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FEDERAL HOUSING FINANCE BOARD

Waiver of a Provision of Section 950.7(a)(5) to Allow a Federal Home Loan Bank to Accept as Collateral For Advances, on a Proportional Basis, a Security Representing Equity Ownership in a Pool of Assets, Only a Portion of Which Qualify as Eligible Advances Collateral

WHEREAS, section 950.7(a)(5) of the regulations of the Federal Housing Finance Board (Finance Board), 12 C.F.R. § 950.7(a)(5), authorizes each Federal Home Loan Bank (FHLBank) to accept as collateral for advances any security the ownership of which represents an undivided equity interest in underlying assets, all of which qualify as eligible collateral under section 950.7(a)(1), (2), (3) or (4), or as cash equivalents;

WHEREAS, on January 11, 2000, a FHLBank submitted to the Finance Board a request for a no-action letter stating that the Finance Board would take no supervisory or other action against the FHLBank if the FHLBank were to accept as collateral from its member an indirect equity interest in the member's second tier subsidiary unit investment trust (UIT), which would hold approximately \$1 billion in assets, only a portion of which would be eligible collateral under section 950.7(a)(1) through (4);

WHEREAS, on March 8, 2000 the member wrote to the Finance Board and asked the Finance Board to convert the FHLBank request for a no-action letter into a request for a waiver under section 907.2 (formerly section 903.2) of the Finance Board's regulations, 12 C.F.R. § 907.2, and that the information set forth in the FHLBank request for a no-action letter be incorporated by reference into the waiver request;

WHEREAS, on March 22, 2000, the FHLBank officially withdrew the request for a no-action letter and asked that the content of the request be used to supplement and support the member's waiver request;

WHEREAS, the member proposes to form the UIT and take an interest in the assets held by the UIT as follows: (1) the member will grant to a holding trust a 100 percent participation interest in a pool of approximately \$1 billion of the member's assets, a portion of which qualify as eligible collateral under section 950.7(a)(1) through (4) and a portion of which do not so qualify; (2) in return, the member will acquire a 100 percent ownership interest in the holding trust; (3) the holding trust will then transfer the participation interests to the UIT; (4) in return, the holding trust will acquire a 100 percent ownership interest in the UIT; (5) so that the UIT will qualify as a regulated investment company under the Internal Revenue Code, the holding trust will transfer less than a one percent ownership interest in the UIT to employees of the member who will, in turn, manage, administer and service the assets; and (6) consequently, the member, through its investment in the holding trust, will have an indirect equity interest in at least 99 percent of the assets held by the UIT;

WHEREAS, despite the fact that the asset pool held by the UIT will include assets that are not eligible collateral under section 950.7(a)(1) through (4), the member desires to use its equity ownership interest in the assets held by the UIT that are eligible collateral under section 950.7(a)(1) through (4) to secure advances from the FHLBank;

WHEREAS, the FHLBank states that, if so permitted, it will lend against only that portion of the UIT's assets that constitute eligible collateral under section 950.7(a)(1) through (4), but that it will also hold a security interest in the non-eligible assets as additional security for any advances extended to the member, all of which will be effected through a unit pledge agreement in favor of the FHLBank under which the member will transfer to the FHLBank a security interest in its shares in the holding trust;

WHEREAS, when it originally adopted the provision that now appears at 12 C.F.R. § 950.7(a)(5), the Finance Board declined to permit FHLBanks to accept as collateral for advances, securities representing interests in asset pools that include assets other than those that are eligible advances collateral due to "the complexities of monitoring the fluctuating asset pools of mutual funds and similar investments," *see* 64 FR 16620 (Apr. 6, 1999);

WHEREAS, both the member and the FHLBank have represented that the composition of the asset pool held by the UIT will fluctuate to a lesser degree than a typical mutual fund asset pool and that, therefore, it will be practicable to monitor, through periodic reports provided by UIT to the FHLBank, the level of eligible collateral represented by the member's interest in the UIT;

WHEREAS, as additional precaution, the FHLBank proposes to: (1) prohibit both the member and the UIT from pledging, transferring, assigning or otherwise encumbering the UIT-held collateral; (2) prohibit the holding trust from pledging, transferring, assigning or otherwise encumbering the shares representing its interest in the UIT; (3) prohibit both the UIT and holding trust from incurring any indebtedness; (4) prohibit the UIT from conducting any business other than holding a pool of assets; (5) prohibit the holding trust from engaging in any business other than the passive holding of the shares of UIT; (6) require the member to provide the FHLBank with periodic financial statements for the UIT, which will allow the FHLBank to determine if the UIT has transacted any business that would place the FHLBank's security interest in the UIT's assets at risk; (7) retain the power, under specified circumstances, to require that the UIT be liquidated and that the assets be returned to the member; (8) perfect its interest in the equity security representing the member's ownership interest in the UIT; and (9) by agreement with the member, retain the legal right to require the dissolution of the UIT upon the default of the member or the occurrence of certain other materially adverse events, and to take possession of and liquidate the underlying assets of the UIT in a manner substantially similar to that which would occur if such underlying assets were to be pledged to the FHLBank directly; and

WHEREAS, the Finance Board recognizes the need for FHLBanks to accommodate members' desire to structure their asset holdings in the most efficient way possible, and believes that the precautions proposed to be taken as part of the transaction will be sufficient to ensure that the advances to the member will be fully secured by collateral eligible to secure advances under section 10(a) of the Federal Home Loan Bank Act, 12 U.S.C. § 1430(a).

NOW, THEREFORE, IT IS RESOLVED THAT, for purposes of the transaction or series of transactions between the FHLBank and its member described in the FHLBank's January 11, 2000 request for a no-action letter and the member's subsequent March 8, 2000 waiver request, the provision of 12 C.F.R. § 950.7(a)(5) requiring that all assets underlying a security representing an equity ownership in an underlying pool of assets be otherwise eligible collateral under 12 C.F.R. § 950.7(a)(1) through (4) in order for that security to be used itself as eligible collateral is hereby waived, subject to the following provisions:

1. The member, the holding trust and the UIT are prohibited from pledging, transferring, assigning or otherwise encumbering the UIT collateral;
2. The member is prohibited from pledging, transferring, assigning or otherwise encumbering the shares representing its interest in the holding trust;
3. The holding trust is prohibited from pledging, transferring, assigning or otherwise encumbering the shares representing its interest in the UIT;
4. The UIT and holding trust are prohibited from incurring any indebtedness, or from conducting any business other than passively holding, respectively, a pool of assets or the shares of the UIT;
5. The FHLBank shall perfect its interest in the equity security representing the member's ownership interest in the UIT;
6. Through legal arrangements between the FHLBank and the member and, if necessary, the holding trust and UIT, the FHLBank shall reserve to itself the legal right - upon the default of the member on any advances obligation, or upon the member's becoming undercapitalized, or entering into a supervisory agreement with or becoming subject to a cease and desist order of a governmental entity - to dissolve, or require the dissolution of, the UIT and to take possession of and liquidate the underlying assets of the UIT in a manner and in a timeframe that are substantially similar to that which would occur if the FHLBank were to have maintained a direct security interest in the underlying assets of the UIT; and
7. The FHLBank may make advances to the member only in an amount less than or equal to the value of the assets held by the UIT that meet the definition of eligible collateral, discounted by: (a) the percentage normally applied by the FHLBank to advances collateral of the type represented by the underlying assets; (b) a percentage calculated by the FHLBank reasonably to account for the indirect nature of its security interest in the underlying assets; and (c) the percentage of the equity interest in the UIT that is not held by the holding trust (*i.e.*, the interests transferred to member employees).

By the Federal Housing Finance Board

/s/ Allan I. Mendelowitz

Allan I. Mendelowitz, Chairman