REGULATORY INTERPRETATION 2010-RI-03

Subject: Acceptance of Federal Deposit Insurance Corporation Guarantee as Collateral for Advances

Issue: Whether a Federal Home Loan Bank (Bank) may accept a guarantee from the Federal Deposit Insurance Corporation (FDIC) as collateral to secure advances held by a Bank member in receivership.

Conclusion: A Bank has the statutory authority to accept an FDIC corporate guarantee as collateral for advances held by a member in receivership, and may release its lien on the collateral securing those advances in exchange for the FDIC guarantee.

Background:

A Bank is authorized to make advances to its members only if their repayment obligations are fully secured by certain types of eligible collateral. 12 U.S.C. § 1430(a)(1). The Federal Home Loan Bank Act (Bank Act) specifies five categories of eligible assets that a Bank may accept as collateral at the time that it originates or renews an advance.[1] To ensure that it remains fully secured, a Bank typically holds collateral with a value that exceeds the amount due on the advance. The Bank Act further authorizes a Bank to accept other types of assets as collateral for outstanding advances, if the Bank deems it necessary to protect its security interest. *Id.* at § 1430(a)(4). Regardless of the type of collateral, a Bank's security interest is afforded priority over the claims of nearly all other parties, including the claims of a receiver or conservator. *Id.* at § 1430(e).

If a Bank member is placed into receivership, the Bank typically has a contractual right to call due any outstanding advances and liquidate the associated collateral. In most cases, however, the FDIC as receiver for the member will repay the amounts due on the advances in order to obtain the release of the Bank's lien on the collateral. Doing so allows the receiver greater latitude in facilitating the prompt resolution of the failed institution, such as by the sale of its assets and liabilities to a third party.

[1] Section 10(a)(3) of the Bank Act authorizes a Bank originating or renewing an advance to accept as collateral whole first mortgage loans on improved residential property (including securities representing whole interests in such loans), securities issued, insured or guaranteed by the United States or any agency thereof, cash or deposits of a Bank, other real estate related collateral, and, for "community financial institutions," secured loans for small business, agriculture, or community development activities. 12 U.S.C. § 1430(a)(3).

As the number of Bank members in receivership has increased, the FDIC and the Banks have considered whether the Banks would have the authority to accept a guarantee of repayment from the FDIC, acting in its corporate capacity, as a substitute for the existing collateral that the Banks hold for advances that remain outstanding to Bank members in receivership. Although a definitive determination would require an assessment of the terms of an actual guarantee agreement between the FDIC and a Bank, the Bank Act would allow a Bank to accept an FDIC guarantee as substitute collateral for outstanding advances under certain circumstances.

The analysis set out below assumes that the FDIC and a Bank were to enter into a written agreement pursuant to which the FDIC, acting in its corporate capacity, would guarantee the timely repayment in full of all principal and interest due on particular advances, and the Bank would release its lien on the collateral securing those advances and return that collateral to the FDIC, acting in its capacity as the receiver for the member of the Bank.

Analysis:

Whether a Bank may accept a corporate guarantee from the FDIC as substitute collateral for outstanding advances depends on whether the guarantee would be eligible under provisions of Section 10(a) of the Bank Act. 12 U.S.C. § 1430(a). Section 10(a) includes two distinct provisions relating to permissible collateral. The first provision, Section 10(a)(3), is limited in scope and identifies five categories of assets that a Bank may take as collateral when originating or renewing an advance. A Bank may not accept any other types of collateral when making an advance. The second provision, Section 10(a)(4), is more broad in scope and addresses the types of collateral that a Bank may take with respect to advances that are already outstanding. For the reasons stated below, a Bank would have the authority under Section 10(a)(4) to accept a guarantee from the FDIC in exchange for the release of the original collateral securing the outstanding advances of a member in receivership.

Section 10(a)(4) provides that the statutory limits on the types of collateral that may be used for originating an advance "shall not affect the ability of any [Bank] to take such steps as it deems necessary to protect its security position with respect to outstanding advances, including requiring deposits of additional collateral security, whether or not such additional security would be eligible to originate an advance." *Id.* at § 1430(a)(4). That language is broad, in that it makes clear that a Bank may accept as collateral for outstanding advances assets that cannot be used when originating an advance, and it commits to the discretion of the Bank the authority to decide what collateral may best protect its interests with respect to those advances. Such broad authority likely reflects a determination by Congress that imposing limits on the types of collateral that may be taken for outstanding advances could be imprudent, particularly if the initial collateral proved to be insufficient, and that the paramount objective of the provision is that the Bank remain fully secured over the duration of any outstanding advances.

Although Section 10(a)(4) explicitly authorizes a Bank to require a member to provide "additional" collateral for its outstanding advances, *i.e.,* collateral in addition to that obtained when originating the advance, that language does not preclude a Bank from taking other actions to protect its interests. Indeed, by using the phrase "including requiring deposits of additional collateral" Congress has made clear that a demand for additional collateral is simply one means for a Bank to protect its interests. Thus, a Bank may take other actions to protect its security position, such as exchanging its existing collateral for other collateral, provided that it determined that such an exchange were a necessary or appropriate means of ensuring that it remained fully secured with respect to the underlying advances.

As this authority is applied to a corporate guarantee from the FDIC for the repayment of advances held by an institution in receivership, a Bank could reasonably determine that the guarantee would enhance its security position because it would reduce or eliminate any credit or market risks that may be associated with the original collateral.[2] Under such circumstances, Section 10(a)(4) would allow the Bank to accept the FDIC guarantee as collateral for the outstanding advances. Moreover, if the Bank were to determine that the outstanding advances would remain fully secured by the FDIC guarantee alone, then the Bank could release its lien on the original collateral and return it to the member institution in receivership.

This Regulatory Interpretation is informed by the consideration that it is generally in the interest of the Banks to facilitate the FDIC's resolution of failed members, both specifically with respect to orderly payment of a Bank's claims on such a member without the necessity of a Bank's managing the liquidation of its collateral in an uncertain market and generally with respect to maintaining the stability of the markets in which the Banks operate.

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This Regulatory Interpretation is issued pursuant to 12 C.F.R. § 907.5 and is subject to modification or rescission by the Director of the Federal Housing Finance Agency.

[2] By statute, the full faith and credit of the United States is pledged to the payment of any obligation issued by the FDIC, with respect to both principal and interest, provided that the principal amount of the obligation and its maturity are both stated in the obligation. 12 U.S.C. § 1825(d).