

owned subsidiary of a member differently from other affiliates that are not controlled by the member, and whether the rule should allow an affiliate to sell loans to a Bank, so long as the related member provides the required credit enhancement.

### 3. Credit Risk-Sharing Requirements—Proposed § 955.5

The proposed rule would revise certain aspects of the credit risk-sharing requirements and would reorganize the credit risk-sharing requirements to achieve greater clarity. As noted below, the proposed rule would retain the requirements that the member must enhance the AMA to at least investment grade and that supplemental insurance providers must be rated at least the second highest investment grade. The Finance Board believes that these provisions are important for safety and soundness reasons.

#### a. Required Credit Risk-Sharing Structure—Proposed § 955.5(a)

*AMA product requirement.* Proposed § 955.5(a)(1) would retain the current requirement that the Bank implement a credit risk-sharing structure for each AMA Product,<sup>1</sup> under which a member or housing associate provides the credit enhancement necessary to enhance an asset or pool of assets acquired by the Bank to the equivalent of investment grade. 12 CFR 955.3(b). The proposed rule also would add a definition of “investment grade” to § 955.1, which would define the term to mean a credit quality rating in one of the four highest credit rating categories provided by an NRSRO.

*Asset requirement.* Proposed § 955.5(a)(2) would require a Bank to specify the level within investment grade to which the credit quality of the particular AMA asset or pool of assets must be equivalent. In substance, this revision is the same as the current provision, which authorizes a Bank to require a member or housing associate to provide sufficient credit enhancement to raise the credit quality of the AMA assets above the minimum level of investment grade, e.g., BBB. See 12 CFR 955.3(b).

*Satisfaction of credit enhancement requirement.* Proposed § 955.5(a)(3) would require, for each AMA Product, that the Bank have in place a process and methodology that determines the credit enhancement required, and that demonstrates that the economic value of the credit enhancement provided by the

member or housing associate is sufficient to meet the credit enhancement required. The Bank must have the process and methodology in place prior to the acquisition of any AMA assets, and must maintain the process and methodology for however long the assets remain on its books. The Bank would be required to satisfy the Finance Board as to the adequacy of the process and methodology.

While the proposed rule would maintain the requirement that a Bank must demonstrate the sufficiency of the methodology and economic value of the credit enhancement, to the satisfaction of the Finance Board, the proposed rule would eliminate the requirement that such demonstration may be provided only by written verification from an NRSRO. 12 CFR 955.3(a), (b)(4). Although a Bank could continue to use written NRSRO verification to demonstrate this sufficiency, the proposed rule is intended to allow the Banks the opportunity to determine other means by which to satisfy the requirement. Moreover, although the Finance Board is proposing to eliminate the specific requirement that a Bank obtain written verification from an NRSRO, the Finance Board would continue to use NRSRO standards and practices as the benchmark against which it judges the sufficiency of a Bank's methodology and the economic value of the credit enhancement. Thus, as under the current rule, to the extent an NRSRO were to decline to rate a structured finance transaction because the underlying asset pool included particular types or categories of assets, then the presence of such assets within an AMA pool would effectively preclude a Bank from calculating a putative credit rating for that pool and from complying with the proposed credit enhancement requirements with regard to that particular pool.<sup>2</sup>

The proposed requirement that a Bank must have in place its process and methodology “prior to the acquisition of any asset or pool of assets and throughout the life of the asset or pool of assets on the Bank's books,” would replace the current requirement that the Bank must determine the required credit enhancement at the earlier of 270 days from the date of the Bank's acquisition of the first loan in a pool, or the date at which the amount of a pool's assets

reaches \$100 million. 12 CFR 955.3(a). As a result of this provision, a Bank would be responsible for ensuring that none of its actions, such as the approval of the sale of mortgage servicing rights by a member or housing associate that is responsible for the required credit enhancement, would affect the estimated credit rating of an asset.

#### *Elimination of outdated provisions.*

The proposed rule would eliminate § 955.3(c) of the current rule, which established a 90-day period within which AMA programs in existence at the time of the effective date of the current rule had to obtain new NRSRO opinion letters. 12 CFR 955.3(c). This provision no longer has any effect, as the 90-day period has since passed.

*Decline in estimated credit rating.* Section 955.5(a)(4) of the proposed rule would clarify the responsibilities of a Bank in the event that the estimated credit rating of an AMA asset or pool of assets were to decline to below the initially required credit rating. In those circumstances, the Bank must either require the member or housing associate to provide sufficient additional credit enhancement to restore the rating, or must recalculate and comply with the risk-based capital requirement for that asset to reflect the reduced estimated credit rating. The substance of this provision is much the same as § 955.6(b) of the current rule. See 12 CFR 955.6(b).

#### b. Credit Enhancement Requirements—Proposed § 955.5(b)

*Member or housing associate responsibility.* Proposed § 955.5(b)(1) would retain the requirement in § 955.3(b) of the current rule that the credit enhancement must be provided by a member or housing associate of the Bank or, with the approval of both Banks, by a member or housing associate of another Bank. 12 CFR 955.3(b). The proposed rule would eliminate, however, many of the prescriptive structural requirements with regard to the credit enhancement that are now contained in § 955.3(b). Instead, the proposed rule would allow a Bank greater freedom to design specific AMA Products. The Finance Board intends to rely on its examination and review process to verify that a Bank's AMA Products comply with the proposed credit enhancement requirements. Because the proposed credit enhancement requirements would not refer to “expected losses,” as does the current rule, the Finance Board is also proposing to delete the definition of this term from § 955.1.

*Economic cost; third party credit enhancement.* Section 955.5(b)(2) of the proposed rule would broadly state that

<sup>1</sup> The Finance Board is proposing to add a new definition to § 955.1 that “AMA Product” means an AMA structure defined by a specific set of terms and conditions.

<sup>2</sup> For example, if Standard & Poor's continues to decline to rate mortgage pools that contain loans subject to the Georgia Fair Lending Act, as in effect from October 1, 2002, until March 7, 2003, the Banks would not be in a position to demonstrate that they could rate such loans. Thus, the Banks could not buy such mortgage loans as AMA and still comply with proposed § 955.5(a)(3).