

the member or housing associate that initially provides the credit enhancement must bear all of the direct economic consequences of the credit enhancement responsibility. This means that no part of the credit enhancement costs can be paid by a Bank, either directly or indirectly. The proposed rule also would eliminate the criteria in § 955.3(b)(1) of the current rule that apply if a member or housing associate provides a portion of its required credit enhancement through a third party, *i.e.*, by contracting with an insurance affiliate, by purchasing loan-level or pool-level insurance, or by contracting with another member or housing associate. Instead, the authority to provide the required credit enhancement through a third party would be implied from the more general requirement in proposed § 955.5(b)(2) that the member or housing associate must bear all of the economic consequences of the credit enhancement responsibility. This broader language would allow a member or housing associate to purchase insurance (which could include United States government guarantees or insurance) for a portion or all of the credit enhancement obligation, or to sell a portion or all of the obligation to another qualified party, so long as the member or housing associate bears all of the economic consequences of the credit enhancement obligation. See proposed § 955.5(b)(1). The current requirement that a third party may cover only those losses that remain after the member or housing associate has borne expected losses, would be eliminated. See 12 CFR 955.3(b)(1)(i), (b)(1)(ii)(B), (b)(1)(iii)(B), (b)(2). Additional requirements applicable where the third party is an insurer are discussed in the *Use of mortgage insurance* section below.

Although the proposed rule would retain the current requirement that members or housing associates are responsible for providing the necessary credit enhancement to raise the credit quality to investment grade, it is less prescriptive than the current rule. This approach is not intended to alter the economics of the current risk-sharing requirement. Instead, it is intended that with fewer restrictions on the form of the credit enhancement, and on the type and degree of supplemental mortgage insurance (SMI), the Banks may develop alternative credit enhancement structures, such as through greater use of pool insurance.

Direct obligations of members. Section 955.5(b)(3) of the proposed rule would clarify provisions in the current rule by stating that any portion of a credit enhancement that is a direct

obligation of a member or housing associate and that is not covered by third party insurance generally must be fully secured by that member or housing associate with collateral that is eligible to secure an advance. The current rule had prompted questions about the need for collateral for obligations that are covered by insurance, and the proposed rule would make clear that collateral is required only to support a direct obligation of the member or housing associate itself, not the obligations of an insurer. The proposed rule also would clarify the effect of a transfer of the credit enhancement responsibility to another member or housing associate, by providing expressly that the successor shall continue to comply with any collateral requirements that applied to the initial member or housing associate. Under the proposed rule, a Bank would have an option of holding permanent capital against such direct obligations, in an amount equal to 100 percent of the nominal value of the obligation, in lieu of obtaining collateral from the member or housing associate.

The Finance Board has been asked previously to permit a member or housing associate to secure its credit enhancement obligation with collateral that is not eligible under the Bank Act to secure advances. The Finance Board has not included such a provision in the proposed rule, but requests comment on whether it would be appropriate to allow a member or housing associate to use such non-Bank Act-eligible collateral to secure its credit enhancement obligations.

Use of mortgage insurance. Section 955.5(b)(4) of the proposed rule would authorize a member or housing associate to provide all or a portion of its required credit enhancement through mortgage insurance, provided that the insurer is rated not lower than the second highest credit rating. If the rating of the insurer were to fall below the second highest credit rating, the member or housing associate would have 60 days to replace the insurance with an insurer that has the required credit rating. This provision would modify the current rule, which requires that such insurance be maintained at all times, and is intended to recognize that a member or housing associate may not be able to immediately obtain replacement insurance. 12 CFR 955.3(b)(1)(ii)(A). The proposed rule also would clarify the current rule by making clear that the minimum credit rating requirement is applicable to both loan-level and pool-level insurers.

The proposed rule also would eliminate the current restrictions on the type of insurance, particularly pool

insurance, that may be used to cover any portion of the credit enhancement. Under the current rule, a member may use pool-level insurance only to cover that portion of the credit enhancement obligation that is attributable to geographic concentration and pool size. See 12 CFR 955.3(b)(1)(iii). Allowing broader use of pool insurance may enhance the safety and soundness of the Banks' AMA programs. Although the proposed rule would place fewer limitations on the use of mortgage insurance, the Finance Board expects the Banks to continue to monitor closely their exposures to individual mortgage insurers and to manage these exposures prudently. A Bank should perform an independent credit analysis of the SMI companies with which it does business to gain a more detailed understanding of their financial condition and operating performance considering the potential credit concentrations and exposure levels involved. A Bank should evaluate its potential exposure in determining the depth of credit analysis appropriate for individual SMI providers.

c. Grandfathered Transactions

The proposed rule would retain the existing AMA grandfather provision, with minor technical revisions, and would relocate it to proposed § 955.5(c). 12 CFR 955.2(c)(2). Under the proposed provision, any AMA-type assets acquired by a Bank in accordance with prior resolutions of the Finance Board would not be subject to the credit enhancement requirements in proposed § 955.5 of the AMA rule, provided that they remain within any total dollar cap imposed by the Finance Board.

D. AMA-Qualified Interests in Whole Loans

The Finance Board is proposing to incorporate into the AMA rule previous guidance addressing the acquisition of instruments that represent an interest in AMA-eligible loans. The Finance Board had previously provided this guidance as part of the **SUPPLEMENTARY INFORMATION** section of the final AMA rule. See final AMA rule, 65 FR at 43974–78. Codifying this guidance is intended to make more transparent the existing authority for the Banks to acquire such instruments as AMA. In adopting the Final AMA Rule, the Finance Board stated that a Bank may acquire certificates representing interests in whole loans as AMA only if:

(1) The certificates are rated by an NRSRO to meet the credit enhancement requirement of § 955.3;

(2) The certificates are issued following the execution of, and for the purpose of implementing an agreement between and