


Federal Housing Finance Board
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 FEDERAL HOME LOAN BANK
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 LAW & EXTERNAL AFFAIRS DEPT.

JUN 20 1996

June 10, 1996

MEMORANDUM

Referred to _____

TO: Mitchell Berns
 Director, Office of Supervision

THROUGH: Deborah F. Silberman *DS*
 Deputy General Counsel

FROM: Brandon B. Straus *BS*
 Attorney-Advisor

SUBJECT: Interpretation Of The "Readily Ascertainable Value" Requirement For Eligible Collateral Under Section 10(a)(4) Of The Federal Home Loan Bank Act (Bank Act)

I. BACKGROUND

In a memorandum of May 17, 1996, you requested a legal analysis of whether mortgage loans insured by the Federal Housing Administration (FHA) or the Veterans Administration (VA) that are over 90 days delinquent meet the requirement of section 10(a)(4) of the Bank Act that such loans "have a readily ascertainable value" in order to qualify as collateral under that section (category (4) collateral).¹ As further discussed below, the determination whether the above-described loans have a "readily ascertainable value" is a factual issue that must be determined and documented by the FHLBank that accepts such loans as collateral.

II. ANALYSIS

Section 10(a) of the Bank Act provides that at the time of originating or renewing an advance, a FHLBank:

shall obtain and maintain a security interest in collateral eligible pursuant to one or more of the following categories:

(4) Other real estate related collateral acceptable to the Bank if such collateral has a readily ascertainable value and the Bank can perfect a security interest in the collateral. . . .

12 U.S.C. § 1430(a)(4) (emphasis added).

¹ See 12 U.S.C. § 1430(a)(4). This issue arose in connection with the 1996 examination of the Federal Home Loan Bank of Topeka (FHLBank-Topeka).

Section 935.9(a)(4) of the Federal Housing Finance Board's (Finance Board) regulation on advances, which implements section 10(a)(4) of the Bank Act, provides:

At the time of origination or renewal of an advance, each Bank shall obtain, and thereafter maintain, a security interest in collateral that meets the requirements of one or more of the following categories:

(4) OTHER COLLATERAL

(i) Except as provided in paragraph (a)(4)(iii), other real estate-related collateral if:

(A) Such collateral has a readily ascertainable value; 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.

12 C.F.R. § 935.9(a)(4) (emphasis added).

Neither the Bank Act nor the advances regulation defines or further elaborates on the meaning of the term "readily ascertainable value." The Conference Report accompanying the Financial Institutions Reform, Recovery and Enforcement Act of 1989² (FIRREA Conference Report),³ which added section 10(a)(4) to the Bank Act, describes category (4) collateral as:

a limited basket of other real estate related collateral that is sufficiently liquid to have a readily ascertainable value.

FIRREA Conference Report at 427. In the preamble to the advances regulation, the Finance Board provided the following discussion of category (4) collateral:

The Board interprets the inclusive "other real estate-related collateral" language of category (4), in conjunction with the 30 percent of capital limitation, to mean that category (4) permits limited amounts of mortgage-related collateral otherwise ineligible under category (1). For example, the following types of collateral may be considered eligible under category (4): the subordinated, derivative, or residual tranches of privately issued MBSs not otherwise eligible under category (1)(ii); second mortgage loans, including home equity loans; and mortgage loan participations. Commercial real estate loans are also eligible under category (4). This list is not intended to be all inclusive.

Section 935.9(a)(4) of the final rule interprets category (4) broadly to include any other real estate-related collateral acceptable to the Bank, if such collateral has a readily ascertainable value and the Bank can perfect a security interest in such collateral. (Citation

² Pub. L. No. 101-73, 103 Stat. 183 (Aug. 9, 1989).

³ H.R. Conf. Rep. No. 222, 101st Cong., 1st Sess. (Aug. 4, 1989).

omitted). Each Bank will determine the other types of real estate-related collateral acceptable to the Bank, consistent with the regulatory definition of eligible collateral, and will appraise its members accordingly. . . .

58 Fed. Reg. 29462 (May 20, 1993).

The legislative history of section 10(a)(4) of the Bank Act suggests that the determination of whether collateral has a "readily ascertainable value" is based on the collateral's degree of liquidity. See FIRREA Conference Report at 27. The preamble to the advances regulation suggests that this is a factual determination to be made by each Bank. See 58 Fed. Reg. 29462 (May 20, 1993) (providing that "Each Bank will determine the other types of real estate-related collateral acceptable to the Bank, consistent with the regulatory definition of eligible collateral . . ."). Furthermore, the preamble suggests that the Finance Board intends category (4) collateral to be a broadly defined. Therefore, the "readily ascertainable value" requirement should be interpreted as giving the FHLBanks fairly broad discretion to determine whether particular kinds of collateral meet this requirement. We are not aware of any additional policy guidance issued by the Finance Board on this issue.

In a memorandum you provided us from the Credit Department of the FHLBank-Topeka to the Finance Committee of that FHLBank's board of directors, the Credit Department recommended assessing the FHA- and VA-insured loans described therein with "loading values" of 65 percent and 50 percent, respectively, based on the level of government guarantee and the performance, delinquency, and anticipated loss built into the pools of loans described.⁴ We read this to mean that, for purposes of determining the value of such loans as collateral, the FHLBank would value the FHA-insured loans at 65 percent of the unpaid principal balance of such loans and the VA-insured loans at 50 percent of the unpaid principal balance of such loans.

Based on the foregoing analysis, we believe that in order to comply with section 10(a)(4) of the Bank Act and § 935.9(a)(4) of the advances regulation, the FHLBank of Topeka must have a factual basis for using the valuation methodology chosen and for making the valuation assessments described above. Further, the FHLBank must maintain documentation sufficient to permit Finance Board examiners to verify the reasonableness of the FHLBank's valuation methodology and assessments.

cc: Jim Winning
Gary B. Townsend
Thomas D. Sheehan

⁴ See Memorandum from Credit Dept. to Finance Committee, FHLBank-Topeka (April 25, 1995).