing such collateral. However, in order to expedite the Banks' acceptance of such collateral while ensuring that it is done in a safe and sound manner, § 980.4(b) of the final rule allows a Bank to begin accepting such collateral immediately upon receipt by the Finance Board of the notice. The Finance Board intends to review the Banks' acceptance of such collateral through either special examinations or the regular examination process as it deems appropriate.

*b. Pledge of all available collateral before pledge of other real estate-related collateral.* The Finance Board requested comment in the **SUPPLEMENTARY**

**INFORMATION** section of the proposed rule on whether members should be required to pledge all available collateral under proposed §§ 950.7(a)(1) through (3) prior to pledging other real estate-related collateral under paragraph (4), in order to prevent members from using only their least liquid collateral to secure Bank advances. While each Bank has the discretion to include such a requirement in its member products policy, the Finance Board questioned whether it would be appropriate to require collateral prioritization by regulation, especially in light of the Modernization Act authorization for the Finance Board to review, and increase, the Banks' standards for other real estate-related collateral. *See* Modernization Act, section 604(a)(7).

A number of commenters opposed imposition of a collateral prioritization requirement, recommending instead that decisions on adoption of any collateral prioritization standards be left to the discretion of each Bank, although one Bank supported the proposal as sound credit policy. The Finance Board believes generally that decisions on adopting collateral prioritization standards should be dealt with by each Bank in the context of its collateral policies. Accordingly, the final rule does not include a collateral prioritization requirement.

*c. Readily ascertainable value.* Current § 950.9(a)(4)(i)(A) of the Advances Regulation requires other real estate-related collateral to have a readily ascertainable value. *See* 12 CFR 950.9(a)(4)(i)(A). The Finance Board stated in the **SUPPLEMENTARY INFORMATION** section of the proposed rule that the liquidation value of collateral, and the ability to liquidate the collateral quickly, is a more appropriate measure of the value of other real estate-related collateral securing an advance, particularly given the lifting of the 30 percent cap. Accordingly, proposed § 950.7(a)(4)(i)(A) provided that other real estate-related collateral have a readily ascertainable liquidation value and be able to be freely liquidated in due course. As discussed above, this change also was proposed in § 950.7(b)(1)(i) with respect to CFI-eligible collateral.

A significant number of Bank commenters opposed this change on the ground that liquidation value is difficult or impossible to measure and, therefore, impractical as a standard. The commenters also found the phrase "freely liquidated in due course" to be unclear in terms of when and how frequently such determination would have to be made.

In response to the Banks' concerns, the final rule has been revised to provide that other real estate-related collateral is eligible to secure advances if it has "a readily ascertainable value, can be reliably discounted to account for liquidation and other risks, and can be liquidated in due course." This standard is intended to clarify that the critical factor is the Bank's ability to reliably discount the collateral in question. The phrase "can be liquidated in due course" is intended to mean that there are no known impediments to liquidation at the time the collateral is accepted by the Bank. As discussed above, this change also is made in § 950.7(b)(1)(i) of the final rule with respect to CFI-eligible collateral.

#### 4. Removal of Combination Business or Farm Property From Definition of "Residential Real Property"

Under current § 950.1 of the Advances Regulation, the term "residential real property" is defined to include combination business or farm property, where at least 50 percent of the total appraised value of the combined property is attributable to the residential portion of the property or, in the case of a CFI, combination business or farm property on which is located a permanent structure actually used as a residence (other than for temporary or seasonal housing), where the residence constitutes an integral part of the property. 12 CFR 950.1. This provision allows mortgage loans on combination properties to qualify as eligible collateral and to be included in a member's total residential housing assets for the purposes of qualifying for membership and obtaining long-term advances. The Modernization Act's removal of the statutory limit on the amount of advances that may be secured by other real estate-related collateral has eliminated the need to allow combination business or farm property to be counted under the mortgage loan category of eligible collateral. In addition, the Modernization Act's removal of the requirement that CFI members have 10 percent of their total assets in residential mortgage loans to qualify for membership and the expansion of the purposes for which advances may be made to CFI members has reduced the significance of counting such combination properties as residential mortgage loans.

The Finance Board requested comment on whether there were any reasons to retain combination business or farm property in the definition of "residential real property." A number of commenters generally acknowledged that for most institutions seeking to join

and borrow from the Bank System, the removal of the 30 percent cap on other real estate-related collateral and the exemption of CFI members from the 10 percent residential mortgage loans requirement reduced the need for the inclusion of combination business or farm property loans as "residential real estate." However, commenters pointed out that institutions that do not qualify as CFI members would still benefit from the inclusion of combination property loans held in portfolio so long as such loans continued to qualify as "residential real estate." For that reason, commenters urged that these types of loans be retained in the definition.

The Finance Board believes that non-CFI members have sufficient other means available by which to meet the 10 percent residential mortgage loans requirement (for example, purchasing mortgage-backed securities), and would not have to rely on loans on combination properties to meet the requirement. Accordingly, as proposed, the final rule removes combination business or farm property from the definition of "residential real property" in § 950.1.

#### B. New Business Activity Requirement

As discussed above, the changes in types and amounts of collateral that may now be pledged to secure advances will present new management challenges for the Banks. In order to ensure that entering into these and other new types of business activities will not create safety and soundness concerns, the proposed rule added a new part 980. Proposed § 980.3 required a Bank to provide at least 60 days prior written notice to the Finance Board of any new business activity that the Bank wished to undertake—including the acceptance of increased volumes of other real estate-related collateral (based on a 125% trigger, discussed in section II.A.3.a. above) and of new CFI-eligible collateral for the first time—so that the Finance Board could disapprove, examine, or impose restrictions on, such activities, as necessary, on a case-by-case basis. In addition to the acceptance of new or increased volumes of collateral, proposed § 980.1 defined a "new business activity" as any business activity undertaken, transacted, conducted or engaged in by a Bank that has not been previously approved by the Finance Board, including: (1) A business activity that has not been undertaken previously by that Bank, or was undertaken previously under materially different terms and conditions; (2) a business activity that entails risks not previously and regularly managed by that Bank, its

members, or both, as appropriate; or (3) a business activity that involves operations not previously undertaken by that Bank. The prior notice requirement applied to any Bank desiring to pursue a new business activity, even if another Bank had already undertaken the same activity. With respect to accepting either newly eligible collateral or significantly higher volumes of other real estate-related collateral, proposed § 980.3(b) required that the written notice include: a description of the classes or amounts of collateral proposed to be accepted by the Bank; a copy of the Bank's member products policy; a copy of the Bank's procedures for determining the value of the collateral in question; and a demonstration of the Bank's capacity, personnel, technology, experience and expertise to value, discount and manage the risks associated with the collateral in question. This requirement was intended to ensure that a Bank has the capacity to value, discount and manage the additional collateral prior to making advances secured by such collateral.

Many commenters, including most of the Banks, criticized the proposed definition of "new business activity" in § 980.1 as vague or overly broad, and recommended that the definition be revised to include only a new program or new product undertaking and not an expansion or refinement of an existing line of business. Some commenters opposed any prior notice requirement for undertaking new business activities, while other commenters opposed a prior notice requirement specifically for acceptance of increased volumes of other real estate-related collateral and CFI-eligible collateral for the first time. Commenters stated that a prior notice requirement was unnecessary and inconsistent with the general movement toward devolution of corporate governance responsibilities by the Finance Board to the Banks' boards of directors. Commenters expressed concern that a prior notice requirement would significantly delay a Bank's ability to meet marketplace demand or engage in new business activities, or stifle innovation.

Notwithstanding the concerns of the commenters, the Finance Board continues to believe, as discussed above, that a prior notice requirement is necessary in order to maintain adequate safety and soundness oversight over the Banks' acceptance of the newly eligible types of collateral and undertaking of other new business activities.

Accordingly, the proposed prior notice requirement is retained in the final rule. However, the Finance Board agrees with commenters that the proposed definition of "new business activity"



may be more broad than necessary. Accordingly, the final rule revises the definition of "new business activity" in § 980.1 by substituting the words "such that" for "and that" in the introductory text, which has the effect of including only those activities specifically enumerated in paragraphs (1) through (4) of the definition as "new business activities." In addition, as further discussed in section II.A.3.a. above, based on the comments, the Finance Board believes that the proposed 125% trigger requiring notice of acceptance of other real estate-related collateral in § 950.7(a)(4)(iii) may be more restrictive than necessary, and has deleted the trigger from the final rule. Instead, "new business activity" is defined in the final rule to include the acceptance of any other real estate-related collateral, and § 980.4 is revised to permit a Bank to commence accepting other real estate-related collateral immediately upon receipt by the Finance Board of a notice of new business activity under § 980.3. This change will enable Banks to accept other real estate-related collateral without undue delay as a result of the § 980.3 prior notice requirement.

A substantial number of commenters also stated that the proposed requirement that the Banks establish procedures for determining the value of other real estate-related collateral and new CFI-eligible collateral on a loan-by-loan basis was administratively burdensome. Commenters recommended that the Banks therefore be permitted to adopt a valuation methodology based on evaluating a member's credit management systems ("institutional underwriting"). Although the Banks evaluate their members from a credit risk perspective, the Banks historically have been collateralized lenders, relying on the collateral securing advances. The Banks' policies of overcollateralizing advances have resulted in the Bank System never suffering a credit loss since it was established in 1932. In light of the significant challenges associated with implementation of the new collateral authority in the Modernization Act, the Finance Board does not believe that this is an appropriate time for the Bank System to turn its attention away from its traditional focus of evaluating the collateral securing its advances.

### *C. Clarification of Other Collateral Provisions in Existing Regulation*

#### **1. Securities Representing Equity Interests in Eligible Collateral**

Current § 950.9(a)(5) of the Advances Regulation provides that a Bank may accept as collateral any security, such as

mutual fund shares, the ownership of which represents an undivided equity interest in underlying assets, all of which qualify either as: (i) Eligible collateral under paragraph (a)(1) (mortgage loans and privately issued mortgage-backed securities) or paragraph (a)(2) (agency securities); or (ii) cash or cash equivalents. As discussed above, cash is now included as eligible collateral under paragraph (a)(3). Accordingly, for greater clarity, a reference to paragraph (a)(3) is included in § 950.7(a)(5)(i) of the final rule and the reference to cash in paragraph (a)(5)(ii) is removed.

The current Advances Regulation does not include a definition of "cash equivalents." As proposed, § 950.1 of the final rule defines "cash equivalents" as investments that: (1) Are readily convertible into known amounts of cash; (2) have a remaining maturity of 90 days or less at the acquisition date; and (3) are held for liquidity purposes. This definition codifies a Finance Board regulatory interpretation (Regulatory Interpretation 2000-RI-1 (March 6, 2000)) that allowed a Bank to accept as collateral under § 950.7(a)(5), shares of mutual funds that enter into certain limited types of repurchase agreements. For cash management purposes, mutual funds typically hold securities, pursuant to repurchase agreements, that represent short-term investments as part of their daily cash management activities. A mutual fund's ability to enter into such repurchase agreements, typically with a maturity of less than 90 days, allows the excess cash in the fund to be invested without losing liquidity or incurring price risk. Even mutual funds with particularly restrictive investment limitations, such as those limited to mortgage loans, government securities, and agency securities, typically use repurchase agreements to maintain a liquidity position and manage the fund.

The Financial Accounting Standards Board (FASB) defines "cash equivalents" for financial reporting purposes as short-term, highly liquid investments that are both: (a) readily convertible into cash; and (b) so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. See FAS 95 Paragraphs 8–10. FASB also states that, generally, only investments with original maturities of three months or less qualify under that definition. See *id.*

The definition of "cash equivalents" is derived from the FASB definition, but adapts it by requiring that investments have a remaining maturity of 90 days or less at the acquisition date, because this standard is more practical to implement

than a requirement that investments be so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. In addition, a requirement that the investments be held for liquidity purposes is included in the definition. The Banks will be required to determine on a case-by-case basis whether this requirement has been met.

Other real estate-related collateral under current § 950.9(a)(4) was not originally included in current § 950.9(a)(5)(i) because the dollar amount of advances that could be secured by other real estate-related collateral was limited to 30 percent of the member's capital and the Finance Board believed this limitation would result in monitoring complexities that would make the inclusion of other real estate-related collateral in § 950.9(a)(5)(i) impractical. See 64 FR 16618 (April 6, 1999). As discussed above, the Modernization Act amended section 10(a)(4) of the Bank Act by removing the 30 percent cap on other real estate-related collateral. See Modernization Act, section 604(a)(5)(B). Since this impediment has been eliminated, § 950.7(a)(5)(i) of the final rule includes a reference to other real estate-related collateral under § 950.7(a)(4).

#### **2. Bank Restrictions on Eligible Collateral**

Section 9 of the Bank Act provides that the Banks have discretion to deny, or to approve with conditions, a request for an advance, and section 10(a)(1) confers on the Banks the authority to determine whether collateral is sufficient to fully secure an advance. See 12 U.S.C. 1429, 1430(a)(1). Current § 950.9(b) of the Advances Regulation grants a Bank the discretion to further restrict the types of eligible collateral it will accept as security for advances based on the creditworthiness or operations of the borrower, the quality of the collateral, or other reasonable criteria. 12 CFR 950.9(b). In the SUPPLEMENTARY INFORMATION section of the proposed rule, the Finance Board stated that the discretionary authority conferred on the Banks by current § 950.9(b) was unnecessary in light of the Banks' statutory authority, and because the factors listed in current § 950.9(b) are ordinarily considered in valuing collateral. Accordingly, the proposed rule removed current § 950.9(b). However, a number of Bank commenters requested that this provision be retained in the final rule because it further clarifies the Banks' statutory authority in this area. Based on



these comments, the provision has been retained in § 950.7(c) of the final rule.

### 3. Pledge of Advances Collateral by Affiliates

The Bank Act does not directly address the acceptance of eligible collateral from an affiliate, apart from section 10(e) of the Bank Act, which gives a priority to any security interest granted by a member or its affiliates, subject to certain exceptions. *See* 12 U.S.C. 1430(e). Implicit in Congress' inclusion of collateral pledged by an affiliate in the so-called "superlien provision" is the authority for the Banks to accept collateral from members' affiliates. Accordingly, the Finance Board has determined that Congress has authorized the Banks to accept collateral not only from a wholly-owned subsidiary, but from any affiliate of a member, and states that expressly, as proposed, in § 950.7(f) of the final rule. Several Bank commenters supported this interpretation of the statutory authority of the Banks to accept eligible collateral from members' affiliates.

As proposed, § 950.7(f)(1) of the final rule requires that the pledge of collateral by an affiliate of a member used to secure advances to the member shall either directly secure the member's obligation to repay the advances, or secure a surety or other agreement under which the affiliate has assumed, along with the member, a primary co-obligation to repay the advances made to the member. Because the Bank Act requires that each advance be fully secured, *see* 12 U.S.C. 1430(a), a guaranty by an affiliate of a member's obligation, backed by the eligible assets held by the affiliate, would not meet the requirements of the Bank Act or the final rule, as the collateral would then be securing the affiliate's secondary obligation and not the advance itself. As provided by § 950.7(f)(1), however, where the affiliate enters into a surety arrangement under which it assumes a primary joint and several co-obligation to repay the advance made to the member, and fully secures this primary surety obligation with eligible collateral, such collateral would be considered as securing the advance itself, as required by the statute.

As proposed, § 950.7(f)(2) of the final rule requires the Bank to obtain from an affiliate, and maintain, a legally enforceable security interest pursuant to which the Bank's legal rights and privileges with respect to the collateral are functionally equivalent in all material respects to those that the Bank would possess if the member were to pledge the same collateral directly. The Bank would be required to have on file

adequate documentation demonstrating this functional equivalence. The Finance Board anticipates that Banks that decide to accept collateral from affiliates of members will need to make this determination on a case-by-case basis, after careful legal review and analysis, taking into consideration the structure of the transaction and the law of the state that governs the transaction.

These regulatory additions represent a modification of an earlier proposal on third-party collateral that was published for comment by the Finance Board, but that was subsequently withdrawn. In December 1998, the Finance Board published a proposed rule to amend the Advances Regulation (at that time designated as 12 CFR part 935), that, among other things, would have permitted the Banks to accept pledges of eligible collateral from a member's "qualifying investment subsidiary" (QIS) if the Bank were able to obtain and maintain a security interest in the collateral pursuant to which its rights and privileges were functionally equivalent to those that the Bank would possess if the member were to pledge the collateral directly. Under the December 1998 proposed rule, the term "qualifying investment subsidiary" would have included business entities that: (1) Are wholly owned by a member; (2) are operated solely as passive investment vehicles on behalf of that member; and (3) hold only cash equivalents and assets that are eligible collateral under §§ 935.9(a)(1) and (2) of the Advances Regulation. *See* 63 FR 67625 (Dec. 8, 1998).

In proposing the December 1998 amendments, the Finance Board intended to codify into regulation a series of Finance Board regulatory interpretations regarding the acceptance of eligible collateral held by a real estate investment trust and state security corporation subsidiaries. However, in response to the proposed rule, a large number of commenters questioned the Finance Board's proposal to address only pledges of collateral from a narrow class of wholly-owned subsidiaries, while ignoring collateral arrangements with other types of affiliates that may be permissible under the Bank Act. In light of these comments, the Finance Board removed the QIS provisions from the text of the final rule pending further analysis of the issue. *See* 64 FR 16618 (April 6, 1999).

In conjunction with § 950.7(f) of the final rule, and consistent with the proposed rule, the final rule amends § 950.1 by defining an "affiliate" as any business entity that controls, is controlled by, or is under common control with, a member. The definition

of "affiliate" is intended to limit the scope of eligible third-party collateral to assets over which the member exercises control or shares control.

### 4. Bank Advances Policy

Consistent with the proposed rule, the final rule removes existing § 950.3 of the Finance Board's Advances Regulation. That section requires each Bank's board of directors to adopt and review a policy on advances and outlines some basic criteria for the content of the advances policy. The final rule moves the requirement for the Bank's board of directors to adopt and periodically re-adopt an advances or credit policy to new § 917.4, "Bank Member Products Policy." The Finance Board believes that it would make for a more logical presentation in its regulations to have all of the requirements for Bank policies contained in one regulatory part (part 917), rather than to have such requirements scattered throughout its regulations. The requirements for Bank member products policies are discussed in section II.F. 2., below.

### 5. Removal of Non-QTL Definitions

Prior to the enactment of the Modernization Act, section 10(e) of the Bank Act restricted access to Bank advances to Bank members that did not meet the qualified thrift lender (QTL) test.<sup>4</sup> These restrictions limited the purposes for which non-QTL members could obtain advances, limited Bank System-wide advances to non-QTL members to 30 percent of total Bank System advances outstanding, and gave QTL members a priority over non-QTL members in obtaining advances. *See* 12 U.S.C. 1430(e)(1), (2) (1994). The Bank Act also established a statutory presumption, for the purpose of determining the minimum amount of Bank capital stock that a member must purchase pursuant to section 6(b) of the Bank Act, that each member has at least 30 percent of its assets in home mortgage loans. *See* 12 U.S.C. 1430(e)(3) (1994). Coupled with the section 6(b) requirement that all members must subscribe to Bank stock equaling at least one percent of the member's aggregate

<sup>4</sup> The "qualified thrift lender" test is set forth in section 10(m) of the Home Owners' Loan Act, 12 U.S.C. 1467a(m), and applies directly only to savings associations. Originally enacted in 1987, the QTL test was intended to ensure that savings associations remained committed to the business of providing housing-related loans. Failure to meet the test subjected both the savings association and its holding company to certain statutory penalties, including reduced access to Bank advances for the association. In 1989, Congress revised the QTL test and the penalties for failing to meet it, including more severe restrictions on access to Bank advances for savings associations, as well as for commercial banks, that did not meet the test.

unpaid loan principal, this presumption effectively limited the dollar amount of advances that a non-QTL member could obtain in relation to the amount of Bank stock it had purchased. *See id.*

The Modernization Act repealed section 10(e) of the Bank Act in its entirety, thereby providing access to Bank advances without regard to the percentage of housing-related assets a member holds. *See* Modernization Act, section 604(c). In a recently adopted Interim Final Rule that was finalized on June 23, 2000, the Finance Board removed the provisions in its Membership and Advances Regulations containing the additional capital stock purchase requirements and limitations on advances applicable to non-QTL members. *See* 65 FR 13866 (March 15, 2000). Consistent with the proposed rule, the final rule removes all remaining references to non-QTL status from the Advances Regulation. *See* 12 CFR 950.1, 950.21 (1999). Specifically, § 950.1 of the final rule deletes the following QTL-related definitions from the Advances Regulation: definitions of the terms “Actual thrift investment percentage” or “ATIP;” “Non-Qualified Thrift Lender Member;” “Qualified Thrift Lender” or “QTL;” and “Qualified Thrift Lender test” or “QTL test.” 12 CFR 950.1.

#### *D. Modernization Act Amendment to Long-term Advances Purpose Provision for CFI Members*

Section 10(a) of the Bank Act formerly provided that all long-term advances shall be made only for the purpose of providing funds for residential housing finance. *See* 12 U.S.C. 1430(a) (1994). This purpose is set forth in current § 950.14(a), and is implemented by use of a proxy test set forth in current § 950.14(b). 12 CFR 950.14(a), (b). Specifically, current § 950.14(b)(1) provides that, before funding a long-term advance (*i.e.*, an advance with a maturity greater than five years), a Bank shall determine that the principal amount of all long-term advances currently held by the member does not exceed the total book value of the member’s “residential housing finance assets.” 12 CFR 950.1, 950.14(b)(1). “Residential housing finance assets” are defined in current § 950.1 to mean any of the following: (1) Loans secured by residential real property; (2) mortgage-backed securities; (3) participations in loans secured by residential real property; (4) loans or investments financed by advances made pursuant to a CICA program; (5) loans secured by manufactured housing, regardless of whether such housing qualifies as residential real property; or (6) any

loans or investments which the Finance Board, in its discretion, otherwise determines to be residential housing finance assets. 12 CFR 950.1. Current § 950.14(b)(1) requires a Bank to determine the total book value of the member’s residential housing finance assets using the most recent Thrift Financial Report, Report of Condition and Income, or financial statement made available by the member. 12 CFR 950.14(b)(1). This proxy test was determined by the Finance Board to be an operationally feasible compliance monitoring mechanism for residential housing finance assets to implement the statutory requirement that long-term advances be only for residential housing finance purposes. *See* 57 FR 45338 (Oct. 1, 1992).

The Modernization Act amended section 10(a) of the Bank Act to provide that a Bank may make long-term advances not only for the purpose of providing funds for residential housing finance, but also for the purpose of providing funds to any CFI for small businesses, small farms and small agri-businesses. *See* Modernization Act, section 604(a)(3). Accordingly, consistent with the proposed rule, the final rule amends current § 950.14 by adding this new purpose in redesignated § 950.3. Section 950.3(a) of the final rule provides that a Bank shall make long-term advances only for the purpose of enabling any member to purchase or fund new or existing residential housing finance assets, which include, for CFI members, small business loans, small farm loans and small agri-business loans. Instead of the statutory terms “small businesses,” “small farms” and “small agri-businesses,” § 950.3 utilizes the terms “small business loans,” “small farm loans” and “small agri-business loans,” which the Finance Board is defining for purposes of identifying the new types of collateral that Banks are authorized to accept from CFI members. *See* Modernization Act, section 604(a)(5)(C). As discussed in the **SUPPLEMENTARY INFORMATION** section of the proposed rule, the Finance Board believes that a single set of terms that would apply to both CFI-eligible collateral and the new purposes for which Banks may make advances to CFI members will reduce confusion and otherwise provide an efficient means of implementing the new authorities conferred on the Banks in regard to their CFI members. Further, the Modernization Act provides that the terms “small business,” “small farm” and “small agri-business” shall have the meanings given to those terms by regulation of the Finance Board. *See*

Modernization Act, section 604(a)(7). Accordingly, the Finance Board is interpreting the statutory phrase “providing funds to any community financial institution for small businesses, small farms, and small agri-businesses” to mean making advances to CFI members for small business loans, small farm loans and small agri-business loans. Section 950.3(b)(1) of the final rule maintains the proxy test in its current form. However, revisions to certain definitions will have the effect of including small business loans, small farm loans and small agri-business loans in the denominator of the proxy test for CFI members.

Specifically, as proposed, the final rule amends § 900.1 by adding a new definition of “community lending,” which applies, wherever it appears, in all of the Finance Board’s regulations. The term “community lending” currently is defined in § 952.3 of the CICA Regulation as “providing financing for economic development projects for targeted beneficiaries.” 12 CFR 952.3. The definition of “community lending” in § 900.1 adds to that definition, “and, for community financial institutions, purchasing or funding small business loans, small farm loans or small agri-business loans, as defined in § 950.1 of this chapter.” This addition to the definition implements changes made by the Modernization Act and supports the Finance Board’s belief that CFI lending to small businesses, small farms and small agri-businesses is community lending. For purposes of the CICA and Community Support Regulations, the current definition of “community lending,” redesignated in the final rule as “targeted community lending,” would continue to apply.

Concurrently, the definition of “residential housing finance assets” is amended in the final rule to change the element that currently reads “Loans or investments financed by advances made pursuant to a CICA program” to “Loans or investments qualifying under the definition of community lending in § 900.1 of this chapter.”

Thus, by operation of the revised definitions of “residential housing finance assets” and “community lending,” the proxy test calculation of the total book value of residential housing assets will include, for CFI members, small business loans, small farm loans and small agri-business loans. This result implements section 604(a)(5)(C) of the Modernization Act, which authorizes a Bank to make long-term advances to CFIs for the purpose of providing financing for small businesses, small farms and small agri-

businesses. *See* Modernization Act, section 604(a)(5)(C).

Current § 950.14(b)(1) of the Advances Regulation allows a Bank to determine the total book value of residential housing financial assets using the most recent Thrift Financial Report, Report of Condition and Income, or financial statement made available by the member. 12 CFR 950.14(b)(1). As proposed, § 950.3(b)(1) of the final rule adds to this list “other reliable documentation” made available by the member. This revision is intended to give the Banks more flexibility in the form of documentation they may use in administering the proxy test, as long as the data supplied by the member is reliable.

#### *E. Clarification of Other Advances Provisions in Current Regulation*

##### 1. Pricing

The Finance Board proposed to clarify a provision of the Advances Regulation dealing with the pricing of advances. Current § 950.6(b)(1) of the Advances Regulation requires each Bank to price its advances to members taking into account two factors: (1) The marginal cost to the Bank of raising matching maturity funds in the marketplace; and (2) the administrative and operating costs associated with making such advances to members. 12 CFR 950.6(b)(1). A separate provision, current § 950.8(b)(1), provides that each Bank shall establish and charge a prepayment fee pursuant to a specified formula which sufficiently compensates the Bank for providing a prepayment option on an advance, and which acts to make the Bank financially indifferent to the borrower’s decision to repay the advance prior to its maturity date. 12 CFR 950.8(b)(1). These provisions do not clearly indicate whether Banks must consider the costs of associated options and the administrative costs of funding advances with such options in pricing an advance. Further, because current § 950.6(b)(1) merely requires the Bank “to take into account” the marginal cost to the Bank of raising matching maturity funds in the marketplace, and the administrative and operating costs associated with making such advances to members, the current rule allows a Bank to price an advance below its marginal cost of funds, a practice the Finance Board could find to be an unsafe and unsound practice in some circumstances and one the Finance Board wishes to discourage.

Therefore, redesignated § 950.5(b)(1) of the proposed rule prohibited a Bank from pricing an advance below the Bank’s marginal cost of funds, including

the cost of any embedded options, plus the administrative and operating costs associated with making the advance when funding an advance with similar maturity and options characteristics.

Several Banks commented that the proposed prohibition on pricing advances below a Bank’s marginal cost of funds was too restrictive in that it could prohibit Banks from passing on the benefits of lower costs to member borrowers. However, the Finance Board believes that the proposed exceptions, discussed below, provide the Banks with ample flexibility to pass on lower costs to borrowers for special purposes. Accordingly, the advance pricing prohibition in proposed § 950.5(b) is adopted without change in the final rule.

Proposed § 950.5(b)(3)(i) provided that the advance pricing prohibition would not apply to a Bank’s CICA programs. This was intended to provide the Banks with maximum flexibility in designing and offering AHP and other CICA programs. Proposed § 950.5(b)(3)(ii) also provided that the advance pricing prohibition would not apply to any other advances that are volume limited and specifically approved by a Bank’s board of directors. This exception was intended to allow a Bank to price targeted advances at below the cost of funds for some special purpose that does not meet all of the criteria for CICA advances. It was intended that the special purpose involve some social benefit, such as providing relief from a natural disaster. The proposed exception also would allow a Bank to conduct market testing of alternative pricing strategies for advances.

The exceptions have been adopted in the final rule as proposed. In response to a Bank comment, the final rule substitutes the term “advances program” for “advances” in § 950.5(b)(3)(ii) to make clear that the exception for volume limited advances does not require a Bank’s board of directors to approve each individual advance.

##### *2. Putable and Convertible Advances Disclosure; Replacement Funding for Putable Advances*

Current § 950.6(d)(1) of the Advances Regulation provides that a Bank that offers a putable advance to a member shall disclose in writing to such member the type and nature of the risks associated with putable advance funding, and that such disclosure should include detail sufficient to describe such risks. 12 CFR 950.6(d)(1). A convertible advance is similar to a putable advance in that it carries risks

associated with a triggering event, usually a shift in a designated interest rate index. Accordingly, redesignated § 950.5(d)(1) of the proposed rule made the current disclosure requirements for putable advances applicable to convertible advances as well. Current § 950.6(d)(2) was not proposed to be revised because replacement funding is not an issue for convertible advances, as convertible advances involve only a change in the stated interest rate, not the repayment of funds.

The Finance Board requested comment on whether there are other appropriate requirements for putable or convertible advances. A Bank commenter suggested that the final rule clarify that replacement funding for putable advances is subject to normal and customary safety and soundness considerations. The final rule adopts § 950.5(d) as proposed except for a revision to paragraph (d)(2), in response to the Bank comment, to clarify that a member receiving replacement funding for putable advances must be able to satisfy the normal credit and collateral requirements of the Bank for such funding.

#### *F. Other Technical Changes*

##### 1. Bank Housing Associates—Parts 900.1, 926

As part of a continuing effort to revise and achieve consistency in regulatory nomenclature regarding nonmember borrowers, the proposed rule amended the text, where appropriate, to refer to nonmember borrowers who are eligible under section 10b of the Bank Act, 12 U.S.C. 1430b, to obtain advances from the Banks, as “associates.” The definition of “associate” was recently added to 12 CFR 900.1, which contains definitions of terms that apply to all parts of the Finance Board’s regulations. In response to a commenter’s suggestion, the final rule replaces the term “associates” with the term “housing associates,” which the Finance Board has acknowledged represents a more accurate description of such borrowers. Consistent with this change, the final rule revises the title of subpart B to “Advances to Housing Associates.” Since the term “housing associate” is defined in § 900.1, it is not defined in any of the individual parts addressed by this final rule.

Eligibility requirements for housing associates, including application procedures and requirements for advances to housing associates, currently are contained in the Advances Regulation. *See* 12 CFR 950.22, 950.23. For the sake of greater organizational clarity, consistent with the proposed

rule, the final rule sets forth the housing associate eligibility requirements and advances requirements in separate regulations, by moving the housing associate eligibility requirements to a new part 926 under subpart B. No substantive changes have been made in subpart B.

## 2. Bank Member Products Policy—Section 917.4

In its recently adopted final rule, “Powers and Responsibilities of Bank Boards of Directors and Senior Management,” the Finance Board consolidated all of the requirements for the Bank’s board of directors’ operational policies into one regulatory part, part 917, rather than have such requirements scattered throughout its regulations. *See* 65 FR 25267 (May 1, 2000). As proposed, § 917.4 of the final rule adds to that part a new requirement for adoption by a Bank’s board of directors of a member products policy that would combine the requirements for an advances policy from current § 950.3(a), with the requirements for a standby letter of credit policy from current § 961.5(a), into one policy. The member products policy also addresses other products that the Banks may offer, such as acquired member assets.

As proposed, § 917.4(b) of the final rule requires a Bank’s member products policy to address the following items: the credit underwriting criteria to be applied to advances (including renewals) and standby letters of credit; collateralization (including levels, valuation and discounts) for advances and standby letters of credit; advances-related fees (including any schedules or formulas pertaining to such fees); standards and criteria for pricing member products (including differential pricing of advances pursuant to § 950.4(b)(2)); criteria regarding the pricing of standby letters of credit (including any special pricing provisions for standby letters of credit that facilitate the financing of projects that are eligible for any CICA programs under part 952); the maintenance of appropriate systems, procedures and internal controls; and the maintenance of appropriate operational and personnel capacity.

A Bank’s member products policy also must provide that, for any draw made by a beneficiary under a standby letter of credit, the member will be charged a processing fee calculated in accordance with § 975.6(b).

As proposed, § 917.4(a)(2) of the final rule requires each Bank’s board of directors to review the Bank’s member products policy annually, amend the policy as appropriate, and re-adopt the

policy, including interim amendments, not less often than every three years.

References to the “advances policy” in other sections of the Finance Board’s current regulations are changed in the final rule to references to the “member products policy.”

A few commenters questioned whether it was appropriate to include all of the information required by a Bank in a policy that may be distributed to members. Commenters also stated that policies governing member credit products should be separate and distinct from policies governing acquired member assets, that the regulation should accommodate policy differences among Banks from one year to the next, and that some of the member products policy requirements may already be covered in the regulatory requirements for the Banks’ risk management policies.

The final rule retains all of the member products policy requirements contained in the proposed rule because it is important that the Banks’ boards consider and address all of these issues as they pertain to advances and other member products. By requiring that each Bank adopt its own member products policy, the Finance Board recognizes that such policies will differ among the Banks, as is currently the case with the Banks’ advances policies. The Finance Board also recognizes that some provisions contained in the member products policies will apply only to certain products, and that a Bank may address different products separately in its policy as it sees fit. In addition, the member products policy requirement does not preclude a Bank from creating separate materials for distribution to members.

## 3. Bank Primary Credit Mission—Removal of § 950.2

In the Finance Board’s recently adopted final rule on parts 900, 917 and 940, the Finance Board revised part 940 to add a new definition of the mission of the Banks. *See* 65 FR 25267 (May 1, 2000). Accordingly, as proposed, the final rule removes existing § 950.2 of the Advances Regulation, which states the primary credit mission of the Banks and how the Banks must fulfill such mission, as no longer necessary.

## 4. Community Support Requirements and Community Investment Cash Advance programs—Parts 944 and 952

As discussed previously, the final rule amends part 944 and § 952.3 by redesignating the term “community lending” as “targeted community lending,” with no substantive change to the corresponding definition. This revision is intended to differentiate

CICA community lending, which is targeted, from the broader term “community lending” that the final rule adds to § 900.1. The broader definition of “community lending” in § 900.1 would include, for CFIs, purchasing or funding small business loans, small farm loans and small agri-business loans, as defined in § 950.1 of this chapter.

## 5. Standby Letters of Credit—Part 961

As proposed, the final rule amends part 961 to update cross-references to reflect the reorganization of Finance Board regulations, change references from nonmember mortgagees to housing associates, and make other technical and conforming changes. The proposed rule amended § 961.2(c)(2)(i) to allow standby letters of credit issued for a purpose described in § 961.2(a)(1) or (2) to be secured by CFI-eligible collateral, regardless of whether the applicant is a CFI. The final rule removes this provision because the loan-to-one-borrower approach to the definition of “small business loans,” “small farm loans” and “small agribusiness loans” adopted in the final rule does not apply to members that do not qualify as CFIs. The final rule retains the current provision in § 961.2(c)(2)(ii) authorizing investment-grade obligations of state or local government units or agencies as additional collateral eligible to secure standby letters of credit issued for a purpose described in § 961.2(a)(1) or (2).

## III. Paperwork Reduction Act

The final rule does not contain any collections of information pursuant to the Paperwork Reduction Act of 1995. *See* 33 U.S.C. 3501 *et seq.* Therefore, the Finance Board has not submitted any information to the Office of Management and Budget for review.

## IV. Regulatory Flexibility Act

The final rule applies only to the Banks, which do not come within the meaning of “small entities,” as defined in the Regulatory Flexibility Act (RFA). *See* 5 U.S.C. 601(6). Therefore, in accordance with section 605(b) of the RFA, *see id.* § 605(b), the Finance Board hereby certifies that this final rule will not have a significant economic impact on a substantial number of small entities.

## List of Subjects in 12 CFR Parts 900, 917, 926, 944, 950, 952, 961 and 980

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

Accordingly, the Finance Board hereby amends title 12, chapter IX, parts

900, 917, 926, 944, 950, 952, 961 and 980, Code of Federal Regulations, as follows:

#### PART 900—GENERAL DEFINITIONS

1. The authority citation for part 900 is revised to read as follows:

**Authority:** 12 U.S.C. 1422, 1422b(a)(1).

2. Amend § 900.1 by:

a. Adding, in alphabetical order, definitions of “appropriate regulator”, “community financial institution”, “community financial institution asset cap”, “community lending” and “regulatory financial report”; and

b. Removing the term “Associate” and, in its place, adding the term “Housing associate”, to read as follows:

##### § 900.1 Definitions applying to all regulations.

\* \* \* \* \*

*Appropriate regulator* means a regulatory entity listed in § 925.8 of this chapter, as applicable.

\* \* \* \* \*

*Community financial institution or CFI* means an institution—

(1) The deposits of which are insured under the Federal Deposit Insurance Act; and

(2) That has, as of the date of the transaction at issue, less than the community financial institution asset cap in total assets, based on an average of total assets over three years, which shall be calculated by the Bank as follows:

(i) For purposes of determining eligibility for membership under part 925 of this chapter, based on the average of total assets drawn from the institution's regulatory financial reports filed with its appropriate regulator for the most recent calendar quarter and the immediately preceding 11 calendar quarters; and

(ii) For purposes of making advances under part 950 of this chapter:

(A) The calculation shall be based on the average of total assets drawn from the institution's regulatory financial reports filed with its appropriate regulator for the three most recent calendar year-ends; and

(B) The calculation shall be made annually and shall be effective April 1 of each year.

*Community financial institution asset cap* means, for 2000, \$500 million. Beginning in 2001 and for subsequent years, the cap shall be adjusted annually by the Finance Board to reflect any percentage increase in the preceding year's Consumer Price Index (CPI) for all urban consumers, as published by the U.S. Department of Labor. Each year, as soon as practicable after the publication

of the previous year's CPI, the Finance Board shall publish notice by **Federal Register** of the CPI-adjusted cap.

*Community lending* means providing financing for economic development projects for targeted beneficiaries, and, for community financial institutions, purchasing or funding small business loans, small farm loans or small agribusiness loans, as defined in § 950.1 of this chapter.

\* \* \* \* \*

*Regulatory financial report* means a financial report that an institution is required to file with its appropriate regulator on a specific periodic basis, including the quarterly call report for commercial banks, thrift financial report for savings associations, quarterly or semi-annual call report for credit unions, the National Association of Insurance Commissioners' annual or quarterly report for insurance companies, or other similar report, including such report maintained by the primary regulator on the computer online database.

#### PART 917—POWERS AND RESPONSIBILITIES OF BANK BOARDS OF DIRECTORS AND SENIOR MANAGEMENT

3. The authority citation for part 917 continues to read as follows:

**Authority:** 12 U.S.C. 1422a(a)(3), 1422b(a)(1), 1427, 1432(a), 1436(a), 1440.

4. Add § 917.4 to read as follows:

##### § 917.4 Bank Member Products Policy.

(a) *Adoption and review of member products policy.* (1) *Adoption.* Beginning November 15, 2000, each Bank's board of directors shall have in effect at all times a policy that addresses the Bank's management of products offered by the Bank to members and housing associates, including but not limited to advances, letters of credit and acquired member assets, consistent with the requirements of the Act, paragraph (b) of this section, and all applicable Finance Board regulations and policies.

(2) *Review and compliance.* Each Bank's board of directors shall:

(i) Review the Bank's member products policy annually;

(ii) Amend the member products policy as appropriate; and

(iii) Re-adopt the member products policy, including interim amendments, not less often than every three years.

(b) *Member products policy requirements.* In addition to meeting any other requirements set forth in this chapter, each Bank's member products policy shall:

(1) Address credit underwriting criteria to be applied in evaluating

applications for advances, standby letters of credit, and renewals;

(2) Address appropriate levels of collateralization, valuation of collateral and discounts applied to collateral values for advances and standby letters of credit;

(3) Address advances-related fees to be charged by each Bank, including any schedules or formulas pertaining to such fees;

(4) Address standards and criteria for pricing member products, including differential pricing of advances pursuant to § 950.5(b)(2) of this chapter, and criteria regarding the pricing of standby letters of credit, including any special pricing provisions for standby letters of credit that facilitate the financing of projects that are eligible for any of the Banks' CICA programs under part 952 of this chapter;

(5) Provide that, for any draw made by a beneficiary under a standby letter of credit, the member will be charged a processing fee calculated in accordance with the requirements of § 975.6(b) of this chapter;

(6) Address the maintenance of appropriate systems, procedures and internal controls; and

(7) Address the maintenance of appropriate operational and personnel capacity.

5. Revise the heading of subchapter D to read as follows:

#### SUBCHAPTER D—FEDERAL HOME LOAN BANK MEMBERS AND HOUSING ASSOCIATES

6. In subchapter D, add a new part 926 to read as follows:

#### PART 926—FEDERAL HOME LOAN BANK HOUSING ASSOCIATES

Sec.

926.1 Definitions.

926.2 Bank authority to make advances to housing associates.

926.3 Housing associate eligibility requirements.

926.4 Satisfaction of eligibility requirements.

926.5 Housing associate application process.

926.6 Appeals.

**Authority:** 12 U.S.C. 1422b(a), 1430b.

##### § 926.1 Definitions.

As used in this part:

*Advance* has the meaning set forth in § 950.1 of this chapter.

*Governmental agency* means the governor, legislature, and any other component of a federal, state, local, tribal, or Alaskan native village government with authority to act for or on behalf of that government.

*HUD* means the Department of Housing and Urban Development.

*State housing finance agency or SHFA* means:

(1) A public agency, authority, or publicly sponsored corporation that serves as an instrumentality of any state or political subdivision of any state, and functions as a source of residential mortgage loan financing in that state; or

(2) A legally established agency, authority, corporation, or organization that serves as an instrumentality of any Indian tribe, band, group, nation, community, or Alaskan Native village recognized by the United States or any state, and functions as a source of residential mortgage loan financing for the Indian or Alaskan Native community.

#### **§ 926.2 Bank authority to make advances to housing associates.**

Subject to the provisions of the Act and part 950 of this chapter, a Bank may make advances to an entity that is not a member of the Bank if the Bank has certified the entity as a housing associate under the provisions of this part.

#### **§ 926.3 Housing associate eligibility requirements.**

(a) *General.* A Bank may certify as a housing associate any applicant that meets the following requirements, as determined using the criteria set forth in § 926.4:

(1) The applicant is approved under title II of the National Housing Act (12 U.S.C. 1707, *et seq.*);

(2) The applicant is a chartered institution having succession;

(3) The applicant is subject to the inspection and supervision of some governmental agency;

(4) The principal activity of the applicant in the mortgage field consists of lending its own funds; and

(5) The financial condition of the applicant is such that advances may be safely made to it.

(b) *State housing finance agencies.* In addition to meeting the requirements in paragraph (a) of this section, any applicant seeking access to advances as a SHFA pursuant to § 950.17(b)(2) of this chapter shall provide evidence satisfactory to the Bank, such as a copy of, or a citation to, the statutes and/or regulations describing the applicant's structure and responsibilities, that the applicant is a state housing finance agency as defined in § 926.1.

#### **§ 926.4 Satisfaction of eligibility requirements.**

(a) *HUD approval requirement.* An applicant shall be deemed to meet the requirement in section 10b(a) of the Act and § 926.3(a)(1) that it be approved under title II of the National Housing

Act if it submits a current HUD Yearly Verification Report or other documentation issued by HUD stating that the Federal Housing Administration of HUD has approved the applicant as a mortgagee.

(b) *Charter requirement.* An applicant shall be deemed to meet the requirement in section 10b(a) of the Act and § 926.3(a)(2) that it be a chartered institution having succession if it provides evidence satisfactory to the Bank, such as a copy of, or a citation to, the statutes and/or regulations under which the applicant was created, that:

(1) The applicant is a government agency; or

(2) The applicant is chartered under state, federal, local, tribal, or Alaskan Native village law as a corporation or other entity that has rights, characteristics, and powers under applicable law similar to those granted a corporation.

(c) *Inspection and supervision requirement.* (1) An applicant shall be deemed to meet the inspection and supervision requirement in section 10b(a) of the Act and § 926.3(a)(3) if it provides evidence satisfactory to the Bank, such as a copy of, or a citation to, relevant statutes and/or regulations, that, pursuant to statute or regulation, the applicant is subject to the inspection and supervision of a federal, state, local, tribal, or Alaskan native village governmental agency.

(2) An applicant shall be deemed to meet the inspection requirement if there is a statutory or regulatory requirement that the applicant be audited or examined periodically by a governmental agency or by an external auditor.

(3) An applicant shall be deemed to meet the supervision requirement if the governmental agency has statutory or regulatory authority to remove an applicant's officers or directors for cause or otherwise exercise enforcement or administrative control over actions of the applicant.

(d) *Mortgage activity requirement.* An applicant shall be deemed to meet the mortgage activity requirement in section 10b(a) of the Act and § 926.3(a)(4) if it provides documentary evidence satisfactory to the Bank, such as a financial statement or other financial documents that include the applicant's mortgage loan assets and their funding liabilities, that it lends its own funds as its principal activity in the mortgage field. For purposes of this paragraph, lending funds includes, but is not limited to, the purchase of whole mortgage loans. In the case of a federal, state, local, tribal, or Alaskan Native village government agency,

appropriated funds shall be considered an applicant's own funds. An applicant shall be deemed to satisfy this requirement notwithstanding that the majority of its operations are unrelated to mortgage lending if its mortgage activity conforms to this requirement. An applicant that acts principally as a broker for others making mortgage loans, or whose principal activity is to make mortgage loans for the account of others, does not meet this requirement.

(e) *Financial condition requirement.* An applicant shall be deemed to meet the financial condition requirement in § 926.3(a)(5) if the Bank determines that advances may be safely made to the applicant. The applicant shall submit to the Bank copies of its most recent regulatory audit or examination report, or external audit report, and any other documentary evidence, such as financial or other information, that the Bank may require to make the determination.

(The Office of Management and Budget has approved the information collection contained in this section and assigned control number 3069-0005 with an expiration date of November 30, 2002.)

#### **§ 926.5 Housing associate application process.**

(a) *Authority.* The Banks are authorized to approve or deny all applications for certification as a housing associate, subject to the requirements of the Act and this part. A Bank may delegate the authority to approve applications for certification as a housing associate only to a committee of the Bank's board of directors, the Bank president, or a senior officer who reports directly to the Bank president other than an officer with responsibility for business development.

(b) *Application requirements.* An applicant for certification as a housing associate shall submit an application that satisfies the requirements of the Act and this part to the Bank of the district in which the applicant's principal place of business, as determined in accordance with part 925 of this chapter, is located.

(c) *Bank decision process.* (1) *Action on applications.* A Bank shall approve or deny an application for certification as a housing associate within 60 calendar days of the date the Bank deems the application to be complete. A Bank shall deem an application complete, and so notify the applicant in writing, when it has obtained all of the information required by this part and any other information it deems necessary to process the application. If a Bank determines during the review process that additional information is

necessary to process the application, the Bank may deem the application incomplete and stop the 60-day time period by providing written notice to the applicant. When the Bank receives the additional information, it shall again deem the application complete, so notify the applicant in writing, and resume the 60-day time period where it stopped.

(2) *Decision on applications.* The Bank or a duly delegated committee of the Bank's board of directors, the Bank president, or a senior officer who reports directly to the Bank president other than an officer with responsibility for business development shall approve, or the board of directors of a Bank shall deny, each application for certification as a housing associate by a written decision resolution stating the grounds for the decision. Within three business days of a Bank's decision on an application, the Bank shall provide the applicant and the Finance Board with a copy of the Bank's decision resolution.

(3) *File.* The Bank shall maintain a certification file for each applicant for at least three years after the date the Bank decides whether to approve or deny certification or the date the Finance Board resolves any appeal, whichever is later. At a minimum, the certification file shall include all documents submitted by the applicant or otherwise obtained or generated by the Bank concerning the applicant, all documents the Bank relied upon in making its determination regarding certification, including copies of statutes and regulations, and the decision resolution.

(The Office of Management and Budget has approved the information collection contained in this section and assigned control number 3069-0005 with an expiration date of November 30, 2002.)

#### **§ 926.6 Appeals.**

(a) *General.* Within 90 calendar days of the date of a Bank's decision to deny an application for certification as a housing associate, the applicant may submit a written appeal to the Finance Board that includes the Bank's decision resolution and a statement of the basis for the appeal with sufficient facts, information, analysis, and explanation to support the applicant's position. Appeals shall be sent to the Federal Housing Finance Board, 1777 F Street, NW, Washington, DC 20006, with a copy to the Bank.

(b) *Record for appeal.* Upon receiving a copy of an appeal, the Bank whose action has been appealed shall provide to the Finance Board a complete copy of the applicant's certification file maintained by the Bank under § 926.5(c)(3). Until the Finance Board

resolves the appeal, the Bank shall promptly provide to the Finance Board any relevant new materials it receives. The Finance Board may request additional information or further supporting arguments from the applicant, the Bank, or any other party that the Finance Board deems appropriate.

(c) *Deciding appeals.* Within 90 calendar days of the date an applicant files an appeal with the Finance Board, the Finance Board shall consider the record for appeal described in paragraph (b) of this section and resolve the appeal based on the requirements of the Act and this part.

(The Office of Management and Budget has approved the information collection contained in this section and assigned control number 3069-0005 with an expiration date of November 30, 2002.)

#### **PART 944—COMMUNITY SUPPORT REQUIREMENTS**

7. The authority citation for part 944 continues to read as follows:

**Authority:** 12 U.S.C. 1422a(a)(3)(B), 1422b(a)(1), 1429, and 1430.

8. Amend part 944 by removing the term "community lending" wherever it appears, and, in its place, adding the term "targeted community lending".

##### **§ 944.6 [Amended]**

9. Amend § 944.6(b)(2) by removing the term "nonmember borrowers" and, in its place, adding the term "housing associates".

#### **PART 950—ADVANCES**

10. The authority citation for part 950 continues to read as follows:

**Authority:** 12 U.S.C. 1422a(a)(3), 1422b(a)(1), 1426, 1429, 1430, 1430b and 1431.

11. The table of contents for part 950 is revised to read as follows:

##### **Subpart A—Advances to Members**

Sec.

- 950.1 Definitions.
- 950.2 Authorization and application for advances; obligation to repay advances.
- 950.3 Purpose of long-term advances; Proxy text.
- 950.4 Limitations on access to advances.
- 950.5 Terms and conditions for advances.
- 950.6 Fees.
- 950.7 Collateral.
- 950.8 Banks as secured creditors.
- 950.9 Pledged collateral; verification.
- 950.10 Collateral valuation; appraisals.
- 950.11 Capital stock requirements; unilateral redemption of excess stock.
- 950.12 Intradistrict transfer of advances.
- 950.13 Special advances to savings associations.

950.14 Advances to the Savings Association Insurance Fund.

950.15 Liquidation of advances upon termination of membership.

##### **Subpart B—Advances to Housing Associates**

950.16 Scope.

950.17 Advances to housing associates.

12. Amend § 950.1 by:

- a. Adding, in alphabetical order, a definition of "affiliate";
- b. Adding, in alphabetical order, a definition of "cash equivalents";
- c. Removing the definitions of "Actual thrift investment percentage" or "ATIP", "combination business or farm property", "Non-Qualified Thrift Lender member", "Qualified Thrift Lender" or "QTL", and "Qualified Thrift Lender test" or "QTL test";
- d. Amending the definition of "Community Investment Cash Advance" or "CICA" by removing the term "community lending", and, in its place, adding the term "targeted community lending";
- e. Revising paragraph (4) of the definition of "residential housing finance assets";
- f. Amending the definition of "residential real property" by removing paragraph (1)(v); and
- g. Adding, in alphabetical order, definitions of "small agri-business loans", "small business loans", and "small farm loans", to read as follows:

##### **§ 950.1 Definitions.**

\* \* \* \* \*

*Affiliate* means any business entity that controls, is controlled by, or is under common control with, a member.

\* \* \* \* \*

*Cash equivalents* means investments that—

- (1) Are readily convertible into known amounts of cash;
- (2) Have a remaining maturity of 90 days or less at the acquisition date; and
- (3) Are held for liquidity purposes.

\* \* \* \* \*

*Residential housing finance assets* means any of the following:

\* \* \* \* \*

- (4) Loans or investments qualifying under the definition of "community lending" in § 900.1 of this chapter;

\* \* \* \* \*

*Small agri-business loans* means loans to finance agricultural production and other loans to farmers that are within the legal lending limit of the reporting CFI member, and that are reported on either: Schedule RC-C, Part I, item 3 of the Report of Condition and Income filed by insured commercial banks and FDIC-supervised savings banks; or



Schedule SC300, SC303 or SC306 of the Thrift Financial Report filed by savings associations (or equivalent successor schedules).

*Small business loans* means commercial and industrial loans that are within the legal lending limit of the reporting CFI member and that are reported on either: Schedule RC-C, Part I, item 1.e or Schedule RC-C, Part I, item 4 of the Report of Condition and Income filed by insured commercial banks and FDIC-supervised savings banks; or Schedule SC300, SC303 or SC306 of the Thrift Financial Report filed by savings associations (or equivalent successor schedules)

*Small farm loans* means loans secured primarily by farmland that are within the legal lending limit of the reporting CFI member, and that are reported on either: Schedule RC-C, Part I, item 1.a. or 1.b. of the Report of Condition and Income filed by insured commercial banks and FDIC-supervised savings banks; or Schedule SC260 of the Thrift Financial Report filed by savings associations (or equivalent successor schedules).

\* \* \* \* \*

#### **§ 950.2 [Removed]**

13. Remove § 950.2.

#### **§ 950.3 [Removed]**

14. Remove § 950.3.

#### **§ 950.4 [Redesignated as § 950.2]**

15. Section 950.4 is redesignated as § 950.2.

#### **§ 950.14 [Redesignated as § 950.3]**

16. Section 950.14 is redesignated as § 950.3, and the heading and paragraphs (a) and (b)(1) are revised to read as follows:

\* \* \* \* \*

#### **§ 950.3 Purpose of long-term advances; Proxy test.**

(a) A Bank shall make long-term advances only for the purpose of enabling any member to purchase or fund new or existing residential housing finance assets, which include, for CFI members, small business loans, small farm loans and small agri-business loans.

(b)(1) Prior to approving an application for a long-term advance, a Bank shall determine that the principal amount of all long-term advances currently held by the member does not exceed the total book value of residential housing finance assets held by such member. The Bank shall determine the total book value of such residential housing finance assets, using the most recent Thrift Financial Report,

Report of Condition and Income, financial statement or other reliable documentation made available by the member.

\* \* \* \* \*

#### **§ 950.5 [Redesignated as § 950.4]**

17. Section 950.5 is redesignated as § 950.4.

#### **§ 950.6 [Redesignated as § 950.5]**

18. Section 950.6 is redesignated as § 950.5, and paragraphs (b)(1), (b)(2)(ii), (b)(3), (d)(1) and (d)(2) are revised to read as follows:

#### **§ 950.5 Terms and conditions for advances.**

\* \* \* \* \*

(b) *Advance pricing.* (1) *General.* A Bank shall not price its advances to members below:

(i) The marginal cost to the Bank of raising matching term and maturity funds in the marketplace, including embedded options; and

(ii) The administrative and operating costs associated with making such advances to members.

(2) \* \* \*

(ii) Each Bank shall include in its member products policy required by § 917.4 of this chapter, standards and criteria for such differential pricing and shall apply such standards and criteria consistently and without discrimination to all members applying for advances.

(3) *Exceptions.* The advance pricing policies contained in paragraph (b)(1) of this section shall not apply in the case of:

(i) A Bank's CICA programs; and

(ii) Any other advances programs that are volume limited and specifically approved by the Bank's board of directors.

\* \* \* \* \*

(d) *Putable or convertible advances.*

(1) *Disclosure.* A Bank that offers a putable or convertible advance to a member shall disclose in writing to such member the type and nature of the risks associated with putable or convertible advance funding. The disclosure should include detail sufficient to describe such risks.

(2) *Replacement funding for putable advances.* If a Bank terminates a putable advance prior to the stated maturity date of such advance, the Bank shall offer to provide replacement funding to the member, provided the member is able to satisfy the normal credit and collateral requirements of the Bank for the replacement funding requested.

\* \* \* \* \*

#### **§ 950.8 [Redesignated as § 950.6]**

19. Section 950.8 is redesignated as § 950.6, and paragraphs (a) and (b)(1) are revised to read as follows:

#### **§ 950.6 Fees.**

(a) *Fees in member products policy.* All fees charged by each Bank and any schedules or formulas pertaining to such fees shall be included in the Bank's member products policy required by § 917.4 of this chapter. Any such fee schedules or formulas shall be applied consistently and without discrimination to all members.

(b) *Prepayment fees.* (1) Except where an advance product contains a prepayment option, each Bank shall establish and charge a prepayment fee pursuant to a specified formula which makes the Bank financially indifferent to the borrower's decision to repay the advance prior to its maturity date.

\* \* \* \* \*

20. Amend § 950.9 by:

#### **§ 950.9 [Redesignated as § 950.7]**

a. Redesignating § 950.9 as § 950.7;

b. Revising paragraphs (a) introductory text, (a)(3), (a)(4), and (a)(5);

c. Redesignating paragraphs (b), (c), (d) and (e) as paragraphs (c), (d), (e) and (f) respectively;

d. Revising newly designated paragraphs (c) and (d); and

e. Adding paragraphs (b) and (g), to read as follows:

#### **§ 950.7 Collateral.**

(a) *Eligible security for advances to all members.* At the time of origination or renewal of an advance, each Bank shall obtain from the borrowing member or, in accordance with paragraph (g) of this section, an affiliate of the borrowing member, and thereafter maintain, a security interest in collateral that meets the requirements of one or more of the following categories:

\* \* \* \* \*

(3) *Cash or deposits.* Cash or deposits in a Bank.

(4) *Other real estate-related collateral.* (i) Other real estate-related collateral provided that:

(A) Such collateral has a readily ascertainable value, can be reliably discounted to account for liquidation and other risks, and can be liquidated in due course; and

(B) The Bank can perfect a security interest in such collateral.

(ii) Eligible other real estate-related collateral may include, but is not limited to:

(A) Privately issued mortgage-backed securities not otherwise eligible under paragraph (a)(1)(ii) of this section;

(B) Second mortgage loans, including home equity loans;  
(C) Commercial real estate loans; and  
(D) Mortgage loan participations.

(5) *Securities representing equity interests in eligible advances collateral.* Any security the ownership of which represents an undivided equity interest in underlying assets, all of which qualify either as:

(i) Eligible collateral under paragraphs (a)(1), (2), (3) or (4) of this section; or  
(ii) Cash equivalents.

(b) *Additional collateral eligible as security for advances to CFI members or their affiliates.* (1) *General.* Subject to the requirements set forth in part 980 of this chapter, a Bank is authorized to accept from CFI members or their affiliates as security for advances small business loans, small farm loans or small agri-business loans fully secured by collateral other than real estate, or securities representing a whole interest in such loans, provided that:

(i) Such collateral has a readily ascertainable value, can be reliably discounted to account for liquidation and other risks, and can be liquidated in due course; and

(ii) The Bank can perfect a security interest in such collateral.

(2) *Change in CFI status.* If a Bank determines, as of April 1 of each year, that a member that has previously qualified as a CFI no longer qualifies as a CFI, and the member has total advances outstanding that exceed the amount that can be fully secured by collateral under paragraph (a) of this section, the Bank may:

(i) Permit the advances of such member to run to their stated maturities; and

(ii) Renew such member's advances to mature no later than March 31 of the following year; provided that the total of the member's advances under paragraphs (b)(2)(i) and (ii) of this section shall be fully secured by collateral set forth in paragraphs (a) and (b) of this section.

(c) *Bank restrictions on eligible advances collateral.* A Bank at its discretion may further restrict the types of eligible collateral acceptable to the Bank as security for an advance, based upon the creditworthiness or operations of the borrower, the quality of the collateral, or other reasonable criteria.

(d) *Additional advances collateral.* The provisions of paragraph (a) of this section shall not affect the ability of any Bank to take such steps as it deems necessary to protect its secured position on outstanding advances, including requiring additional collateral, whether or not such additional collateral conforms to the requirements for

eligible collateral in paragraphs (a) or (b) of this section or section 10 of the Act (12 U.S.C. 1430).

\* \* \* \* \*

(g) *Pledge of advances collateral by affiliates.* Assets held by an affiliate of a member that are eligible as collateral under paragraphs (a) or (b) of this section may be used to secure advances to that member only if:

(1) The collateral is pledged to secure either:

(i) The member's obligation to repay advances; or

(ii) A surety or other agreement under which the affiliate has assumed, along with the member, a primary obligation to repay advances made to the member; and

(2) The Bank obtains and maintains a legally enforceable security interest pursuant to which the Bank's legal rights and privileges with respect to the collateral are functionally equivalent in all material respects to those that the Bank would possess if the member were to pledge the same collateral directly, and such functional equivalence is supported by adequate documentation.

#### **§ 950.10 [Redesignated as § 950.8]**

21. Section 950.10 is redesignated as § 950.8.

#### **§ 950.11 [Redesignated as § 950.9]**

22. Section 950.11 is redesignated as § 950.9.

#### **§ 950.12 [Redesignated as § 950.10]**

23. Section 950.12 is redesignated as § 950.10, and is revised to read as follows:

#### **§ 950.10 Collateral valuation; appraisals.**

(a) *Collateral valuation.* Each Bank shall determine the value of collateral securing the Bank's advances in accordance with the collateral valuation procedures set forth in the Bank's member products policy established pursuant to § 917.4 of this chapter.

(b) *Fair application of procedures.* Each Bank shall apply the collateral valuation procedures consistently and fairly to all borrowing members, and the valuation ascribed to any item of collateral by the Bank shall be conclusive as between the Bank and the member.

(c) *Appraisals.* A Bank may require a member to obtain an appraisal of any item of collateral, and to perform such other investigations of collateral as the Bank deems necessary and proper.

#### **§ 950.15 [Redesignated as § 950.11]**

24. Section 950.15 is redesignated as § 950.11.

#### **§ 950.17 [Redesignated as § 950.12]**

25. Section 950.17 is redesignated as § 950.12.

#### **§ 950.18 [Redesignated as § 950.13]**

26. Section 950.18 is redesignated as § 950.13.

#### **§ 950.20 [Redesignated as § 950.14]**

27. Section 950.20 is redesignated as § 950.14 and transferred to subpart A.

#### **§ 950.19 [Redesignated as § 950.15]**

28. Section 950.19 is redesignated as § 950.15.

29. The heading of Subpart B is revised to read as follows:

### **Subpart B—Advances to Housing Associates**

#### **§ 150.21 [Redesignated as § 950.16]**

30. Section 950.21 is redesignated as § 950.16, and is revised to read as follows:

#### **§ 950.16 Scope.**

Except as otherwise provided in § 950.14 and 950.17, the requirements of subpart A apply to this subpart.

#### **§ 950.22 [Removed]**

#### **§ 950.23 [Removed]**

31. Sections 950.22 and 950.23 are removed.

#### **§ 950.24 [Redesignated as § 950.17]**

32. Section 950.24 is redesignated as § 950.17, and is amended by:

a. Revising the section heading;  
b. Removing the words "nonmember mortgagee" and "nonmember mortgagees", wherever they appear, and, in their place, adding the words "housing associate" and "housing associates", respectively; and

c. In paragraph (b)(2)(i) introductory text, removing the term "\$ 950.22(d)", and, in its place, adding the term "\$ 926.3(b)";

d. In paragraph (b)(2)(i)(B), removing the terms "\$ 950.9(a)(3)" and "\$ 950.22(d)", and in their place, adding the terms "\$ 950.7(a)(3)" and "\$ 926.3(b)", respectively; and

e. Revising paragraph (b)(2)(i)(C), to read as follows:

#### **§ 950.17 Advances to housing associates.**

\* \* \* \* \*

(b) \* \* \*

(2) \* \* \*

(i) \* \* \*

(C) The other real estate-related collateral described in § 950.7(a)(4), provided that such collateral is comprised of mortgage loans on one-to-

four family or multifamily residential property.

\* \* \* \* \*

## PART 952—COMMUNITY INVESTMENT CASH ADVANCE PROGRAMS

33. The authority citation for part 952 continues to read as follows:

**Authority:** 12 U.S.C. 1422b(a)(1) and 1430.

### § 952.3 [Amended]

34. Amend § 952.3 by removing the definition of “nonmember borrower”.

35. Amend part 952 by:

- a. Removing the term “community lending”, wherever it appears, and, in its place, adding the term “targeted community lending”; and
- b. Removing the terms “nonmember borrower” and “nonmember borrowers”, wherever they appear, and, in their place, adding the terms “housing associate borrower” and “housing associate borrowers”, respectively.

## PART 961—STANDBY LETTERS OF CREDIT

36. The authority citation for part 961 continues to read as follows:

**Authority:** 12 U.S.C. 1422b, 1429, 1430, 1430b, 1431.

37. Amend § 961.1 by:

- a. Removing the definition of “community lending”;
- b. Removing the definition of “nonmember mortgagee”;
- c. Removing the definition of “nonmember SHFA”;
- d. Adding the definition of “SHFA associate”; and
- e. Removing the definition of “small business”, to read as follows:

### § 961.1 Definitions.

\* \* \* \* \*

*SHFA associate* means a housing associate that is a “state housing finance agency,” as that term is defined in § 926.1 of this chapter, and that has met the requirements of § 926.3(b) of this chapter.

\* \* \* \* \*

38. Amend part 961 by:

- a. Removing the terms “nonmember mortgagee” and “nonmember mortgages”, wherever they appear, and, in their place, adding the terms “housing associate” and “housing associates”, respectively; and
- b. Removing the terms “nonmember SHFA” and “nonmember SHFAs”, wherever they appear, and, in their place, adding the terms “SHFA associate” and “SHFA associates”, respectively.

39. Amend § 961.2 by revising paragraphs (a)(2), (c)(1), and (c)(2), to read as follows:

### § 961.2 Standby letters of credit on behalf of members.

(a) \* \* \*

(2) To assist members in facilitating community lending;

\* \* \* \* \*

(c) *Eligible collateral.* (1) Any standby letter of credit issued or confirmed on behalf of a member may be secured in accordance with the requirements for advances under § 950.7 of this chapter.

(2) A standby letter of credit issued or confirmed on behalf of a member for a purpose described in paragraphs (a)(1) or (a)(2) of this section may, in addition to the collateral described in paragraph (c)(1) of this section, be secured by obligations of state or local government units or agencies rated as investment grade by an NRSRO.

40. Amend § 961.3 by:

- a. In the introductory text of paragraph (a), removing the term “§ 950.24(b)(1)(i) or (ii)” and, in its place, adding the term “§ 950.17(b)(1)(i) or (ii)”;
- b. Revising paragraph (a)(2); and
- c. In paragraph (b), removing the term “950.24(b)(2)(i)(A), (B) or (C)” and, in its place, adding the term “950.17(b)(2)(i)(A), (B) or (C)”, to read as follows:

### § 961.3 Standby letters of credit on behalf of housing associates.

(a) \* \* \*

(2) To assist housing associates in facilitating community lending;

\* \* \* \* \*

### § 961.4 [Amended]

41. Amend § 961.4 by removing the term “§§ 950.24(b)(2)(i)(B), 950.24(d), or 965.2(a)(2)” in paragraph (a)(1) and, in its place, adding the term “§ 950.17(b)(2)(i)(B), 950.17(d), or 969.2”.

42. Amend § 961.5 by:

- a. Revising paragraph (a); and
- b. In paragraph (b)(2), removing the reference to “§ 950.9(b), 950.9(d), 950.9(e), 950.10, 950.11 and 950.12”, and, in its place, adding a reference to “§ 950.7(d), 950.7(e), 950.8, 950.9 and 950.10”, to read as follows:

### § 961.5 Additional provisions applying to all standby letters of credit.

(a) *Requirements.* Each standby letter of credit issued or confirmed by a Bank shall:

- (1) Contain a specific expiration date, or be for a specific term; and
- (2) Require approval in advance by the Bank of any transfer of the standby

letter of credit from the original beneficiary to another person or entity.

\* \* \* \* \*

43. In subchapter J, add a new part 980 to read as follows:

## PART 980—NEW BUSINESS ACTIVITIES

Sec.

980.1 Definitions.

980.2 Limitation on Bank authority to undertake new business activities.

980.3 New business activity notice requirement.

980.4 Commencement of new business activities.

980.5 Notice by the Finance Board.

980.6 Finance Board consent.

980.7 Examinations; requests for additional information.

**Authority:** 12 U.S.C. 1422a(a)(3), 1422b(a), 1431(a), 1432(a).

### § 980.1 Definitions.

As used in this part:

*New business activity* means any business activity undertaken, transacted, conducted, or engaged in by a Bank that has not been previously undertaken, transacted, conducted, or engaged in by that Bank, or was previously undertaken, transacted, conducted, or engaged in under materially different terms and conditions, such that it:

(1) Involves the acceptance of collateral enumerated under § 950.7(a)(4) of this chapter;

(2) Involves the acceptance of classes of collateral enumerated under § 950.7(b) of this chapter for the first time;

(3) Entails risks not previously and regularly managed by that Bank, its members, or both, as appropriate; or

(4) Involves operations not previously undertaken by that Bank.

### § 980.2 Limitation on Bank authority to undertake new business activities.

No Bank shall undertake any new business activity except in accordance with the procedures set forth in this part.

### § 980.3 New business activity notice requirement.

At least sixty days prior to undertaking a new business activity, except as provided in § 980.4(b), a Bank shall submit to the Finance Board a written notice containing the following information:

(a) *General requirements.* Except as provided in paragraph (b) of this section, a Bank's notice of new business activity shall include:

(1) An opinion of counsel citing the statutory, regulatory, or other legal authority for the new business activity;

(2) A good faith estimate of the anticipated dollar volume of the activity over the short-and long-term;

(3) A full description of:

(i) The purpose and operation of the proposed activity;

(ii) The market targeted by the activity;

(iii) The delivery system for the activity;

(iv) The effect of the activity on the housing, or relevant community lending, market; and

(4) A demonstration of the Bank's capacity, through staff, or contractors employed by the Bank, sufficiency of experience and expertise, to safely administer and manage the risks associated with the new activity; and

(5) An assessment of the risks associated with the activity, including the Bank's ability to manage these risks and the Bank's ability to manage the risks associated with increasing volumes of the new activity; and

(6) The criteria that the Bank will use to determine the eligibility of its members or housing associates to participate in the new activity.

(b) *New collateral activities.* If a proposed new business activity relates to the acceptance of collateral under § 950.7 of this chapter, a Bank's notice of new business activity shall include:

(1) A description of the classes or amounts of collateral proposed to be accepted by the Bank;

(2) A copy of the Bank's member products policy, adopted pursuant to § 917.4 of this chapter;

(3) A copy of the Bank's procedures for determining the value of the collateral in question, established pursuant to § 950.10 of this chapter; and

(4) A demonstration of the Bank's capacity, personnel, technology, experience and expertise to value, discount and manage the risks associated with the collateral in question.

#### **§ 980.4 Commencement of new business activities.**

A Bank may commence a new business activity:

(a) Sixty days after receipt by the Finance Board of the notice of new business activity under § 980.3, if the Finance Board has not issued to the Bank a notice as described in § 980.5(a)(1) through (4);

(b) In the case of the acceptance of collateral enumerated under § 950.7(a)(4) of this chapter, immediately upon receipt by the Finance Board of a notice of new business activity under § 980.3; or

(c) Immediately upon issuance by the Finance Board of a letter of approval under § 980.6.

#### **§ 980.5 Notice by the Finance Board.**

(a) *Issuance.* Within sixty days after receipt of a notice of new business activity under § 980.3, the Finance Board may issue to a Bank a notice that:

(1) Disapproves the new business activity;

(2) Instructs the Bank not to commence the new business pending further consideration by the Finance Board;

(3) Declares an intent to examine the Bank;

(4) Requests additional information including but not limited to the requests listed in § 980.7;

(5) Establishes conditions for the Finance Board's approval of the new business activity, including but not limited to the conditions listed in § 980.7; or

(6) Contains other instructions or information that the Finance Board deems appropriate under the circumstances.

(b) *Effect.* Following receipt of a notice issued pursuant to paragraph (a) of this section, a Bank may not undertake any new business activity that is the subject of the notice until the Bank has received the Finance Board's consent pursuant to § 980.6.

#### **§ 980.6 Finance Board consent.**

The Finance Board may at any time provide consent for a Bank to undertake a particular new business activity and setting forth the terms and conditions that apply to the activity, with which the Bank shall comply if the Bank undertakes the activity in question.

#### **§ 980.7 Examinations; requests for additional information.**

(a) *General.* Nothing in this part shall limit in any manner the right of the Finance Board to conduct any examination of any Bank.

(b) *Requests for additional information and conditions for approval.* With respect to a new business activity, nothing in this part shall limit the right of the Finance Board at any time to:

(1) Request further information from a Bank concerning a new business activity; and

(2) Require a Bank to comply with certain conditions in order to undertake, or continue to undertake, the new business activity in question, including but not limited to:

(i) Successful completion of pre- or post-implementation safety and soundness examinations;

(ii) Demonstration by the Bank of adequate operational capacity, including the existence of appropriate policies, procedures and controls;

(iii) Demonstration by the Bank of its ability to manage the risks associated with accepting increasing volumes of particular collateral, or holding increasing volumes of particular assets, including the Bank's capacity reliably to value, discount and market the collateral or assets for liquidation;

(iv) Demonstration by the Bank that the new business activity is consistent with the housing finance and community lending mission of the Banks and the cooperative nature of the Bank System; and

(v) Finance Board review of any contracts or agreements between the Bank and its members or housing associates.

Dated: June 29, 2000.

By the Board of Directors of the Federal Housing Finance Board.

**Bruce A. Morrison,**

*Chairman.*

[FR Doc. 00-17133 Filed 7-17-00; 8:45 am]

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## **DEPARTMENT OF TRANSPORTATION**

### **Federal Aviation Administration**

#### **14 CFR Part 39**

[Docket No. 99-NM-66-AD; Amendment 39-11799; AD 2000-12-21]

RIN 2120-AA64

#### **Airworthiness Directives; Boeing Model 747-400 Series Airplanes Equipped with Pratt & Whitney PW4000 Series Engines**

**AGENCY:** Federal Aviation Administration, DOT.

**ACTION:** Final rule; correction.

**SUMMARY:** This document corrects information in an existing airworthiness directive (AD) that applies to certain Boeing Model 747-400 series airplanes. That AD currently requires installation of a modification of the thrust reverser control and indication system and wiring on each engine; and repetitive functional tests of that installation to detect discrepancies, and repair, if necessary. This document publishes Appendix 1, which was referenced in, but inadvertently omitted from, the existing AD. Appendix 1 describes procedures for a functional test to detect discrepancies of the additional locking system on each engine thrust reverser. This correction is necessary to ensure that operators have the procedures necessary to perform the required functional test.

**DATES:** Effective July 28, 2000.