



Federal Housing Finance Board

1777 F Street, N.W. Washington, D.C. 20006

Telephone: (202) 408-2500

Facsimile: (202) 408- 1435

www. fhfb.gov

December 2, 1998

[REDACTION]  
[REDACTION]  
[REDACTION]  
[REDACTION]

Dear [REDACTION]:

This is in response to your letters dated August 14 and September 8, 1998, in which you requested confirmation that two members of the Federal Home Loan Bank (FHLBank) [REDACTION] may secure advances made to them by the FHLBank through a pledge of eligible mortgage assets by their respective Real Estate Investment Trust (REIT) subsidiaries. The first transaction described involves the [REDACTION] Bank [REDACTION], [REDACTION], which has created a wholly-owned subsidiary called [REDACTION] has established its own wholly-owned subsidiary; called [REDACTION], that will qualify as a REIT for state and federal tax purposes. [REDACTION] has transferred to [REDACTION] certain whole residential mortgage loans and mortgage-backed securities in exchange for 100 percent of the common and non-voting preferred stock of [REDACTION]. In turn, [REDACTION] has transferred all of the [REDACTION] common stock and 80 percent of the [REDACTION] preferred stock to [REDACTION] and will distribute the remaining 20 percent of the [REDACTION] preferred stock to at least 100 other persons.

The second transaction described in your letters involves the [REDACTION] Bank [REDACTION] of [REDACTION], [REDACTION], which has established a two-tier operating structure similar to the one implemented by [REDACTION]. Specifically, [REDACTION] has established as its wholly-owned subsidiary a holding company called [REDACTION] Company, Inc. [REDACTION], as well as a REIT, called [REDACTION], Inc. [REDACTION], which is a wholly-owned subsidiary of [REDACTION]. Using a real estate mortgage investment conduit (REMIC), [REDACTION] has internally securitized certain whole residential mortgage loans and has transferred its interest in some of these securities and other whole loans to [REDACTION] in exchange for all of [REDACTION]'s stock. In turn, [REDACTION] has transferred its interest in these securities and whole loans to [REDACTION] in exchange for all of the common and preferred stock of [REDACTION].

In your letters, you indicated that, in each case, the members' REIT subsidiaries [REDACTION] and [REDACTION] will sign a hypothecation agreement pledging to the FHLBank as collateral for advances to the members [REDACTION] and [REDACTION], respectively) mortgage assets held by the REITs that are eligible to secure advances under

section 10(a) of the Federal Home Loan Bank Act, 12 U.S.C. § 1430(a), and section 935.9(a) of the regulations of the Federal Housing Finance Board (Finance Board), 12 C.F.R. § 935.9(a). You have also indicated that, in order to avoid any possible claim that such pledges constitute a fraudulent conveyance should either of these REITs become insolvent, the amount of each pledge will be limited at all times to 99 percent of the fair market value of the assets pledged as collateral. In addition, through revised blanket collateral agreements to be signed by [REDACTION] and [REDACTION] and through hypothecation agreements to be signed by their respective REIT holding company subsidiaries [REDACTION] and [REDACTION], the FHLBank will obtain and maintain a security interest in: (1) the remaining interest (if any) of both [REDACTION] and [REDACTION] in the mortgage assets transferred to their REIT subsidiaries; (2) the stock of the REIT holding companies held by FANB and FTB; and (3) the stock of the REITs held by the REIT holding companies.

Based upon the descriptions of the proposed transactions that you have provided, the Finance Board's Office of General Counsel (OGC) has no legal objection to the collateral arrangement that will exist if the proposed transactions are completed as described, provided that the FHLBank assures itself that: the REITs' pledge of assets to secure obligations of their parent companies is enforceable under applicable state law; adequate precautions have been taken to ensure that the hypothecation agreements with the REITs and REIT holding companies will remain legally enforceable if any of the parties become insolvent; and that all of the collateral to be pledged is perfectible under applicable state law. In addition, staff of the Finance Board's Office of Policy, Research and Analysis (OPRA) has indicated that it has no safety and soundness concerns regarding the proposed transaction, provided that the FHLBank maintains an enforceable security interest that will give it access to all collateral, should the need arise, and takes all steps, necessary to minimize and manage the additional legal risks involved with accepting collateral from a third party, instead of from the member itself. OPRA staff is relying on the FHLBank's representation that it will meet these conditions and will take additional steps to manage the risks associated with this transaction. Neither OGC nor OPRA have performed the underlying analyses to determine whether the FHLBank will maintain an enforceable security interest in the collateral, or whether the FHLBank has policies and procedures in place to manage the legal and operational risks.

Any changes in the factual descriptions of the proposed transaction that you have provided to us, or any failure of the parties to fulfill the legal and factual contingencies described in this letter may result in a reconsideration by the Finance Board of its conclusions regarding this matter. As with other aspects of the FHLBank's advances and collateral operations, this transaction will be subject to review through the examination process by the Finance Board's Office of Supervision. If you have any questions concerning the issues raised in this letter, please feel free to contact me (at 202-408-2570) or Eric Raudenbush (at 202-408-2932).

Sincerely,

*Deborah F. Silberman*

Deborah F. Silberman  
General Counsel

This is a Finance Board regulatory interpretation within the meaning of the Procedures for Requests and Applications adopted by the Board of Directors of the Finance Board pursuant to Resolution No. 98-51 (Oct. 28, 1998). The regulatory guidance set forth herein is applicable only to the specific transactions described above and may be relied upon by the recipient subject to being modified or superceded by action of the Board of Directors of the Finance Board.

I concur: William W. Ginsberg  
William W. Ginsberg, Managing Director

cc: W. Ginsberg  
J. Bothwell  
M. Berns  
E. Raudenbush