

Proposed Rules

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This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

FEDERAL HOUSING FINANCE BOARD

12 CFR Part 933

[No. 95-34]

Membership Approval

AGENCY: Federal Housing Finance Board.

ACTION: Proposed rule.

SUMMARY: The Federal Housing Finance Board (Finance Board) is proposing to amend its regulation on membership in the Federal Home Loan Banks (Bank). The proposed rule will allow the 12 Banks, rather than the Finance Board, to approve applications for Bank membership subject to the standards provided in the rule. The proposed rule will require the Banks to apply tests and criteria for determining compliance with the statutory eligibility requirements for Bank membership currently used by the Finance Board in approving applications. The proposed rule is part of an effort by the Finance Board and the Banks to transfer as many governance functions as possible from the Finance Board to the Banks.

DATES: Comments must be submitted in writing to the Finance Board by December 26, 1995.

ADDRESSES: Written comments may be mailed to: Elaine L. Baker, Executive Secretary, Federal Housing Finance Board, 1777 F Street NW., Washington, DC 20006. Comments will be available for public inspection at this address.

FOR FURTHER INFORMATION CONTACT: Amy R. Maxwell, Associate Director, District Banks Secretariat, Office of Managing Director, (202) 408-2882, or James H. Gray Jr., Associate General Counsel, Office of General Counsel, (202) 408-2538, Federal Housing Finance Board, 1777 F Street NW., Washington, DC 20006.

SUPPLEMENTARY INFORMATION:

I. Statutory and Regulatory Background

In its role as primary regulator of the savings association industry and as overseer of the Banks, the Finance

Board's predecessor agency, the former Federal Home Loan Bank Board (FHLBB), reviewed and approved all applications for Bank membership from federal and state chartered savings associations, institutions for which Bank membership was required. The FHLBB delegated the authority to approve membership applications from insurance companies and state-chartered savings banks insured by the Federal Deposit Insurance Corporation (FDIC), for which Bank membership was voluntary, to the Bank presidents acting as Principal Supervisory Agents of the FHLBB. See 12 U.S.C. 1437 (1988), *repealed by* Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183 (Aug. 9, 1989) (FIRREA).

FIRREA amended the membership provisions of the Federal Home Loan Bank Act, 12 U.S.C. 1421-1449 (Bank Act). Section 704 of FIRREA amended section 4 of the Bank Act to make commercial banks and credit unions eligible for Bank membership for the first time. Section 704 of FIRREA also revised the membership eligibility criteria. Section 702 of FIRREA added sections 2A and 2B to the Bank Act, establishing the Finance Board and enumerating its powers and duties. Section 2B of the Bank Act limited the Finance Board's authority to delegate responsibilities to the Banks. From the enactment of FIRREA in 1989 until July, 1993, all Bank membership applications were reviewed and approved by the Finance Board. In July 1993, the Finance Board delegated to its Managing Director the authority to approve all applications for Bank membership from institutions that met all of the statutory criteria and received a composite rating of "1," "2" or "3" under the Uniform Financial Institutions Rating System (the regulatory examination rating system). See Finance Board Res. No. 90-143 (Dec. 18, 1990); Chairman's Order No. 93-05 (July 19, 1993).

In August 1993, the Finance Board amended its membership regulation to incorporate the FIRREA changes to the Bank Act. The revised membership regulation established the Finance Board's general policies pertaining to Bank membership, including specifying the appropriate Bank district for applicants and, member stock requirements, outlining procedures for consolidation of members with other

members and with nonmembers, and for withdrawal and removal from membership. Other than defining certain terms, the membership regulation did not establish standards for compliance with the statutory membership eligibility criteria. See 58 FR 43542 (1993), *codified at* 12 CFR Part 933.

In November 1993, the Finance Board adopted policy guidelines to assist staff in processing applications for Bank membership. See Membership Application Processing Guidelines, Finance Board Res. No. 93-88 (Nov. 17, 1993) (Guidelines). The purpose of the Guidelines was to clarify the more subjective membership eligibility criteria in the Bank Act, such as "character of management and * * * home-financing policy * * * consistent with sound and economical home financing * * *." 12 U.S.C. 1424(a)(2)(C). In the Guidelines, the Finance Board also delegated to the Banks authority to approve a delineated subset of membership applications; that is, applications from institutions meeting all of the criteria in the Bank Act, the membership regulation and the Guidelines.

The Guidelines set forth specific, objective primarily financial criteria to be met in order for an applicant to be deemed in compliance with the statutory criteria. However, the Guidelines establish neither a minimum level of financial performance nor standards for evaluating applicants that fail to meet the requirements in the Guidelines. So, for instance, an application from an institution with a minimum composite regulatory examination rating that does not satisfy the criteria for delegated approval by the Banks must be evaluated by Finance Board staff and approved by the Managing Director pursuant to delegated authority. The Board of Directors of the Finance Board has not itself considered or acted upon any membership applications since authority to approve membership applications was delegated to the Managing Director in July 1993. Since December 1993, the Banks have approved 778 membership applications and the Finance Board's Managing Director has approved 834 membership applications, all pursuant to delegated authority.

The Finance Board and the Banks have been considering ways to transfer a variety of governance responsibilities from the Finance Board to the Banks since the completion of studies required by the Housing and Community Development Act of 1992, Pub. L. No. 102-550, 106 Stat. 3672 (Oct. 28, 1992), including the Finance Board's own study completed in April 1993. See Report on the Structure and Role of the Bank System 153 (Apr. 28, 1993). Finance Board staff and Bank staff have consistently identified membership application approval as one of the governance responsibilities that should be devolved from the Finance Board to the Banks because the Banks should be allowed broad discretion to manage their affairs as long as the Banks comply with the Bank Act and Finance Board regulations. This proposed rule is designed to transfer authority to approve all Bank membership applications from the Finance Board to the Banks. The proposed rule will codify many of the tests and criteria for determining compliance with the statutory eligibility requirements that are currently in the Finance Board's Guidelines for approving applications.

II. Analysis of the Proposed Rule

A. Membership Application Process

1. Requirements

Section 933.2 of the proposed rule sets forth the procedures for submission and review of membership applications. Under § 933.2(a), an applicant is required to submit an application which satisfies the requirements of part 933 and to certify in writing that it has reviewed the requirements of part 933, provided the most recent, accurate and complete information available, and will supplement the application if additional relevant information becomes available prior to the Bank's decision on whether to approve the application and where applicable, prior to the Finance Board's resolution of any appeal.

Under § 933.2(b), a Bank is required to prepare a written digest for each applicant that describes the reasons and findings that support the Bank's determination whether the applicant meets the requirements of this part. This requirement is consistent with the requirements in the Guidelines.

Under § 933.2(c), the Banks are required to maintain a membership file for each applicant for at least three years that includes the digest, all documents the Bank is required to obtain and review under this part, any additional documents the Bank obtains during the application process, and the Bank's decision resolution.

Under § 933.2(d), the Banks are required to use regulatory financial reports and other sources independent of the applicant to evaluate and analyze all conclusions offered by the applicant regarding its membership eligibility. "Regulatory financial report" is defined in § 933.1(z) of the proposed rule to include periodic financial reports filed by the applicant with its primary regulator, including quarterly call reports for commercial banks, thrift financial reports for thrifts, quarterly or semi-annual call reports for credit unions, the National Association of Insurance Commissioners' (NAIC) annual statements or quarterly reports for insurance companies, and other similar reports. "Primary regulator" is defined in § 933.1(x) of the proposed rule as the chartering authority for federally chartered applicants, the insuring authority for federally-insured applicants that are not federally chartered, or the appropriate state agency for all other applicants. The Finance Board included § 933.2(d) to ensure that the Banks evaluate membership applications without relying unduly on representations made by the applicants.

2. Decision on Application

Section 933.3 of the proposed rule establishes the Banks' authority and method for making decisions on applications. Under § 933.3(a), the Finance Board authorizes the Banks to approve membership applications, subject to the appeal procedure in proposed § 933.5. The proposed rule requires that the authority to approve applications be exercised only by the Bank's board of directors, a committee of the Bank's board of directors, the Bank president, or a senior officer who reports directly to the Bank president other than an officer who has responsibility for business development. Section 933.3(b) requires the Bank to prepare for each applicant a decision resolution that includes the Bank's decision on whether to approve the applicant and the reasons therefor, and states that the information in the digest is accurate and based on a diligent and comprehensive review of all available information. If the application is approved, the decision resolution also must state that the applicant is authorized under the laws of the United States and the appropriate state to become a member of, purchase stock in, do business with and maintain deposits in the Bank to the which the applicant has applied, and that the applicant meets all of the eligibility criteria set forth in the Bank Act and part 933. The Guidelines currently require the Banks

to make these certifications to the Finance Board when recommending an application for approval.

Section 933.3(c) requires the Bank to act on an application within 60 calendar days of the date the Bank deems the application to be complete. Within three business days of the Bank's decision on an application, the Bank must provide the applicant and the Finance Board's Executive Secretary with a copy of the Bank's decision resolution. Section 933.3(c) is intended to ensure expeditious action on membership applications. The current Guidelines do not establish applications-processing time frames.

3. Automatic Membership

Section 933.4 of the proposed rule provides for automatic Bank membership in appropriate circumstances. Section 933.4(a) continues the automatic membership provision in current § 933.2(d) for applicants required by law to become a member of a Bank. Section 5(f) of the Home Owners' Loan Act (HOLA) requires all federally chartered savings associations and savings banks to be members of a Bank and to qualify for Bank membership in the manner provided in the Bank Act. 12 U.S.C. 1464(f). The factors considered by the Office of Thrift Supervision when reviewing an application for a federal charter include the factors considered in determining eligibility for Bank membership. See 12 U.S.C. 1464(e). Therefore, it would be duplicative and unnecessarily burdensome to require these institutions to file an additional application for Bank membership. Section 933.4(b) continues the provision in current § 933.2(e) for automatic membership for insured depository institution members that convert from one charter type to another, provided that the converting institution continues to be an insured depository institution and the assets of the institution immediately before and immediately after the conversion are identical. All relationships existing between the member and the Bank at the time of such conversion may continue. Section 933.4(c) adds a new automatic membership provision for members that transfer membership from one Bank to another pursuant to § 933.18(d) of this part.

4. Appeals

Section 933.5 of the proposed rule establishes a process for appealing Bank membership decisions to the Finance Board. The appeal procedure is intended to ensure that membership standards are applied consistently by

the Banks, and that similarly situated applicants are treated similarly. Under § 933.5(a), applicants denied membership by a Bank may, within 90 calendar days of the Bank's decision, appeal the denial to the Finance Board by writing the Finance Board's Executive Secretary, with a copy to the Bank. The applicant's appeal must include a copy of the Bank's decision resolution, and a detailed statement of the basis for the appeal, including sufficient supporting facts, information, analysis and explanation.

Under § 933.5(b), within 60 calendar days of the date that a Bank approves an application for membership, another Bank (appellant Bank) may appeal to the Finance Board the determination of the appropriate district for membership, pursuant to § 933.18 of this part. The appeal must be in writing and addressed to the Finance Board's Executive Secretary with a copy to the Bank that granted membership, and must include a statement of the basis for the appeal with sufficient facts, information, analysis and explanation to support the appellant Bank's contentions. As the banking industry consolidates, the Finance Board anticipates more questions from the Banks regarding the determination of an applicant's principal place of business. The appeals procedure will permit recourse to the Finance Board when Banks cannot agree on an applicant's principal place of business. The Finance Board invites comment on alternative means of addressing this concern.

Section 933.5(c) explains how the Finance Board will obtain the information necessary to decide appeals under § 933.5(a) and (b). The Bank whose action has been appealed (appellee Bank) must provide to the Finance Board a complete copy of the applicant's membership file within five business days of receiving an appeal. Until the Finance Board resolves the appeal, the appellee Bank is required to provide to the Finance Board any new materials it receives. The Finance Board also may request additional information from the appellant (Bank or applicant), the appellee Bank, or any other party the Finance Board deems appropriate.

Section 933.5(d) provides that the Finance Board must resolve appeals based on the requirements of the Bank Act and part 933, within 90 calendar days of the date the appeal is filed with the Finance Board, after considering the record for appeal described in § 933.5(c). When it decides an appeal, the Finance Board must follow the presumptions in part 933, unless the appellant or appellee Bank presents compelling evidence to rebut a

presumption. The current Guidelines do not include any provision for appeals.

B. Membership Eligibility Requirements

1. Setting Membership Standards

Like the current Guidelines, the proposed rule establishes objective standards for approving applications for Bank membership. The standard for each of the two objective statutory membership eligibility criteria and each of the four subjective statutory membership eligibility criteria are discussed below. For the objective statutory eligibility criteria, failure to comply with the standards established by the proposed rule will render an applicant ineligible for membership.

For the subjective statutory eligibility criteria, including the requirement that an applicant's financial condition be such that advances may be safely made, *id.* § 1424(a)(2)(B), and that the character of an applicant's management and its home financing policy be consistent with sound and economical home financing, *id.* § 1424(a)(2)(C), the proposed rule, like the Guidelines, establishes objective, yet flexible, standards.

The proposed rule establishes the presumption that if an applicant complies with the regulatory standards, it will be deemed to satisfy the statutory criteria; conversely, if an applicant does not meet the regulatory standards, it will be presumed, subject to rebuttal, not to satisfy the statutory eligibility criteria. The proposed rule, like the Guidelines, does allow an applicant to rebut any negative presumption, by presenting additional information.

The Finance Board considered establishing more rigid "bright-line" standards, but believed that the results—i.e., that an applicant not meeting every standard would be ineligible for membership, regardless of any other evidence the applicant could have presented to demonstrate its compliance with the statutory eligibility criteria—would be too harsh. "Bright-line" tests eliminate all discretion in the approval process. The Finance Board specifically requests comment on whether the membership eligibility standards should be adopted as "bright-line" tests or as presumptions.

2. General Eligibility Requirements

Section 4(a)(1) of the Bank Act defines the types of financial institutions eligible to become Bank members as any building and loan association, savings and loan association, cooperative bank, homestead association, insurance company, savings bank, or any insured depository institution. *Id.* § 1424(a)(1).

The definition of insured depository institution in the Bank Act includes commercial banks and credit unions. *Id.* § 1422(12).

The eligibility criteria set forth in section 4(a)(1) of the Bank Act apply to all applicants for Bank membership. Under section 4(a)(1) of the Bank Act, an institution is eligible for Bank membership if the institution:

(A) Is duly organized under the laws of any State or of the United States;

(B) Is subject to inspection and regulation under the banking laws, or under similar laws, of the State or of the United States; and

(C) Makes such home mortgage loans as, in the judgment of the [Finance] Board, are long-term loans * * *.

Id. § 1424(a)(1).

Section 4(a)(2) of the Bank Act establishes the following membership eligibility criteria for "insured depository institutions" that were not Bank members on January 1, 1989 (section 4(a)(2) criteria):

(A) The insured depository institution has at least 10 percent of its total assets in residential mortgage loans;

(B) The insured depository institution's financial condition is such that advances may be safely made to such institution; and

(C) The character of its management and its home-financing policy are consistent with sound and economical home financing.

Id. § 1424(a)(2). Although the section 4(a)(2) criteria apply only to "insured depository institutions," the Finance Board has determined to extend that requirement to insurance company applicants.

Sections 933.10 through 933.13 of the proposed rule apply the section 4(a)(2) criteria to insured depository institution applicants. Section 933.16 of the proposed rule applies these criteria to insurance company and all other applicants. Under the Finance Board's current membership regulation, the financial condition criterion, section 4(a)(2)(B), and the character of management and home financing policy requirement, section 4(a)(2)(C), *id.* § 1424(a)(2)(B), (C), apply to every applicant. See 12 CFR 933.4(a)(4), (5). In addition, prior to the enactment of FIRREA in 1989, the financial condition, character of management and home financing policy criteria were applicable to insurance companies. See 47 Stat. 726 (July 22, 1932). The proposed rule would maintain the current law requirements, and would extend the section 4(a)(2)(A) 10 percent requirement to all applicants. The reasons for this approach are explained more fully below in the discussion of the 10 percent requirement.

3. Duly Organized Requirement

Section 4(a)(1)(A) of the Bank Act provides that an institution is eligible for Bank membership if it is duly organized under the laws of any State or of the United States. Under § 933.7 of the proposed rule, an applicant is deemed to be duly organized as required by section 4(a)(1)(A) of the Bank Act and § 933.6(a)(1) of this part, if the applicant establishes that it is chartered by a state or federal agency as a building and loan association, savings association, cooperative bank, homestead association, insurance company, savings bank or insured depository institution. If an applicant does not satisfy this requirement, the applicant is ineligible for membership. This standard is consistent with the current Guidelines.

4. Subject to Inspection and Regulation Requirement

Section 4(a)(1)(B) of the Bank Act provides that an institution is eligible for Bank membership if it is subject to inspection and regulation under the banking laws, or under similar laws, of any State or of the United States. Under § 933.8 of the proposed rule, an applicant is deemed to meet the inspection and regulation requirement if the applicant can establish that it is subject to inspection and regulation by the Federal Deposit Insurance Corporation, the Federal Reserve Board, the National Credit Union Administration, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, a state insurance commissioner, or other state regulatory agency authorized to regulate depository institutions or insurance companies. If an applicant does not satisfy this requirement, the applicant is ineligible for membership. This standard is consistent with the current Guidelines.

5. Makes Long-Term Home Mortgage Loans Requirement

Section 4(a)(1)(C) of the Bank Act provides that an institution is eligible for Bank membership if it makes such "home mortgage loans" as, in the judgment of the Finance Board, are long-term home mortgage loans. Under § 933.9(a) of the proposed rule, an applicant is deemed to meet this requirement if it originates or purchases "long-term" "home mortgage loans," as those terms are defined in the regulation. If an applicant does not satisfy this requirement, the applicant is ineligible for membership, unless the Finance Board, in its sole discretion, determines on the basis of additional information supplied by the applicant

or otherwise, that the applicant does satisfy the requirement. This standard is consistent with the current Guidelines.

The proposed rule makes one change to the current definition of "home mortgage loan" at 12 CFR 933.1(j). A "home mortgage loan" is defined in the Bank Act as a loan made by a member upon the security of a "home mortgage." 12 U.S.C. 1422(5). The Bank Act defines a "home mortgage" as a mortgage on real estate upon which is located one or more homes or other dwelling units, "all of which may be defined by the Board," including "first mortgages" and such classes of "first liens" as are commonly given to secure advances on real estate. Id. § 1422(6). Based on the Bank Act definition, a "home mortgage loan" essentially is a loan secured by a first mortgage on real property with one or more structures designed primarily for residential use.

The definition of "home mortgage loan," in § 933.1(m) of the proposed rule, includes:

a. A domestic loan, whether or not fully amortizing, or an interest in such a loan, which is secured by a mortgage, deed of trust or other security agreement that creates a first lien on one of the following interest in property:

(1) One-to-four family property or multifamily property, in fee simple;

(2) A leasehold on one-to-four family property or multifamily property under a lease of not less than 99 years which is renewable or under a lease having a period of not less than 50 years to run from the date the mortgage was executed; or

(3) Combination business or farm property where at least 50 percent of the total appraised value of the combined property is attributable to the residential portion of the property; or

b. A mortgage pass-through security that represents an undivided ownership interest in:

(1) Long-term loans, provided that, at the time of issuance of the security, all of the loans meet the requirements of this section; or

(2) A security that represents an undivided ownership interest in long-term loans, provided that, at the time of issuance of the security, all of the loans meet the requirements of this definition.

The Finance Board has deleted the provision allowing it to include additional items within this definition. Instead, § 933.9(b) of the proposed rule allows the Finance Board the discretion to determine on appeal in appropriate cases that an applicant satisfies the long-term home mortgage loans requirement in section 4(a)(1)(C) of the Bank Act, even though the applicant does not make long-term home mortgage

loans as the terms "long-term" and "home mortgage loan" are defined in § 933.1(m) and (q) of the proposed rule.

Section 933.1(i) of the proposed rule adds a definition for "domestic loan." A domestic loan is defined as a loan on property located in a state or the United States.

Section 933.1(q) of the proposed rule revises the definition of "long-term" at current 12 CFR 933.1(l) to delete the provision allowing the Board to change this definition without engaging in rulemaking.

Section 4(a)(1)(C) of the Bank Act provides that an institution is eligible for Bank membership if it "makes" such home mortgage loans as, in the judgment of the Finance Board, are long-term loans. 12 U.S.C. 1424(a)(1)(C). Thus, it is necessary to determine what constitutes "making" a home mortgage loan. Both the Finance Board and the FHLBB have interpreted "makes" to include originating and purchasing qualifying loans and purchasing mortgage pass-through securities backed by qualifying loans. Section 933.9 of the proposed rule does not change the substance of the current Finance Board regulation, 12 CFR 933.4(a)(3), which includes all such transactions within the scope of the "makes" requirement.

6. Ten Percent Residential Mortgage Loans Requirement

Section 4(a)(2)(A) of the Bank Act provides that an insured depository institution is eligible for Bank membership if it has at least 10 percent of its total assets in residential mortgage loans. Under § 933.10(a) an applicant is deemed to comply with the 10 percent requirement in section 4(a)(2)(A) of the Bank Act if the applicant has at least 10 percent of its total assets in "residential mortgage loans" as defined in § 933.1(aa) of the proposed rule. Since mortgage debt securities count toward satisfaction of the 10 percent requirement, the proposed rule, like the current regulation, excludes the assets used to secure mortgage debt securities in determining whether the applicant has 10 percent of its assets in residential mortgage loans. Under § 933.10(b), if an applicant does not satisfy the requirement of this section, the applicant is ineligible for membership, unless the Finance Board, in its sole discretion, determines on the basis of additional information supplied by the applicant or otherwise that the applicant satisfies the requirements of section 4(a)(2)(A) of the Bank Act. Once approved, an institution is not required to maintain a 10 percent residential mortgage loan ratio to retain Bank membership.

The Finance Board is considering whether to extend the 10 percent test or another specific asset test to insurance company applicants similar to the 10 percent test that applies to insured depository institution applicants. This would represent a change from the current Finance Board regulation, which requires applicants that are not insured depository institutions to have "mortgage-related assets that reflect a commitment to housing finance, as determined by the [Finance] Board." 12 CFR 933.4(c). Noninsured depository institution applicants are not currently required to meet the 10 percent requirement, nor does there exist in the current regulation any objective standard to meet this requirement. 12 CFR 933.4 (b) and (c). The Finance Board realizes that, even though an insurance company may be one of the largest mortgage loan investors in its state, it might not be able to meet the 10 percent test because the dollar amount of residential mortgage loan assets it holds, when compared to the total assets of the company, could constitute less than 10 percent of the company's total assets. However, the Finance Board also sees value in applying consistent membership eligibility standards to all applicants to ensure that all Bank members demonstrate a quantifiable minimum commitment to residential housing finance before they are admitted to membership.

The Finance Board also is considering continuing the status quo by applying the 10 percent requirement only to depository institution applicants. The proposed rule continues this approach and does not specifically require that insurance companies have 10 percent of their assets in residential mortgage loans. The Finance Board requests comment on whether the 10 percent requirement should apply to insurance company applicants and whether a different test that would achieve the same objectives as the 10 percent test should be applied to insurance company applicants, and if so, what that test should be.

a. Definition of "residential mortgage loans."

To implement the Bank Act's 10 percent requirement, § 933.10 of the proposed rule provides that an applicant is eligible for membership if it has at least 10 percent of its total assets in "residential mortgage loans." The term "residential mortgage loans" is not defined in the Bank Act. The definition of "residential mortgage loans" in § 933.1(aa) of the proposed rule includes the current definition, see 12 CFR 933.1(r), and additional loans the Finance Board has decided to add to the

definition or is considering adding to the definition.

The definition of "residential mortgage loans" in § 933.1(aa) of the proposed rule, includes any one of the following types of domestic loans, whether or not fully amortizing:

- (1) Home mortgage loans;
- (2) Funded residential construction loans;
- (3) Loans secured by manufactured housing whether or not defined by state law as secured by an interest in real property;
- (4) Loans secured by junior liens on one-to-four family property or multifamily property;
- (5) Qualified private activity exempt facility bonds where 95 percent or more of the net proceeds are used for the construction of qualified residential rental projects as defined in 26 U.S.C. 142(a)(7).
- (6) Mortgage pass-through securities representing an undivided ownership interest in:
 - (i) Loans that meet the requirements of this definition at the time of issuance of the security;
 - (ii) Securities representing an undivided ownership interest in loans, provided that, at the time of issuance of the security, all of the loans meet the requirements of this definition; or
 - (iii) Mortgage debt securities as defined herein;
- (7) Mortgage debt securities secured by:
 - (i) Loans, provided that, at the time of issuance of the security, all of the loans meet the requirements of this definition;
 - (ii) Securities that meet the requirements of this definition; or
 - (iii) Securities secured by assets, provided that, at the time of issuance of the security, all of the assets meet the requirements of this definition; or
- (8) Home mortgage loans secured by leasehold interests, as defined in § 933.1(m)(1)(ii) of the proposed rule, except that the period of the lease term may be for any duration.

The Finance Board proposes to add qualified private activity exempt facility bonds where 95 percent or more of the net proceeds are used for the construction of qualified residential rental property as defined in 26 U.S.C. 142(a)(7). The Internal Revenue Code (IRC) excludes the income from these bonds from a taxpayer's gross income, when used to construct qualified residential rental property. See 26 U.S.C. 103, 141(e)(1)(A), 142(a)(7). To be "qualified" under the IRC, a multifamily residential rental project must meet one of two tests to ensure that it serves moderate- or low-income tenants:

- (1) 20–50 test. Twenty percent or more of the units occupied by

individuals whose income is 50 percent or less of the area median income; or

(2) 40–60 test. Forty percent or more of the units are occupied by individuals whose income is 60 percent or less of the area median income. 26 U.S.C. 142(d). The Finance Board has determined that such bonds are consistent with other instruments that are treated as "residential mortgage loans." Further, treating such bonds as "residential mortgage loans" is consistent with the purpose of the 10 percent requirement, to ensure that new members hold at least 10 percent of their assets in instruments that facilitate home mortgage lending.

The Finance Board also is considering including within the definition of "residential mortgage loans" shares of open-end management companies, also known as "mutual funds," where the assets in the open-end management company's portfolio are comprised solely of instruments that are "residential mortgage loans."

The Finance Board has deleted the provision allowing it to include additional items within the definition of residential mortgage loans. Instead, § 933.10(b) of the proposed rule allows the Finance Board the discretion to determine on appeal in appropriate cases that the applicant has 10 percent of its assets in "residential mortgage loans" as required by section 4(a)(2)(A) of the Bank Act, even though the applicant does not have 10 percent of its assets in "residential mortgage loans" as that term is defined in § 933.1(aa) of the proposed rule.

The Finance Board specifically requests comment on how it should define "residential mortgage loans" in the final rule.

b. Definition of "total assets."
Section 4(a)(2)(a) of the Bank Act and § 933.10 of the proposed rule provide that an applicant is eligible for membership if it has at least 10 percent of its "total assets" in residential mortgage loans. Section 933.1(cc) of the proposed rule adds a definition of "total assets" that includes all assets of a financial institution's consolidated subsidiaries located in a state or the United States, and all assets otherwise required to be reported on a regulatory financial report. Applicants will use this definition of total assets to determine whether they comply with the 10 percent requirement.

7. Financial Condition Requirement

Section 4(a)(2)(B) of the Bank Act requires that, in order to be eligible for Bank membership, an insured depository institution's financial condition must be such that advances

may be safely made to it. 12 U.S.C. 1424(a)(2)(B). Section 933.11 of the proposed rule implements this requirement and applies it to all applicants for membership, including applicants (such as insurance companies) that are not insured depository institutions. However, as discussed below, § 933.16 of the proposed rule establishes financial condition standards for insurance companies that recognize the specialized nature of the insurance business. Section 933.11 of the proposed rule is modeled on the current Guidelines.

a. Review requirement.

Section 933.11(a) of the proposed rule, like the current Guidelines, sets forth the documents pertaining to financial condition that must be reviewed for each applicant. These documents include:

- (1) The regulatory financial reports for at least the last six calendar quarters and three year-ends;
- (2) The most recent annual audited financial statement, or if unavailable, any other such independent external annual financial report as the applicant's primary regulator may require, or if unavailable, such financial statements as the applicant may otherwise have available;
- (3) The most recent available regulatory examination report, a summary of the applicant's strengths and weaknesses as cited in the examination report, and a summary of actions taken by the applicant to respond to examination weaknesses;
- (4) A description of any outstanding enforcement actions, responses by the applicant and reports as required by the enforcement action; and
- (5) Any other relevant information that comes to the Bank's attention or reasonably should come to the Bank's attention in reviewing the applicant's financial condition.

The final review requirement, that a Bank consider other relevant information that comes to its attention or reasonably should come to its attention in reviewing the applicant's financial condition, is intended to incorporate a due diligence concept into the membership approval process. For example, if the Bank were to receive information through the media or other sources that is inconsistent with the information supplied by the applicant, the Bank should evaluate the reliability of the alternative source. The Finance Board does not intend to hold the Banks accountable for finding information that might have been discovered only through extraordinary means, but the Finance Board does expect the Banks to

make reasonable efforts to find information relevant to an applicant's financial condition.

b. Standards of adequate "financial condition."

The Bank Act does not define the term "financial condition" for purposes of membership, except that financial condition must be "such that advances may be safely made." 12 U.S.C. 1424(a)(2)(B). The Finance Board believes that specific, uniform and quantifiable standards for evaluating financial condition are necessary to ensure that Bank funding may be extended in a safe and sound manner. For applicants other than insurance companies, § 933.11(b) enumerates those factors to be reviewed. Because of the special nature of insurance companies, the Finance Board is proposing a separate section, § 933.16 discussed below, to establish the minimum standards for evaluating the financial condition of insurance company applicants.

Section 933.11(b) of the proposed rule establishes a standard for adequate financial condition similar to the interpretation of the term "financial condition" in the current Guidelines and Finance Board practice. An applicant that complies with the standard is presumed to be in adequate financial condition for purposes of section 4 of the Bank Act. This presumption is rebuttable if the Bank obtains information to the contrary. Under § 933.11(b), an applicant is presumed to be in adequate financial condition if:

- (1) The applicant received a composite regulatory examination rating by its primary regulator within two years from the date of the application. The Finance Board requires that the applicant be examined within two years of the date of the application to ensure the accuracy of critical information used for eligibility determinations. Federal and state examiners typically examine regulated entities at least every two years.
- (2) The applicant meets all of its minimum statutory and regulatory capital requirements as reported in its most recent quarter-end regulatory financial report filed with its primary regulator. This provision, modeled on the current Guidelines, supports the other banking regulators' efforts to ensure the safety and soundness of the industry by recognizing the importance of capital adequacy and compliance with statutory and regulatory minimum capital standards.

(3) The applicant's most recent composite regulatory examination rating was "1," or was "2" or "3" and the

applicant also satisfies certain performance trend criteria.

The term "regulatory examination rating" is defined in § 933.1(y) of the proposed rule, as a rating of capital, assets, management, earnings and liquidity following the guidelines of the Uniform Financial Institutions Rating System contained in a written report of examination conducted by the applicant's appropriate regulator, including a CAMEL rating, a MACRO rating or other similar ratings. The composite regulatory examination rating for an insured depository institution is determined according to the Uniform Financial Institutions Rating System (CAMEL, MACRO or equivalent scale). This rating system is based on an evaluation of the five critical dimensions of an institution's operations that reflect, in a comprehensive fashion, an institution's financial condition, compliance with banking statutes and regulations, and overall operating soundness. A composite regulatory examination rating of "1" is the highest possible rating on a 5 point scale. A "5" rating is assigned to institutions that require immediate corrective action and constant supervisory attention. The probability of failure for "5" rated institutions is high.

The importance of the composite regulatory examination rating in the membership approval process may be illustrated in the breakdown of the ratings assigned to applicants approved by the Finance Board since FIRREA—all but one institution approved for membership have been rated "1," "2" or "3"; the single "4" rated institution approved for membership has since been upgraded. No "5" rated institutions have been approved for membership.

Using the Uniform Financial Institutions Rating System to evaluate membership applicants reduces the documentation requirements for applicants, limits the potential for the Banks to be perceived by applicants as another layer in the financial regulatory structure, adds considerable efficiency to the application process and provides an independent assessment by those responsible for the soundness of the entity. The Uniform Financial Institutions Rating System is not used to evaluate insurance company applicants.

Under the proposed rule, an applicant with a recent composite regulatory examination rating of "1" meets the minimum performance standard in § 933.11(b)(3). A composite regulatory examination rating of "2" or "3" may be an acceptable performance standard under § 933.11(b)(3) if the applicant also meets additional performance trend

thresholds. These thresholds are designed to identify trends in the institution's key performance areas by reviewing six calendar quarters of financial data. The performance trend measures include: (1) positive earnings in 4 of the 6 most recent calendar quarters, (2) nonperforming assets not exceeding 10 percent of the applicant's total assets in the most recent calendar quarter, and (3) a ratio of loan loss reserves to nonperforming assets of 60 percent or greater during 4 of the 6 most recent calendar quarters. These performance trends are in the current Guidelines. The Finance Board also is considering setting the performance trend for nonperforming assets at eight percent of the applicant's total assets in the most recent calendar quarter and specifically requests comment on this alternative.

The term "nonperforming assets" is defined in § 933.1(u) of the proposed rule as the sum of loans and leases reported on a regulatory financial report that have been past due for 90 days or longer; loans and leases on a nonaccrual basis; restructured loans and leases (not already reported as nonperforming); and foreclosed real estate, except that nonperforming assets shall be as defined by the National Credit Union Administration (NCUA) for credit union applicants. The Finance Board is considering substituting a specific list of assets that the NCUA would regard as nonperforming assets for a credit union. The term "loan loss reserves" is defined in § 933.1(p) of the proposed rule as a specified balance sheet account held to fund potential losses on loans or leases. The Finance Board requests comment on all aspects of the standard for adequate financial condition.

The Finance Board has designed the proposed rule to ensure that no single measure of financial condition is determinative. An applicant with a regulatory examination rating of "1" may not have an adequate financial condition if the Bank uncovers compelling evidence to the contrary, as described below in the discussion of § 933.17 of the proposed rule. Similarly, an applicant with a low regulatory examination rating could be admitted to membership if the applicant demonstrates other compelling evidence of an adequate financial condition. The Finance Board encourages all financial institutions interested in home mortgage lending to apply for Bank membership.

The performance trend thresholds in § 933.11(b)(3) measure financial performance based on quarterly financial data. However, § 933.11(b)(3)(iv) provides that applicants that are not required to report

financial data on a quarterly basis to their primary regulator may report the information required in § 933.11(b)(3)(i)-(iii) on a semiannual basis.

c. Eligible collateral not considered.

The Bank Act requires that an institution have a "financial condition such that advances may be safely made." 12 U.S.C. 1424(a)(2)(B). The Finance Board considered interpreting the Bank Act to presume that any applicant with "eligible collateral" would meet the financial condition requirement of section 4(a)(2)(B) of the Bank Act. However, since the Finance Board seeks to avoid having the Banks become lenders of last resort to failing or weak institutions, the Finance Board has determined that a minimum level of financial analysis should be required for all applicants as a prerequisite to membership. Section 933.11(c) of the proposed rule states that the availability of sufficient eligible collateral to secure advances to the applicant is presumed and will not be considered in determining whether an applicant meets the financial condition criteria required by section 933.6(a)(5).

The Finance Board seeks public comment on whether the financial condition standards incorporated in the proposed rule or other performance trends or measures of financial condition should be incorporated in the final regulation.

8. Character of Management Requirement

Section 4(a)(2)(C) of the Bank Act requires that the "character" of an applicant's management be "consistent with sound and economical home financing." 12 U.S.C. 1424(a)(2)(C).

a. *Review requirement.* Section 933.12 of the proposed rule sets out the review requirement and the standards to be used to determine whether an applicant may be presumed to have the character of management required by the Bank Act and § 933.6(a)(6) of this part. Section 933.12(a) requires the Bank to review the following to evaluate an applicant's character of management:

- (1) The names of directors and senior officers;
- (2) The most recent regulatory financial report;
- (3) The most recent audited financial statement, or if unavailable, other such independent external financial report that the applicant's primary regulator may require, or if unavailable, such financial statements that the applicant may otherwise have available;
- (4) Enforcement actions;
- (5) Certain pending criminal, civil or administrative matters;

(6) Information concerning potential monetary liabilities, material pending law suits or unsatisfied judgments; and

(7) Any other document that comes to the Bank's attention or reasonably should come to the Bank's attention in reviewing the applicant's character of management.

The term "enforcement action" is defined in § 933.1(k) of the proposed rule as any written notice, directive, order or agreement initiated by an applicant or its appropriate regulator to address any operational, financial, managerial or other deficiencies of the applicant identified by the appropriate regulator. "Appropriate regulator" is defined in § 933.1(e) of the proposed rule and includes the applicant's primary regulator and any officer, agency, supervisor or other entity that has regulatory authority over, or is empowered to institute enforcement action against, an applicant.

As explained above in the discussion of the financial condition review requirement, the Finance Board realizes that § 933.12(a)(7) makes the Bank responsible for determining what additional documents it should review to evaluate an applicant's character of management. The Banks will have to make this determination on a case-by-case basis. The Finance Board expects the Banks to exercise due diligence, but does not expect the Banks to take extraordinary measures or incur great expense to comply with this review requirement. For example, in the past, several Banks have performed computer database searches to verify that an applicant was making full disclosure of potential character of management issues. The Finance Board cites this practice as one relatively quick and inexpensive means by which a Bank may verify character of management.

b. *Standards of adequate "Character of Management."*

Section 933.12(b) of the proposed rule establishes the character of management standards. An applicant that meets these standards is deemed to have the character of management required by the Bank Act and § 933.6(a)(6) of this part. This presumption is rebuttable. The elements of the character of management standard are that:

- (1) Neither the applicant nor any of its directors or senior officers is subject to or operating under any enforcement action instituted by an appropriate regulator;
- (2) Neither the applicant nor any of its directors or senior officers has been the subject of criminal, civil or administrative proceedings reflecting upon creditworthiness, business

judgment or moral turpitude since the most recent examination;

(3) There are no known or potential civil, criminal, or administrative monetary liabilities, material pending law suits or unsatisfied judgments against the applicant, its directors or senior officers since the most recent examination; and

(4) The applicant provides the written certification required in § 933.12(c), described below.

An applicant that does not meet the character of management standards can still be considered for membership as provided in § 933.17 of the proposed rule, if the applicant presents a sufficient explanation of its failure to meet the character of management standards. The character of management standards in the proposed rule are based on the current Guidelines.

c. Written certification.

Section 933.12(c) of the proposed rule requires a written certification either by a majority of the board of directors of the applicant, or by an individual with authority to act on behalf of the board of directors of the applicant, concerning the character of management standards described above. An applicant must provide either an unqualified certification that there are no enforcement actions, objectionable proceedings, or objectionable liabilities, or, if that is not possible, the applicant must provide a qualified certification that includes a detailed explanation regarding any exceptions noted. An applicant that provides a qualified certification is presumed not to have the character of management required by the Bank Act and § 933.6(a)(6) of this part, but this presumption may be rebutted.

The Finance Board is continuing the current policy of applying the character of management requirements in § 933.12 to all applicants, rather than just insured depository institution applicants.

The Finance Board has found the written certification to be the best way to surface any character of management issues, and to get an explanation of those issues because the burden of disclosure is placed on the applicant. The Finance Board requests public comment on the character of management review requirement and standards incorporated in the proposed rule, including alternative character of management measures that should be considered for the final regulation.

9. Home Financing Policy Requirement

Section 4(a)(2)(C) of the Bank Act also requires that an applicant's home financing policy be "consistent with

sound and economical home financing." 12 U.S.C. 1424(a)(2)(C).

Section 933.13(a) of the proposed rule establishes the standards a Bank must use to evaluate an applicant's home financing policy. If an applicant meets the standards, the applicant is deemed to comply with the home financing policy requirement of section 4(a)(2)(C) of the Bank Act and § 933.6(a)(7) of this part. This presumption is rebuttable. Section 933.13(a) of the proposed rule is based on the home financing policy standards in the Guidelines.

Under § 933.13(a), an applicant that has been evaluated for Community Reinvestment Act (CRA) performance within four years from the date of application and has received a CRA rating of "satisfactory" or better on its most recent compliance examination, is presumed to meet the home financing policy requirement.

Section 933.13(b) requires an applicant that is not subject to the CRA, or an applicant that received a "needs to improve" rating on its most recent CRA performance evaluation but received a "satisfactory" or better rating on its prior CRA performance evaluation, to file as part of its application a written justification that demonstrates how and why the applicant's credit policies and lending practices (if applicable) are consistent with the Bank System's housing finance mission.

The Finance Board acknowledges that CRA is not a perfect method for evaluating whether an institution's home financing policy is "consistent with sound and economical home financing." CRA evaluations are based on whether a financial institution meets the credit needs of its assessment area, rather than on its mortgage lending activity. See 60 FR 22180 (May 4, 1995) to be codified at 12 CFR 25.22. Further, CRA does not consider whether a financial institution's home financing policy is "sound and economical." *Id.* The Finance Board seeks comment on the use of CRA as a proxy for the home financing policy criterion and suggestions for alternative measures that the Finance Board might consider.

Since neither the Congress nor the Finance Board have yet specifically defined the Bank System's housing finance mission, the Finance Board also acknowledges limitations in requesting a written justification demonstrating how and why an applicant's policies are consistent with the Bank System's housing finance mission. The Finance Board requests comment on how institutions might best provide the requisite justification.

The Finance Board is continuing its current policy of applying the home financing policy requirements in § 933.17 to all applicants. Currently, to determine whether an insurance company applicant's home-financing policy is adequate, the Guidelines require that the applicant provide evidence that the applicant engages in, or intends to engage in, various housing related activities. Under the proposed rule, an insurance company will be subject to the same requirements as all other applicants.

An applicant that does not comply with the home financing policy standard may still be considered for membership if the applicant can rebut the presumption that it does not have an adequate home financing policy, as provided in § 933.17 of the proposed rule.

The Finance Board requests comment on the home financing policy standards in the proposed rule and on alternative measures of the adequacy of an applicant's home financing policy that should be considered for the final regulation.

10. De Novo Insured Depository Institution Applicants

Section 933.14 of the proposed rule codifies certain exceptions to the membership eligibility standards for de novo or newly chartered insured depository institution applicants that are currently in the Guidelines. An insured depository institution applicant that provides to a Bank written confirmation from its primary regulator that it has been chartered for less than three years or is otherwise considered a de novo insured depository institution by the applicant's primary regulator will receive special consideration for membership eligibility.

Under § 933.14(a)(1), a de novo applicant that has not filed regulatory financial reports for the last six quarters and three year-ends shall provide any such regulatory financial reports as the applicant has filed. Under § 933.14(a)(2), a de novo applicant shall provide its most recent annual audited financial statement, or if unavailable, other such independent external annual financial report as the applicant's primary regulator may require, or if unavailable, a de novo applicant shall, at a minimum, provide financial reports for at least six calendar quarters of operation.

Section 933.14(a)(3) of the proposed rule provides that if a de novo applicant has not yet received a composite regulatory examination rating from its primary regulator, the applicant shall provide a preliminary or informal

written regulatory examination rating from the applicant's primary regulator, if a preliminary or informal rating is acceptable to the Bank. Under § 933.14(a)(4) of the proposed rule, a de novo applicant need not meet the performance trend criteria in § 933.11(b)(3)(i)–(iii) of the proposed rule, if the de novo applicant has completed regulatory financial reports for at least six full quarters of operation and has complied with its regulatory business plan, either as confirmed in writing by the de novo applicant's primary regulator or based on a written analysis provided by the applicant that demonstrates its substantial compliance with its regulatory business plan as determined by the Bank.

Section 4(a)(2) of the Bank Act makes a special exception to the 10 percent requirement for de novo insured depository institution applicants. The Bank Act specifically provides that a de novo applicant may be admitted to membership if it complies with the 10 percent requirement within 1 year after commencement of its operations. See 12 U.S.C. § 1424(a)(2). The proposed rule continues the practice in current Guidelines requiring that applicants, other than mandatory members, must provide financial reports for at least six calendar quarters of operation in order for the Bank to evaluate the applicant's financial condition. Therefore, most de novo applicants already will have been in operation for more than one year at the time of application. However, the provision in section 4(a)(2) of the Bank Act currently applies and, under the proposed rule, will continue to apply during the first year of operation of a de novo applicant that is required by law to be a member and is automatically admitted to membership without satisfying the 10 percent requirement pursuant to § 933.4(a) of the proposed rule.

Under § 933.14(b) of the proposed rule, the Bank may presume that a de novo applicant that has not yet received a CRA performance evaluation has a home financing policy as required by section 4(a)(2)(C) of the Bank Act and § 933.6(a)(7), if the Bank's digest establishes that the de novo applicant has a preliminary or informal written CRA performance evaluation of "satisfactory" or better. Alternatively, the Bank may presume compliance with the home financing policy requirement if the Bank's digest establishes that the de novo applicant has submitted a written justification acceptable to the Bank of how the applicant intends to support the Bank System's housing finance mission. The Guidelines are

consistent with the approach taken in the proposed rule.

11. Recent and Pending Merger Applicants

The Finance Board, based on its general supervisory authority over the Banks, 12 U.S.C. 1422a, 1422b(a)(1), and its authority to interpret the statutory membership eligibility requirements, *id.* § 1424, proposes special standards for applicants involved in a recent or pending merger to ensure that the information evaluated to determine eligibility is appropriate for the entity that results from the merger. Standards for recent and pending merger applicants are not provided in the Bank Act.

Section 933.15 of the proposed rule largely codifies the special eligibility requirements that recent and pending merger applicants must satisfy under the current Guidelines, in addition to or in place of the previously described eligibility requirements. To be considered a "pending merger applicant" or a "recent merger applicant," an applicant must meet two tests, a timing test and a materiality test defined in § 933.15(a) of the proposed rule. For "pending merger applicants," the timing test is whether the applicant is a party to a merger or acquisition agreement that is expected to be consummated within two calendar quarters of submission of the membership application. The materiality test is whether the applicant accounts for 75 percent or less of the combined assets of the resulting entity at the time of application.

For "recent merger applicants," the timing test is whether the applicant has merged with or acquired another institution within the six calendar quarters prior to submission of the membership application. The materiality test is whether the applicant accounts for 75 percent or less of the combined assets of the resulting entity at the time of application.

Section 933.15(b) of the proposed rule establishes an additional review requirement that a Bank shall include in its digest for each recent or pending merger applicant. The general information required includes: (1) The name of each entity involved and its charter type; (2) a general statement of the financial condition of each entity; (3) a brief statement of the business reasons for the merger or acquisition; and (4) the names and positions of management of the resulting entity.

Section 933.15(c) of the proposed rule establishes the special membership eligibility standards for recent and pending merger applicants. A recent or

pending merger applicant shall be deemed to be in compliance with section 4(a) of the Bank Act and § 933.6(a) of the proposed rule, subject to rebuttal, only if the recent or pending merger applicant satisfies the requirements of part 933 as modified and supplemented by § 933.15(c). Section 933.15(c)(1) establishes the financial condition standard for a recent merger applicant. For recent merger applicants that do not yet have a composite regulatory examination rating subsequent to the merger or acquisition, each party (other than existing Bank members) to the merger or acquisition must satisfy the recent examination requirement, the capital requirements and the minimum performance standards in § 933.11(b). Section 933.15(c)(1)(A) of the proposed rule provides that, to the extent a recent merger applicant does not yet have regulatory financial reports for the six most recent calendar quarters needed to calculate performance trends, the applicant must prepare pro forma combined financial statements for those calendar quarters in which actual combined regulatory financial reports are unavailable.

Section 933.15(c)(2) establishes the financial condition standard for a pending merger applicant. Since a pending merger has by definition not been consummated, the applicant cannot provide a composite regulatory examination rating for the combined entity as required by § 933.11(b)(1). In lieu of that, each party to the merger or acquisition, except an incumbent Bank member, is required by § 933.15(c)(2)(A) of the proposed rule to satisfy all of the requirements of § 933.11(b).

Section 933.15(c)(2)(B) of the proposed rule requires that in addition to each party to a pending merger individually satisfying all of the financial condition standards in § 933.11(b), the pending merger applicant must satisfy the capital requirements and the performance trend requirements in § 933.11(b)(2) and (3) as a combined entity based on pro forma combined financial statements to be prepared by the applicant for the six most recent calendar quarters.

Section 933.15(c)(3) provides that the determination of the character of management of a recent or pending merger applicant for purposes of § 933.12 of the proposed rule shall be based on an evaluation of the directors and senior officers of the resulting entity. Section 933.15(c)(4) provides that for a pending merger applicant or for a recent merger applicant that does not yet have a CRA performance evaluation on a combined basis for the

merged entity, the determination of whether the merger applicant's home financing policy satisfies the requirements of § 933.13 shall be based on a review of the most recent CRA performance evaluation available for each party to the merger or acquisition.

12. Insurance Company Applicants

To become a Bank member, the Bank Act requires that an insurance company applicant meet the membership eligibility requirements set forth in section 4(a)(1) of the Bank Act. See 12 U.S.C. 1424(a)(1)(A)–(C); § 933.6(a)(1), (2) and (3) of the proposed rule, discussed in part II(B) above. For the reasons discussed in part II(B)(6) above, the Finance Board proposes to apply the section 4(a)(2) criteria to all applicants for Bank membership, including insurance company applicants, even though the Bank Act specifically applies the section 4(a)(2) criteria only to insured depository institution applicants. See 12 U.S.C. 1424(a)(2).

a. Inspection and regulation.

Insurance companies are subject to state, not federal, regulation and, therefore, the standards applicable to insurance companies are not uniform. Every United States insurance company is subject to examination and regulation by the state insurance department in its domiciliary state, as well as to some level of regulation by the state insurance department in each state where the insurance company applicant is licensed to do business. State insurance laws are similar to federal banking laws in that they require the appropriate regulator to monitor whether the insurance company has complied with minimum capital and reserve, financial condition, asset valuation and various consumer related requirements.

The standards used to examine and regulate insurance companies vary from state to state. Some states adhere to the uniform standards established by the National Association of Insurance Commissioners (NAIC), while other states either do not conduct examinations of insurance companies pursuant to the NAIC standards or do not conduct on-site examinations. Thus, there is no single objective measurement applicable to all insurance companies. The Finance Board specifically requests comment on whether the degree of inspection and regulation imposed by a particular state should be a factor in determining whether an insurance company applicant satisfies the "inspection and regulation" requirement. For example, the Finance Board seeks comment on whether it should require that an insurance company applicant be regulated and

examined by an NAIC accredited state insurance commissioner in order to satisfy the "inspection and regulation" requirement.

b. Financial condition.

The differences between the regulatory scheme for insurance companies and the regulatory scheme for insured depository institutions has led the Finance Board to propose a separate set of financial condition standards for insurance company applicants. Section 933.16 of the proposed rule establishes financial condition standards for insurance company applicants that differ from the financial condition standards applicable to other applicants under § 933.11.

Section 933.16(a) of the proposed rule defines certain terms that are used only in this section.

Section 933.16(b) of the proposed rule establishes performance standards for insurance company applicants.

(1) Examination rating and independent rating.

Section 933.16(b)(1) requires the Bank to review the most recent examination report of an insurance company applicant by its primary regulator. Most insurance company examination reports do not include a rating; however, several private firms rate insurance company performance. Therefore, the Finance Board also requires that an insurance company applicant have a rating from one of the five principal private companies that rate insurance companies, A.M. Best Company, Duff & Phelps, Inc., Moody's Investor Service, Inc., Standard & Poor's Corp., or Weiss Research, Inc. Relying in part on the independent rater's evaluation of an insurance company applicant reduces documentation requirements and makes the application process more efficient.

Section 933.16(b)(2) of the proposed rule requires that an insurance company applicant's most recent examination indicate no major adverse findings pertaining to the applicant's financial condition.

(2) Capital requirement.

Section 933.16(b)(3) of the proposed rule requires that an insurance company applicant meets all of its minimum statutory and regulatory capital requirements and the NAIC capital standards as reported in its most recent quarter-end or year-end regulatory financial report filed with its primary regulator.

(3) Minimum performance standard.

Section 933.16(b)(4) of the proposed rule establishes the minimum performance standard for an insurance company applicant. Under § 933.16(b)(4)(i), the applicant's most recent composite insurance company

rating must have been "strong," defined in the proposed rule as: "A-" or above from A.M. Best Company; "AA-" or above from Duff & Phelps, Inc.; "Aa" or above from Moody's Investor Service, Inc.; "AA" or above from Standard & Poor's Corp.; or "A" from Weiss Research, Inc.

Alternatively, under § 933.16(b)(4)(ii), an insurance company applicant can establish an acceptable financial condition if it has an "adequate" rating and earnings. An "adequate" rating is defined in the proposed rule as: "C+" to "B++" from A.M. Best Company; "BB-" to "A+" from Duff & Phelps, Inc.; "Ba" to "A" from Moody's Investor Service, Inc.; "BB" to "A" from Standard & Poor's Corp.; or "B" or "C" from Weiss Research, Inc. To establish that it has adequate earnings, an insurance company applicant must have positive annualized earnings in two of the three most recent calendar years.

(4) Minimum performance ratios.

(i) Overall ratios.

All insurance company applicants also must meet certain minimum performance ratios established by § 933.16(b)(5) of the proposed rule during the most recent year-end or quarter-end period. Section 933.16(b)(5)(i) defines certain terms that are used only in this paragraph. Section 933.16(b)(5)(ii) establishes the overall minimum performance ratios for insurance company applicants.

Section 933.16(b)(5)(ii)(A) establishes a premium to surplus ratio standard that is designed to measure the adequacy of an insurance company's reserves for absorbing above-average losses. To calculate this ratio, divide net premiums written by total capital and surplus. To meet the standard, an applicant's net premiums may not exceed three times the level of capital and surplus. Section 933.16(a)(7) defines the term "net premiums written" as the total consideration paid for an insurance contract during a specified period of time, net of reinsurance assumed and ceded.

Section 933.16(a)(8) defines the term "reinsurance" as transactions in which an assuming enterprise, known as a reinsurer, assumes, for a premium, all or part of a risk undertaken originally by another insurer.

Section 933.16(a)(9) defines the term "reinsurance assumed" as all premiums generated by policies issued to assume a liability, in whole or in part, of another insurer that is already covering the risk with a policy.

Section 933.16(a)(10) defines the term "reinsurance ceded" as all premiums generated by policies or coverage purchased from another insurer that

transfer liability, in whole or in part, from direct or reinsurance policies.

Section 933.16(a)(14) defines the term "surplus" as the total of common and preferred capital stock, aggregate write-ins for other than special surplus funds, gross paid-in and contributed surplus, surplus notes and unassigned funds, less treasury stock.

Section 933.16(b)(5)(ii)(B) establishes a change in net premiums written ratio standard that is designed to measure the stability of an insurance company's operation. Major increases or decreases in net premiums written may indicate a lack of stability in company operations or an abrupt entry into new product lines or sales territory. To calculate this ratio, divide the change in net premiums written between the two most recent consecutive calendar years by the total net premiums written in the first year. To meet the standard, an applicant's ratio must be between -10 percent and +50 percent.

Section 933.16(b)(5)(ii)(C) establishes a surplus relief ratio standard that is designed to measure the insurance company's level of dependence on net income generated by reinsurance activities to fund capital and surplus. Dependence on income from reinsurance ceded premiums may indicate that company management believes current capital and surplus to be inadequate. To calculate the surplus relief ratio, divide the net of commissions and expenses generated by reinsurance ceded and assumed by total capital and surplus. To meet the standard, an applicant's surplus relief ratio must be less than 30 percent.

Section 933.16(b)(5)(ii)(D) establishes an adequacy of investment income ratio standard that is designed to measure whether the insurance company's investment income is adequate to cover contractual interest obligations on policies and funds held on deposit. To calculate this ratio, divide net investment income by the sum of total tabular interest required on life insurance, accident and health reserves, and total interest credited on funds held on deposit. Section 933.16(a)(15) defines the term "tabular interest" as interest, required by the primary regulator, to be set aside to cover all contractual obligations.

Section 933.16(a)(11) defines the term "reserves" as funds set aside for possible losses on insurance policies, annuities, claims unpaid, funds held for policyholders, and deposit funds.

To meet the adequacy of investment income ratio standard, an applicant's net investment income must provide no less than 1.25 times the coverage on total funds held in reserves to pay

interest on contractual obligations and funds held on deposit.

Section 933.16(b)(5)(ii)(E) establishes a change in capital and surplus ratio standard that is designed to provide an overall measurement of improvement or deterioration in an insurance company's financial condition. To calculate this ratio, divide the net change in capital and surplus between the two most recent consecutive calendar years, by total capital and surplus in the first year. To meet this standard, an applicant's ratio must be between -10 percent and +50 percent.

(ii) Solvency ratios.

Section 933.16(b)(5)(iii) establishes the solvency ratios for insurance company applicants.

Section 933.16(b)(5)(iii)(A) establishes a highly liquid ratio standard that is designed to measure the relationship between highly liquid assets and those liabilities that can be withdrawn or must be paid by the company in less than 30 days.

Section 933.16(a)(4) defines the term "highly liquid assets" as cash or cash equivalent assets readily convertible to cash, including marketable Class 1 (highest investment grade) publicly traded bonds, marketable preferred and common stock, short-term investments, and investment income due. To calculate this ratio, divide highly liquid assets by annuity and deposit fund reserves less reserves with no withdrawal privileges, separate accounts and reinsurance.

To meet the standard, an applicant's highly liquid ratio must be no less than: (1) 75 percent on traditional life insurance products; (2) 85 percent on interest sensitive life insurance products; (3) 85 percent on individual annuity insurance products; (4) 100 percent on group annuity insurance products; (5) 79 percent on property and liability insurance products; (6) 75 percent on accident and health insurance products; and (7) 50 percent on disability income insurance products.

Section 933.16(b)(5)(i)(A) defines "traditional life insurance products" as insurance business that consists of individual term life insurance contracts, individual permanent fixed value life insurance contracts, or policies that consist of fixed premiums, fixed dollar amounts of contract, or fixed reserves (cash value) established by each state.

Section 933.16(b)(5)(i)(B) defines "interest sensitive life insurance products" as insurance business that consists of individual life insurance policies characterized by flexible premiums, dollar amounts of contract that can vary, and reserves which

represent a pool of assets such as mutual funds that are held for the benefit of, and support the investment return to, policy holders.

Section 933.16(b)(5)(i)(D) defines "individual and group annuity insurance products" as insurance business that consists of contracts that accumulate and disburse retirement benefits to individual policyholders or to companies for their employees, hold pension deposit funds, or distribute and hold funds under guaranteed interest contracts.

Section 933.16(b)(5)(i)(F) defines "property insurance products" as insurance business that consists of policies where the majority of premiums go to cover losses to real property, automobiles or similar tangible assets.

Section 933.16(b)(5)(i)(G) defines "liability insurance products" as insurance business that consists of policies that cover losses arising from actions taken by individuals or companies, including losses from litigation or mutual agreements as to the amount of a claim, such as product liability, medical malpractice and worker's compensation.

Section 933.16(b)(5)(i)(C) defines "accident and health insurance products" as insurance business that consists of coverage for care such as basic hospital expense, basic surgical expense, dental care, specific hospital reimbursement, long-term nursing home or home care expenses for the aged or disabled, major medical expense, and Medicare supplemental insurance.

Section 933.16(b)(5)(i)(E) defines "disability income insurance products" as insurance business that consists of contracts that pay income periodically to insureds who are unable to work as a result of sickness or injury.

Section 933.16(b)(5)(ii)(B) establishes a current ratio standard that is designed to measure the relationship between liquid assets and liabilities that are available to meet a company's obligations if the obligations are paid in an orderly fashion in the normal course of business. Section 933.16(a)(6) defines the term "liquid assets" as installment premiums booked but deferred and not yet due, cash, accrued investment income, marketable Class 1 (highest investment grade quality) publicly traded bonds and marketable Class 2 (high investment grade quality) publicly traded bonds, marketable preferred and common stock, cash, short-term investments, and investment income due, less investments in affiliated companies and excess of real estate over five percent of liabilities.

To calculate the current ratio, divide liquid assets by annuity, ordinary life,

and deposit fund reserves, less reserves with no withdrawal privileges, separate accounts, reinsurance, and policy loans.

Section 933.16(a)(12) defines the term "separate accounts" as assets and liabilities maintained by an insurance company predominately to fund fixed-benefit or variable annuity contracts and pension plans. The contract holder assumes the investment risk while the insurance company receives a fee for managing or maintaining the investments.

To meet the standard, an applicant's current ratio must be no less than: (1) 60 percent on traditional life insurance products; (2) 75 percent on interest sensitive life insurance products; (3) 75 percent on individual and group annuity insurance products; (4) 87 percent on property and liability insurance products; (5) 75 percent on accident and health insurance products; and (6) 50 percent on disability income insurance products.

Section 933.16(b)(5)(iii)(C) establishes an adjusted liabilities to adjusted surplus ratio standard that is designed to measure whether an insurance company's surplus account is adequate in relation to its level of current contractual obligations outstanding.

Section 933.16(a)(1) defines the term "adjusted liabilities" as total statutory liabilities less separate account liabilities, asset valuation reserves, and interest maintenance reserves. Section 933.16(a)(13) defines the term "statutory liabilities" as the total of funds set aside to pay future claims and operating expenses, including separate account liabilities and funds held for the benefit of others, as established under the accounting rules and techniques permitted by the NAIC. Examples of statutory liabilities are policy reserves, premiums collected in advance, commissions and expenses payable, and provisions for policyholder dividends.

Section 933.16(a)(3) defines the term "asset valuation reserves" as reserves on the liability side of the balance sheet that are established by the primary regulator to guard against fluctuations in the value of securities and to absorb all unrealized capital gains and losses and certain realized gains and losses on investment activity.

Section 933.16(a)(5) defines the term "interest maintenance reserves" as reserves on the liability side of the balance sheet that are established to hold the amount of realized capital gains and losses on fixed income securities that result from overall interest rate changes.

Section 933.16(a)(2) defines the term "adjusted surplus" as surplus plus asset

valuation reserves and interest maintenance reserves.

To calculate the adjusted liabilities to adjusted surplus ratio, divide adjusted liabilities by adjusted surplus. To meet the standard, an applicant's adjusted liabilities to adjusted surplus ratio must not exceed: (1) 10 to 1 on traditional life insurance products; (2) 10 to 1 on interest sensitive life insurance products; (3) 10 to 1 on individual and group annuity insurance products; (4) 3 to 1 on property and liability insurance products; (5) 3 to 1 on accident and health insurance products; and (6) 5 to 1 on disability income insurance products.

13. Rebuttable Presumptions

For each membership eligibility criteria required by the Bank Act and this part, the Finance Board, based on its general supervisory authority over the Banks, 12 U.S.C. 1422a, 1422b(a)(1), and its authority to interpret the Bank Act's membership requirements, *id.* § 1424, is proposing to establish flexible standards. In the proposed rule, an applicant that meets those standards is presumed to be in compliance with the statutory membership eligibility criteria. So, too, applicants not meeting the standards are presumed not to be in compliance with the Bank Act criteria. The proposed rule provides that these presumptions may be rebutted if the applicant provides compelling or substantial evidence, depending on the standard at issue, or if the Bank otherwise obtains compelling evidence to the contrary. Section 933.17 of the proposed rule establishes the method by which a presumption may be rebutted.

This approach is similar to the current Guidelines, in that it allows an applicant that fails to meet a standard to establish an alternative basis for complying with the statutory membership eligibility criteria.

Under § 933.17(a) of the proposed rule, even if an applicant meets all of the standards, it may not be admitted to membership if the Bank obtains compelling evidence to overcome the presumption that the applicant is in compliance with the Bank Act and the general eligibility requirements of § 933.6(a).

Section 933.17(b) provides that an applicant that does not meet all of the standards or that is unable to provide information sufficient for the Bank to evaluate whether it meets the standards, may nevertheless have the opportunity to rebut the presumption that it is therefore not in compliance with the Bank Act and the general eligibility requirements in § 933.6(a).

The remaining provisions of section 933.17 describe specific rebuttal procedures. Section 933.17(c) of the proposed rule sets out the requirements for rebutting the presumption of noncompliance with the financial condition standards. Under § 933.17(c)(1), for each variance from the required minimum regulatory examination rating, an applicant must prepare a written justification that provides compelling evidence that the applicant is in the financial condition required by § 933.6(a)(4) of the proposed rule, notwithstanding the variance. The Finance Board is proposing a compelling evidence standard to rebut a low regulatory examination rating, a rating of "4" or "5," because of the importance of the regulatory examination rating in determining an applicant's financial condition.

Under section 933.17(c)(2) of the proposed rule, for each variance from a performance trend criterion required by § 933.11(b)(3), the applicant must prepare a written justification that provides substantial evidence that the applicant is in an adequate financial condition, notwithstanding the variance. The Finance Board is proposing a substantial evidence standard to rebut the failure to meet a performance trend standard because, while the performance trend criteria are important, they are less important than the regulatory examination ratings in evaluating financial condition.

Section 933.17(d) of the proposed rule sets out the requirements for rebutting the presumption of noncompliance with the character of management standards. Under § 933.17(d)(1) of the proposed rule, if an applicant or any of its directors or senior officers is subject to or operating under an enforcement action, the applicant must provide written confirmation from its appropriate regulator that the applicant, its directors or senior officers are in substantial compliance with all aspects of the enforcement action. Alternatively, an applicant may prepare a written analysis stating each action the applicant, director or senior officer is required to take by the enforcement action, the actions actually taken by the applicant, director or senior officer, and whether the applicant regards this as substantial compliance. If the Bank is not certain that the applicant has substantially complied with all aspects of the enforcement action, the Bank must consult the applicant's appropriate regulator.

Under § 933.17(d)(2) of the proposed rule, if an applicant or any of its directors or senior officers is subject to criminal, civil or administrative

proceedings that reflect on creditworthiness, business judgment or moral turpitude since the last examination, the applicant must provide written confirmation from the applicant's primary regulator that the proceedings will not likely result in enforcement action. Alternatively, the applicant may prepare a written analysis of the severity of the pending charges and any mitigating actions taken by the applicant, director or senior officer. If the Bank is uncertain whether the proceedings will result in enforcement action, the Bank must consult the applicant's primary regulator.

Under § 933.17(d)(3) of the proposed rule, if there are any material known or potential civil, criminal or administrative monetary liabilities, pending lawsuits, or unsatisfied judgments against the applicant or any of its directors or senior officers as of the most recent quarter-end, the applicant must provide written confirmation from its primary regulator that the matter will not likely cause the applicant to fall below its minimum capital requirements. Alternatively, the applicant may provide a written analysis of each matter, the likelihood of the applicant or its directors or senior officers prevailing and the financial consequences if the applicant or its directors or senior officers do not prevail. If the Bank is uncertain whether the matter will cause the applicant to fall below its minimum capital requirements, the Bank must consult the applicant's primary regulator.

Section 933.17(e) of the proposed rule sets out the requirements for rebutting the presumption of noncompliance with the home financing policy standards. If an applicant received a "substantial non-compliance" rating on its most recent CRA performance evaluation, or two consecutive "needs to improve" CRA ratings, or has not received a CRA performance evaluation within four years from the date of the membership application, the applicant must provide written confirmation from its primary regulator of the applicant's recent satisfactory CRA performance, including any corrective action that substantially improved upon the deficiencies cited in any recent CRA performance evaluation. Alternatively, the applicant may provide a written analysis demonstrating that the applicant's low CRA rating is unrelated to housing finance, or providing substantial evidence that the applicant's home financing credit policies and lending practices (if applicable) are consistent with the Bank System's housing finance mission. The Finance Board is

proposing a compelling evidence standard to overcome the presumption of an inadequate home financing policy because of the likelihood that a "substantial non-compliance" rating or two consecutive "needs to improve" ratings indicate a poor home financing policy.

The Finance Board has made no change to § 933.18, Determination of appropriate Bank district for membership, other than conforming citations to the proposed rule. For the sake of brevity, conforming change to the citations in subparts D through I of part 933 are set out in a table. Part 933 as revised will be set out in its entirety when the final rule is published.

III. Regulatory Flexibility Act

The proposed rule implements statutory requirements binding on all applicants for Bank membership, regardless of their size. The Finance Board is not at liberty to make adjustments in those requirements to accommodate small entities. The Finance Board has not imposed any additional regulatory requirements that will have a disproportionate impact on small entities. The proposed rule would, to some extent, reduce the tests and criteria for determining compliance with statutory eligibility requirements that currently are used by the Finance Board in approving membership applications. Therefore, it is certified, pursuant to section 605(b) of the Regulatory Flexibility Act, 5 U.S.C. 605(b), that this proposed rule, if promulgated as a final rule, would not have a significant economic impact on a substantial number of small entities.

Paperwork Reduction Act

The Finance Board has submitted to the Office of Management and Budget (OMB) an analysis of membership approval collections of information contained in §§ 933.2, 933.3, 933.5, and 933.7 through 933.17 of the proposed rule, described more fully in part II of the Supplementary Information, as well as an analysis of other information collection requirements in redesignated §§ 933.18, 933.22, 933.25, 933.26 and 933.31 of the current membership regulation, which are not otherwise affected by this proposed rule. These information collections are necessary to enable the Finance Board and/or the Banks to determine whether applicants qualify for Bank membership and to satisfy various statutory requirements that apply to FHLBank members. Responses are required to obtain or retain a benefit. See 12 U.S.C. 1424, 44 U.S.C. 3512.

The information collections will be used by Finance Board and/or Bank staff as part of the membership process to determine the eligibility of applicants for Bank membership under the Bank Act and Finance Board regulation, the amount of stock that each member is required to hold pursuant to statutory requirements, information the Finance Board must collect to comply with statutory requirements in the event of a member's withdrawal from membership, and information the Finance Board is required by statute to collect to determine a member's actual principal place of business. Confidentiality of information obtained from respondents pursuant to the collections of information will be maintained by the Finance Board as required by applicable statute, regulation and agency policy. Books or records relating to these collections of information must be retained as provided in the regulation or proposed rule.

Likely respondents and/or recordkeepers will be the types of financial institutions eligible to become Bank members under the Bank Act, 12 U.S.C. 1424(a)(1), including any building and loan association, savings and loan association, cooperative bank, homestead association, insurance company, savings bank, or insured depository institution; the Banks; and the Finance Board. Potential respondents are not required to respond to the collections of information unless the regulation collecting the information displays a currently valid control number assigned by the OMB. See 44 U.S.C. 3512(a).

The estimated annual reporting and recordkeeping hour burden is:

- a. Number of respondents—6,412.
- b. Total annual responses—6,412.
- Percentage of these responses collected electronically 0%.
- c. Total annual hours requested—59,152.1.
- d. Current OMB inventory—38,889.6.
- e. Difference—20,262.5.

The estimated annual reporting and recordkeeping cost burden is:

- a. Total annualized capital/startup costs—0.
- b. Total annual costs (O&M)—\$1,683,923.95.
- c. Total annualized cost requested—1,683,923.95.
- d. Current OMB inventory—1,754,181.95.
- e. Difference—(\$70,258.00).

Comments concerning the accuracy of the burden estimates and suggestions for reducing the burden may be submitted to the Finance Board in writing at the address listed above.

The collections of information have been submitted to OMB for review in accordance with section 3507(d) of the Paperwork Reduction Act of 1995, 44 U.S.C. 3507(d). Comments regarding the proposed collections of information may be submitted in writing to the Office of Information and Regulatory Affairs of OMB, Attention: Desk Officer for Federal Housing Finance Board, Washington, DC 20503, by December 26, 1995.

List of Subjects in 12 CFR Part 933

Credit, Federal home loan banks, Reporting and recordkeeping requirements.

Accordingly, the Board hereby amends title 12, chapter IX, part 933, of the Code of Federal Regulations as follows:

PART 933—MEMBERS OF THE BANKS

1. The heading for part 933 is revised as set forth above.

1a. The authority citation for part 933 continues to read as follows:

Authority: 12 U.S.C. 1422a, 1422b, 1424, 1426, 1430, 1442.

2. The table of contents to part 933 is revised to read as follows:

Subpart A—Definitions

Sec.

933.1 Definitions.

Subpart B—Membership Application Process

933.2 Membership application requirements.

933.3 Decision on application.

933.4 Automatic membership.

933.5 Appeals.

Subpart C—Eligibility Requirements

933.6 General eligibility requirements.

933.7 Duly organized requirement.

933.8 Subject to inspection and regulation requirement.

933.9 Makes long-term home mortgage loans requirement.

933.10 Ten percent requirement

933.11 Financial condition requirement.

933.12 Character of management requirement.

933.13 Home financing policy requirement.

933.14 De novo insured depository institution applicants.

933.15 Recent and pending merger applicants.

933.16 Financial condition standards for insurance company applicants.

933.17 Rebuttable presumptions.

933.18 Determination of appropriate Bank district for membership.

Subpart D—Stock Requirements

933.19 Par value and price of stock.

933.20 Stock purchase.

933.21 Issuance and form of stock.

933.22 Adjustments in stock holdings.

933.23 Purchase of excess stock.

Subpart E—Consolidations Involving Members

933.24 Consolidation of members.

933.25 Consolidations involving nonmembers.

Subpart F—Withdrawal and Removal From Membership

933.26 Procedure for withdrawal.

933.27 Procedure for removal.

933.28 Automatic termination of membership for institutions placed in receivership.

Subpart G—Orderly Liquidation of Advances and Redemption of Stock

933.29 Orderly liquidation of advances and redemption of stock.

Subpart H—Reacquisition of Membership

933.30 Reacquisition of membership.

Subpart I—Bank Access to Information

933.31 Reports and examinations.

Subpart J—Membership Insignia

933.32 Official membership insignia.

Subparts C Through I of Part 933 [Redesignated as Subparts D Through J]

3. Subparts C through I of Part 933 are redesignated as Subparts D through J, respectively.

§§ 933.6 Through 933.19 [Redesignated as §§ 933.19 Through 933.32]

4. Sections 933.6 through 933.19 are redesignated as §§ 933.19 through 933.32, respectively.

5. Subpart A of part 933 is revised to read as follows:

Subpart A—Definitions

§ 933.1 Definitions.

For purposes of this part:

(a) *Act* means the Federal Home Loan Bank Act, as amended (12 U.S.C. 1421 through 1449).

(b) *Aggregate unpaid load principal* means the aggregate unpaid principal of a subscriber's or member's home mortgage loans, home purchase contracts, and similar obligations.

(c) *Annualized adjusted earnings* means net earnings, excluding extraordinary items such as income received from or expense incurred in sales of securities or fixed assets.

(d) *Appropriate Federal banking agency* has the same meaning as used in 12 U.S.C. 1813(q) and, for federally insured credit unions, shall mean the National Credit Union Administration.

(e) *Appropriate regulator* means any officer, agency, supervisor or other entity that has regulatory authority over, or is empowered to institute enforcement action against, an applicant.

(f) *Bank* means a Federal Home Loan Bank established under the authority of the Act.

(g) *Board* means the Federal Housing Finance Board.

(h) *Combination business or farm property* means real property for which the total appraised value is attributable to residential, and business or farm uses.

(i) *Domestic loan* means a loan on property located in a state or the United States.

(j) *Dwelling unit* means a single room or a unified combination of rooms designed for residential use.

(k) *Enforcement action* means any written notice, directive, order or agreement initiated by an applicant or its appropriate regulator to address any operational, financial, managerial or other deficiencies of the applicant identified by the appropriate regulator.

(l) *Funded residential construction loan* means the portion of a loan secured by real property made to finance the on-site construction of dwelling units on one-to-four family property or multifamily property disbursed to the borrower.

(m) *Home mortgage loan* means:

(1) A domestic loan, whether or not fully amortizing, or an interest in such a loan, which is secured by a mortgage, deed of trust, or other security agreement that creates a first lien on one of the following interests in property:

(i) One-to-four family property or multifamily property, in fee simple;

(ii) A leasehold on one-to-four family property or multifamily property under a lease of not less than 99 years that is renewable, or under a lease having a period of not less than 50 years to run from the date the mortgage was executed; or

(iii) Combination business or farm property where at least 50 percent of the total appraised value of the combined property is attributable to the residential portion of the property; or

(2) A mortgage pass-through security that represents an undivided ownership interest in:

(i) Long-term loans, provided that, at the time of issuance of the security, all of the loans meet the requirements of paragraph (m)(1) of this section; or

(ii) A security that represents an undivided ownership interest in long-term loans, provided that, at the time of issuance of the security, all of the loans meet the requirements of paragraph (m)(1) of this section.

(n) *Institutions which are eligible to make application to become members* means for purposes of 12 U.S.C. 1431(e)(2)(A), any building and loan association, savings association, cooperative bank, homestead association, insurance company, savings bank or any insured depository

institution, regardless of whether the institution applies for or would be approved for membership.

(o) *Insured depository institution* means an insured depository institution as defined in 12 U.S.C. 1422(12).

(p) *Loan loss reserves* means a specified balance-sheet account held to fund potential losses on loans or leases.

(q) *Long-term* means a term to maturity of five years or greater.

(r) *Manufactured housing* means a manufactured home as defined in section 603(6) of the Manufactured Home Construction and Safety Standards Act of 1974, as amended (42 U.S.C. 5402(6)).

(s) *Member* means an institution that has been approved for membership in a Bank and has purchased capital stock in the Bank in accordance with §§ 933.20 or 933.24 of this part.

(t) *Multifamily property* means:

(1) Real property that is solely residential and includes five or more dwelling units; or

(2) Real property that includes five or more dwelling units combined with commercial units, provided that the property is primarily residential; and

(3) Property that includes, but is not limited to, nursing homes, dormitories and homes for the elderly.

(u) *Nonperforming assets* means the sum of loans and leases reported on a regulatory financial report that have been past due for 90 days or longer; loans and leases on a nonaccrual basis; restructured loans and leases (not already reported as nonperforming); and foreclosed real estate, except that nonperforming assets shall be as defined by the National Credit Union Administration for credit union applicants.

(v) *Nonresidential real property* means real property that is not used for residential purposes, including business or industrial property, hotels, motels, churches, hospitals, educational and charitable institution buildings or facilities, clubs, lodges, association buildings, golf courses, recreational facilities, farm property not containing a dwelling unit, or similar types of property, except as otherwise determined by the Board, in its discretion.

(w) *One-to-four family property* means:

(1) Real property that is solely residential, including one-to-four family dwelling units or more than four family dwelling units if each dwelling unit is separated from the other dwelling units by dividing walls that extend from ground to roof, such as row houses, townhouses or similar types of property;

(2) Manufactured housing if applicable state law defines the purchase or holding of manufactured housing as the purchase or holding of real property;

(3) Individual condominium dwelling units or interests in individual cooperative housing dwelling units that are part of a condominium or cooperative building without regard to the number of total dwelling units therein; or

(4) Real property which includes one-to-four family dwelling units combined with commercial units, provided the property is primarily residential.

(x) *Primary regulator* means the chartering authority for federally-chartered applicants, the insuring authority for federally-insured applicants that are not federally-chartered; or the appropriate state agency for all other applicants.

(y) *Regulatory examination rating* means a rating of capital, assets, management, earnings and liquidity following the guidelines of the Uniform Financial Institutions Rating System contained in a written report of examination conducted by the applicant's appropriate regulator, including a CAMEL rating, a MACRO rating, or other similar ratings.

(z) *Regulatory financial report* means a financial report that an applicant is required to file with its primary regulator on a specific periodic basis, including the quarterly call report for commercial banks, thrift financial report for thrifts, quarterly or semi-annual call report for credit unions, the National Association of Insurance Commissioners' annual or quarterly report for insurance companies and other similar reports.

(aa) *Residential mortgage loan* means any one of the following types of domestic loans, whether or not fully amortizing:

(1) Home mortgage loans;

(2) Funded residential construction loans;

(3) Loans secured by manufactured housing whether or not defined by state law as secured by an interest in real property;

(4) Loans secured by junior liens on one-to-four family property or multifamily property;

(5) Qualified private activity exempt facility bonds where 95 percent or more of the net proceeds are used for the construction of qualified residential rental projects as defined in 20 U.S.C. 142(a)(7);

(6) Mortgage pass-through securities representing an undivided ownership interest in:

(i) Loans that meet the requirements of paragraphs (aa)(1) through (4) of this section at the time of issuance of the security;

(ii) Securities representing an undivided ownership interest in loans, provided that, at the time of issuance of the security, all of the loans meet the requirements of paragraphs (r)(1) through (4) of this section; or

(iii) Mortgage debt securities as defined in paragraph (aa)(7) of this section;

(7) Mortgage debt securities secured by:

(i) Loans, provided that, at the time of issuance of the security, all of the loans meet the requirements of paragraphs (aa)(1) through (4) of this section;

(ii) Securities that meet the requirements of paragraph (aa)(6) of this section; or

(iii) Securities secured by assets, provided that, at the time of issuance of the security, all of the assets meet the requirements of paragraphs (aa)(1) through (5) of this section; or

(8) Home mortgage loans secured by a leasehold interest, as defined in paragraph (m)(1)(ii) of this section, except that the period of the lease term may be for any duration.

(bb) *State* means a State of the United States, the District of Columbia, Guam, Puerto Rico or the U.S. Virgin Islands.

(cc) *Total assets* means cash and balances due from depository institutions, held to maturity securities, available-for-sale securities, federal funds sold and securities purchased under agreements to resell (in domestic subsidiaries), loans and lease financing receivables, assets held in trading accounts (in domestic offices of the company and its domestic subsidiaries), premiums and fixed assets, other real estate owned, investments in unconsolidated subsidiaries and associated companies, customers' liability to the reporting bank on acceptances outstanding, intangible assets, and other assets.

6. Subpart B of part 933 is revised to read as follows:

Subpart B—Membership Application Process

§ 933.2 Membership application requirements.

(a) *Application.* An applicant for membership in a Bank shall submit to that Bank an application that satisfies the requirements of this part. The application shall include a written certification by a majority of the applicant's directors or by an individual with authority to act on behalf of the applicant of the following:

(1) *Applicant review.* Applicant has reviewed the requirements of this part and, as required by this part, has provided to the best of applicant's knowledge the most recent, accurate and complete information available; and

(2) *Duty to supplement.* Applicant will promptly supplement the application with any relevant information that comes to applicant's attention prior to the Bank's decision on whether to approve the application, and if the Bank's decision is appealed pursuant to § 933.5 of this part, prior to resolution of any appeal by the Board.

(b) *Digest.* The Bank shall prepare a written digest for each applicant stating whether or not the applicant meets each of the requirements in §§ 933.6 to 933.18 of this part, the Bank's findings and the reasons therefor.

(c) *File.* The Bank shall maintain a membership file for each applicant for at least three years after the Bank decides whether to approve membership and the resolution of any appeal to the Board. The membership file shall contain at a minimum:

(1) *Digest.* The digest required by paragraph (b) of this section.

(2) *Required documents.* All documents required by §§ 933.6 to 933.18 of this part, including those documents required to establish or rebut a presumption under this part, shall be described in and attached to the digest. If an applicant's primary regulator requires return of a regulatory examination report, the date that the report is returned shall be noted in the digest.

(3) *Additional documents.* Any document submitted by the applicant, or otherwise obtained or generated by the Bank, concerning the applicant.

(4) *Decision resolution.* Decision resolution described in § 933.3(b) of this part.

(d) *Independent evaluation.* The Bank shall use regulatory financial reports and other sources independent of the applicant to evaluate and analyze all conclusions offered by the applicant regarding the applicant's eligibility for membership. No applicant shall be admitted to membership until the Bank is satisfied that the applicant meets the requirements of the Act and this part independent of any representations by the applicant.

§ 933.3 Decision on application.

(a) *Authority.* The Board authorizes the Banks to approve or deny all applications for membership, subject to § 933.5 of this part. The Bank may delegate the authority to approve membership applications only to a committee of the Bank's board of

directors, the Bank president or a senior officer who reports directly to the Bank president other than an officer with responsibility for business development.

(b) *Decision resolution.* For each applicant, the Bank shall prepare a resolution of its board of directors signed by a majority of the directors or by an officer with delegated authority to approve membership applications. The decision resolution shall state:

(1) That the information in the digest is accurate and is based on a diligent and comprehensive review of all available information; and

(2) The Bank's decision and the reasons therefor. Decisions to approve an application should specifically state that the applicant is authorized under the laws of the United States and the laws of the appropriate state to become a member of, purchase stock in, do business with and maintain deposits in the Bank to which the applicant has applied; and, that the applicant meets all of the membership eligibility criteria of the Act and this part.

(c) *Action on applications.* The Bank shall act on an application within 60 calendar days of the date the Bank deems the application to be complete. Within three business days of a Bank's decision on an application, the Bank shall provide the applicant and the Board's Executive Secretary with a copy of the Bank's decision resolution.

§ 933.4 Automatic membership.

(a) *Automatic membership for mandatory members.* Any institution required by law to become a member of a Bank automatically shall become a member of the Bank of the district in which its principal place of business is located upon the purchase of stock in that Bank pursuant to § 933.20(b)(1) of this part.

(b) *Automatic membership for certain charter conversions.* An insured depository institution member that converts from one charter type to another automatically shall become a member of the Bank of which the converting institution was a member on the effective date of such conversion, provided that the converting institution continues to be an insured depository institution and the assets of the institution immediately before and immediately after the conversion are identical. In such case, all relationships existing between the member and the Bank at the time of such conversion may continue.

(c) *Automatic membership for transfers.* Any member whose membership is transferred pursuant to § 933.18(d) of this part automatically

shall become a member of the Bank to which it transfers.

§ 933.5 Appeals.

(a) *Appeals by applicants—(1) Filing procedure.* Within 90 calendar days of the date of a Bank's decision to deny an application for membership, the applicant may file a written appeal of the decision with the Board.

(2) *Documents.* The applicant's appeal shall be addressed to the Executive Secretary, Federal Housing Finance Board, 1777 F Street, N.W., Washington, D.C. 20006, with a copy to the Bank, and shall include the following documents:

(i) *Bank's decision.* A copy of the Bank's decision resolution; and

(ii) *Basis for appeal.* A statement of the basis for the appeal by the applicant with sufficient facts, information, analysis and explanation to support the applicant's contentions.

(b) *Appeals by Banks.* Within 60 days of the date that a Bank grants an application for membership, another Bank (appellant Bank) may file a written appeal with the Board of the determination of the appropriate district for membership pursuant to § 933.18 of this part, by writing to the Board's Executive Secretary with a copy to the Bank that granted membership. The appeal shall include a statement of the basis for appeal by the appellant Bank with sufficient facts, information, analysis and explanation to support the appellant Bank's contentions.

(c) *Record for appeal.—(1) Copy of membership file.* Within five business days of receiving an appeal, the Bank whose action has been appealed (appellee Bank) shall provide the Board with a complete copy of the applicant's membership file. Until the Board resolves the appeal, the appellee Bank shall supplement the materials provided to the Board as new materials are received.

(2) *Additional information.* The Board may request additional information or further supporting arguments from the appellant, the appellee Bank or any other party that the Board deems appropriate.

(d) *Deciding appeals.* The Board shall consider the record for appeal described in paragraph (c) of this section and shall resolve the appeal based on the requirements of the Act and this part within 90 calendar days of the date the appeal is filed with the Board. In deciding the appeal, the Board shall follow the presumptions in this part, unless the appellant or appellee Bank presents compelling evidence to rebut a presumption.

7. Subpart C of part 933 is added to read as follows:

Subpart C—Eligibility Requirements

§ 933.6 General eligibility requirements.

(a) *Requirements.* Any building and loan association, savings and loan association, cooperative bank, homestead association, insurance company, savings bank, or insured depository institution, upon application satisfying all of the requirements of the Act and this part, shall be eligible to become a member of a Bank if:

(1) It is duly organized under the laws of any State of the United States;

(2) It is subject to inspection and regulation under the banking laws, or under similar laws, of any State or the United States;

(3) It makes long-term home mortgage loans;

(4) It has at least ten percent of its total assets in residential mortgage loans;

(5) Its financial condition is such that advances may be safely made to it;

(6) The character of its management is consistent with sound and economical home financing; and

(7) Its home-financing policy is consistent with sound and economical home financing.

(b) *Ineligibility.* Except as otherwise provided in this part, if an applicant does not satisfy the requirements of this part, the applicant is ineligible for membership.

§ 933.7 Duly organized requirement.

An applicant shall be deemed to be duly organized as required by section 4(a)(1)(A) of the Act and § 933.6(a)(1) of this part, subject to rebuttal, if it is chartered by a state or federal agency as a building and loan association, savings association, cooperative bank, homestead association, insurance company, savings bank or insured depository institution.

§ 933.8 Subject to inspection and regulation requirement.

An applicant shall be deemed to meet the inspection and regulation requirement of section 4(a)(1)(B) of the Act and § 933.6(a)(2) of this part, subject to rebuttal, if it is inspected and regulated by the Federal Deposit Insurance Corporation, the Federal Reserve Board, the National Credit Union Administration, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, a state insurance commissioner or other state regulatory agency authorized to regulate depository institutions or insurance companies.

§ 933.9 Makes long-term home mortgage loans requirement.

(a) *Requirement.* An applicant shall be deemed to meet the makes long-term mortgage loans requirement of section 4(a)(1)(C) of the Act and § 933.6(a)(3) of this part, subject to rebuttal, if the applicant originates or purchases long-term home mortgage loans.

(b) *Ineligible.* If an applicant does not satisfy the requirement in paragraph (a) of this section, the applicant is ineligible for membership, unless the Board, in its sole discretion, determines on appeal, on the basis of additional information supplied by the applicant or otherwise, that the applicant satisfies the requirements of section 4(a)(1)(C) of the Act.

§ 933.10 Ten percent requirement.

(a) *Insured depository institution applicants.* Except as provided in § 933.14(b) of this part, an insured depository institution applicant shall be deemed to be in compliance with the ten percent requirement of section 4(a)(2)(A) of the Act and § 933.6(a)(4) of this part, subject to rebuttal, if, as of the date of the application, the applicant had at least ten percent of its total assets, as reported to its primary regulator, in residential mortgage loans, except that any assets used to secure mortgage debt securities as described in § 933.1(aa)(7) of this part shall not be used to meet this requirement.

(b) *Noninsured depository institution applicants.* A noninsured depository institution applicant shall be deemed to be in compliance with the 10 percent requirement of section 4(a)(2)(A) of the Act and § 933.6(a)(4) of this part, subject to rebuttal, if the applicant has mortgage-related assets that reflect a commitment to housing finance, as determined by the Board.

(c) *Ineligible.* If an applicant does not satisfy the requirements of this section, the applicant is ineligible for membership, unless the Board, in its sole discretion, determines on appeal, on the basis of additional information supplied by the applicant or otherwise, that the applicant otherwise satisfies the requirements of section 4(a)(2)(A) of the Act.

§ 933.11 Financial condition requirement.

(a) *Review requirement.* Except as provided in § 933.14 of this part, in determining whether an applicant has complied with the financial condition requirement of section 4(a)(2)(B) of the Act and § 933.6(a)(5) of this part, the Bank shall obtain as a part of the membership application, and consider each of the following documents:

(1) *Financial report.* The regulatory financial reports for the last six calendar quarters and three year-ends;

(2) *Financial statement.* The most recent annual audited financial statement, or if unavailable, any other such independent external annual financial report as the applicant's primary regulator may require, or if unavailable, such financial statements as the applicant may otherwise have available;

(3) *Examination report.* The most recent available regulatory examination report, a summary of the applicant's strengths and weaknesses as cited in the examination report, and a summary of actions taken by the applicant to respond to examination weaknesses;

(4) *Enforcement actions.* A description of any outstanding enforcement actions, responses by the applicant and reports as required by the enforcement action; and

(5) *Additional information.* Any other relevant information that comes to the Bank's attention or reasonably should come to the Bank's attention in reviewing the applicant's financial condition.

(b) *Standards.* Except as provided in §§ 933.14(a) and 933.16 of this part, an applicant shall be deemed to be in compliance with the financial condition requirement of section 4(a)(2)(B) of the Act and § 933.6(a)(5) of this part, subject to rebuttal, if:

(1) *Recent examination.* The applicant has received a composite regulatory examination rating by its primary regulator within two years from the date of application;

(2) *Meets capital requirement.* The applicant meets all of its minimum statutory and regulatory capital requirements as reported in its most recent quarter-end regulatory financial report filed with its primary regulator; and

(3) *Minimum performance standard.* (i) The applicant's most recent composite regulatory examination rating was "1;" or, was "2" or "3" and, based on the applicant's most recent regulatory financial report, the applicant satisfied all of the following performance trend criteria:

(A) *Earnings.* Applicant had positive annualized adjusted earnings in four of the six most recent calendar quarters;

(B) *Nonperforming assets.* Applicant's nonperforming assets did not exceed ten percent of its total assets in the most recent calendar quarter; and

(C) *Loan loss reserves.* Applicant had a ratio of loan loss reserves to nonperforming assets of 60 percent or greater during 4 of the 6 most recent calendar quarters.

(ii) For applicants that are not required to report financial data to their primary regulator on a quarterly basis, the information required in paragraphs (b)(3)(i) of this section may be reported on a semiannual basis.

(c) *Eligible collateral not considered.* The availability of sufficient eligible collateral to secure advances to the applicant is presumed and shall not be considered in determining whether an applicant is in the financial condition required by § 933.6(a)(5) of this part.

§ 933.12 Character of management requirement.

(a) *Review requirement.* For each applicant, the Bank shall review:

(1) The names of directors and senior officers;

(2) The most recent regulatory financial report;

(3) The most recent audited financial statement, or if unavailable, other such independent external financial report that the applicant's primary regulator may require, or if unavailable, such financial statements that the applicant may otherwise have available;

(4) Enforcement actions as described in paragraph (b)(1) of this section;

(5) Certain pending criminal, civil or administrative matters as described in paragraph (b)(2) of this section;

(6) Information concerning potential monetary liabilities, material pending law suits or unsatisfied judgments as described in paragraph (b)(3) of this section; and

(7) Any other document that comes to the Bank's attention or reasonably should come to the Bank's attention in reviewing the applicant's character of management.

(b) *Standards.* An applicant shall be deemed to be in compliance with the character of management required by section 4(a)(2)(C) of the Act and § 933.6(a)(6) of this part, subject to rebuttal, if:

(1) *No enforcement actions.* Neither the applicant nor any of its directors or senior officers is subject to, or operating under, any enforcement action instituted by an appropriate regulator;

(2) *No objectionable proceedings.* Neither the applicant nor any of its directors or senior officers has been the subject of any criminal, civil or administrative proceedings reflecting upon creditworthiness, business judgment, or moral turpitude since the most recent examination; and

(3) *No objectionable liabilities.* There are no known or potential civil, criminal or administrative monetary liabilities, material pending law suits, or unsatisfied judgments against the applicant, its directors or senior officers since the most recent examination; and

(4) *Applicant certification.* The applicant makes the unqualified certification described in paragraph (c)(1) of this section.

(c) *Applicant certification.* Either a majority of the members of the board of directors of the applicant, or an individual with authority to act on behalf of the board of directors of the applicant shall provide to the Bank:

(1) *Unqualified certification.* An unqualified written certification that the statements submitted in response to the requirements of paragraphs (b) (1) through (3) of this section are true and correct without exception; or

(2) *Qualified certification.* A qualified written certification that the statements submitted in response to the requirements of paragraphs (b) (1) through (3) of this section are true and correct and detailed explanations of any exceptions noted.

§ 933.13 Home financing policy requirement.

(a) *Standards.* An applicant shall be deemed to be in compliance with the home financing policy requirement of section 4(a)(2)(C) of the Act and § 933.6(a)(7) of this part, subject to rebuttal, if the applicant has received:

(1) *Recent evaluation.* A Community Reinvestment Act (CRA) performance evaluation within four years from the date of application; and

(2) *Minimum rating.* A CRA rating of "Satisfactory" or better in the most recent compliance examination.

(b) *Written justification required.* An applicant that is not subject to CRA or an applicant that received a "needs to improve" rating in its most recent CRA performance evaluation but has received a "satisfactory" or better rating on its prior CRA performance evaluation, shall file as a part of its application, a written justification that demonstrates how and why the applicant's home financing credit policies and lending practices (if applicable) are consistent with the Bank System's housing finance mission.

§ 933.14 De novo insured depository institution applicants.

An insured depository institution applicant that provides a Bank with written confirmation from its primary regulator that it has been chartered for less than three years or is otherwise considered to be a de novo insured depository institution (de novo applicant) by the applicant's primary regulator shall receive special consideration for eligibility as follows:

(a) *Financial condition*—(1) *Financial report.* For purposes of § 933.11(a)(1) of this part, a de novo applicant that has not filed regulatory financial reports for

the last six calendar quarters and three year-ends shall provide any regulatory financial reports the applicant has filed.

(2) *Financial statement.* For purposes of § 933.11(a)(2) of this part, a de novo applicant shall provide the most recent annual audited financial statement, or if unavailable other such independent external annual financial report as the applicant's primary regulator may require, or if unavailable, a de novo applicant shall, at a minimum, provide financial reports for six calendar quarters of operation.

(3) *Regulatory examination rating.* For purposes of § 933.11(b)(1) of this part, if a de novo applicant has not yet received a composite regulatory examination rating from its primary regulator, the applicant shall provide a preliminary or informal written regulatory examination rating from the applicant's primary regulator, if a preliminary or informal rating is acceptable to the Bank.

(4) *Performance trends.* A de novo applicant need not meet the performance trend criteria in § 933.11(b)(3)(i) of this part; if:

(i) *Reports for six quarters.* Applicant has completed regulatory financial reports for at least six calendar quarters of operation; and

(ii) *Business plan compliance.* Applicant has provided written confirmation from its primary regulator that applicant is in compliance with the terms of its regulatory business plan; or applicant has prepared a written analysis demonstrating that it is in substantial compliance with its regulatory business plan as determined by the Bank.

(b) *Home financing policy.* For purposes of § 933.13(b) of this part, a de novo applicant that has not yet received a CRA performance evaluation shall be deemed to have a home financing policy as required by § 933.6(a)(7) of this part if it has received a preliminary or informal written CRA performance evaluation of "Satisfactory" or better; or it has submitted a written justification acceptable to the Bank of how the applicant intends to support the Bank System's housing finance mission.

§ 933.15 Recent and pending merger applicants.

(a) *Definitions*—(1) *Pending merger applicant* means an institution that meets both of the following tests:

(i) *Timing test.* The institution is a party to a merger or acquisition agreement expected to be consummated within two calendar quarters of submission of the membership application; and

(ii) *Materiality test.* The institution will account for 75 percent or less of the

combined assets of the resulting entity at the time of the merger or acquisition.

(2) *Recent merger applicant* means an institution that meets both of the following tests:

(i) *Timing test.* The institution merged with or acquired another institution within the six calendar quarters prior to submission of the membership application; and

(ii) *Materiality test.* The institution accounts for 75 percent or less of the combined assets of the resulting entity at the time of the merger or acquisition.

(b) *Review requirement.* For each recent or pending merger applicant, the digest shall include the following additional information:

(1) The name of each entity involved and its charter type;

(2) A general statement of the financial condition of each entity;

(3) A brief statement of the business reasons for the merger or acquisition; and

(4) The names and positions of management of the resulting entity.

(c) *Standards.* A recent or pending merger applicant shall be deemed to be in compliance with section 4(a) of the Act and § 933.6(a) of this part, subject to rebuttal, only if the recent or pending merger applicant satisfies the requirements of this part as modified and supplemented by this section.

(1) *Recent merger applicant financial condition*—(i) *Recent examination and minimum performance standards.* A recent merger applicant that does not have a composite regulatory examination rating subsequent to the merger or acquisition, shall satisfy the requirements of § 933.11(b) of this part on a combined basis and for each party to the merger or acquisition, except an incumbent Bank member.

(ii) *Performance trends.* To the extent that a recent merger applicant does not yet have regulatory financial reports for the six most recent calendar quarters, the applicant shall prepare pro forma combined financial statements for those calendar quarters in which an actual combined regulatory financial report is unavailable to determine whether the applicant meets the performance trend requirements of § 933.11(b)(3) of this part.

(2) *Pending merger applicant financial condition*—(i) *Recent examination and minimum performance standards.* In lieu of a composite regulatory examination rating for the combined entity, as required by § 933.11(b)(1) of this part, each party to the merger or acquisition, except an incumbent Bank member, must satisfy all of the requirements of § 933.11(b) of this part.

(ii) *Capital requirements and performance trends.* In addition to each party to a pending merger individually satisfying all of the requirements of § 933.11(b) of this part, the pending merger applicant shall satisfy the requirements in § 933.11(b) (2) and (3) of this part as a combined entity based on pro forma combined financial statements to be prepared by the applicant for the six most recent calendar quarters.

(iii) *Character of management.* For purposes of § 933.12 of this part, the determination of the character of management of a recent or pending merger applicant shall be based on an evaluation of the directors and senior officers of the resulting entity.

(iv) *Home financing policy.* For a pending merger applicant or for a recent merger applicant that does not yet have a CRA performance evaluation on a combined basis for the merged entity, the determination of whether the merger applicant's home financing policy satisfies the requirements of § 933.13 of this part, shall be based on a review of the most recent CRA performance evaluation for each party to the merger or acquisition.

§ 933.16 Financial condition standards for insurance company applicants.

(a) *Definitions.* For purposes of this section:

(1) *Adjusted liabilities* means total statutory liabilities less separate account liabilities, asset valuation reserves, and interest maintenance reserves.

(2) *Adjusted surplus* means surplus plus asset valuation reserves and interest maintenance reserves.

(3) *Asset valuation reserves* means reserves on the liability side of the balance sheet that are established by the primary regulatory to guard against fluctuations in the value of securities and to absorb all unrealized capital gains and losses and certain realized gains and losses on investment activity.

(4) *Highly liquid assets* means cash or cash equivalents readily convertible to cash, including marketable Class 1 (highest investment grade) publicly traded bonds, marketable preferred and common stock, short-term investments, and investment income due.

(5) *Interest maintenance reserves* means reserves on the liability side of the balance sheet that are established to hold the amount of realized capital gains and losses on fixed income securities that result from overall interest rates changes.

(6) *Liquid assets* means installment premiums booked but deferred and not yet due, cash, accrued investment income, marketable Class 1 (highest

investment grade quality) publicly traded bonds and marketable Class 2 (high investment grade quality) publicly traded bonds, marketable preferred and common stock, cash, short-term investments, and investment income due, less investments in affiliated companies and excess of real estate over five percent of liabilities.

(7) *Net premiums written* means the total consideration paid for an insurance contract during a specified period of time, net of reinsurance assumed and ceded.

(8) *Reinsurance* means transactions in which an assuming enterprise, known as a reinsurer, assumes, for a premium, all or part of a risk undertaken originally by another insurer.

(9) *Reinsurance assumed* means all premiums generated by policies issued to assume a liability, in whole or part, of another insurer that is already covering the risk with a policy.

(10) *Reinsurance ceded* means all premiums generated by policies or coverage purchased from another insurer that transfer liability, in whole or part, from direct or reinsurance policies.

(11) *Reserves* means funds set aside for possible losses on insurance policies, annuities, claims unpaid, funds held for policyholders, and deposit funds.

(12) *Separate accounts* means assets and liabilities maintained by an insurance company predominately to fund fixed-benefit or variable annuity contracts and pension plans. The contract holder assumes the investment risk while the insurance company receives a fee for managing or maintaining the investments.

(13) *Statutory liabilities* means the total of funds set aside to pay future claims and operating expenses, including separate account liabilities and funds held for the benefit of others, as established under the accounting rules and techniques permitted by the National Association of Insurance Commissioners. Examples of statutory liabilities are policy reserves, premiums collected in advance, commission and expenses payable, and provisions for policyholder dividends.

(14) *Surplus* means the total of common and preferred capital stock, aggregate write-ins for other than special surplus funds, gross paid-in and contributed surplus, surplus notes and unassigned funds less treasury stock.

(15) *Tabular interest* means interest, required by the primary regulator, to be set aside to cover all contractual obligations.

(b) *Performance standards.* An insurance company applicant shall be

deemed to meet the financial condition requirement of section 4(a)(2)(B) of the Act and § 933.6(a)(5) of this part, subject to rebuttal, if:

(1) *Recent examination and rating.* The applicant has received a regulatory examination by its primary regulator and a composite independent insurance company rating from A.M. Best Company, Duff & Phelps, Inc., Moody's Investor Service, Inc., Standard & Poor's Corp. or Weiss Research Inc. within three years of the date of application;

(2) *Satisfactory examination.* The applicant's most recent regulatory examination by its primary regulator indicates no major adverse findings pertaining to the company's financial condition;

(3) *Meets capital requirements.* The applicant meets all of its minimum statutory and regulatory capital requirements and the capital standards established by the National Association of Insurance Commissioners as reported in the applicant's most recent regulatory financial report filed with its primary regulator;

(4) *Minimum performance standard—*(i) *Strong rating.* The applicant's most recent composite independent insurance company rating was:

(A) A.M. Best Company: "A—" or above;

(B) Duff & Phelps, Inc.: "AA—" or above;

(C) Moody's Investor Service, Inc.: "Aa" or above;

(D) Standard & Poor's Corp.: "AA" or above; or

(E) Weiss Research, Inc.: "A"; or

(ii) *Adequate rating and earnings—*(A) *Adequate rating.* The applicant's most recent composite independent insurance company rating was:

(1) A.M. Best Company: "C+" to "B++";

(2) Duff & Phelps, Inc.: "BB-" to "A+";

(3) Moody's Investor Service, Inc.: "Ba" to "A";

(4) Standard & Poor's Corp.: "BB" to "A"; or

(5) Weiss Research, Inc.: "B" or "C"; and

(B) *Earnings.* The applicant had positive annualized adjusted earnings in two of the three most recent calendar years; and

(5) *Minimum performance ratios.* The applicant meets the minimum performance ratios in paragraph (b)(5)(ii) of this section during the most recent year-end or quarter-end period.

(i) *Definitions.* For purposes of this paragraph (b)(5):

(A) *Traditional life insurance products* means insurance business that consists of individual term life insurance contracts, individual

permanent fixed value life insurance contracts, or policies that consist of fixed premiums, fixed dollar amounts of contract, or fixed reserves (cash value) established by each state.

(B) *Interest sensitive life insurance products (universal or whole life)* means insurance business that consists of individual life insurance policies characterized by flexible premiums, dollar amounts of contract that can vary, and reserves which represent a pool of assets such as mutual funds that are held for the benefit of, and support the investment return to, policy holders.

(C) *Accident and health insurance products (indemnity)* means insurance business that consists of coverage for care such as basic hospital expense, basic surgical expense, dental care, specific hospital reimbursement, long-term nursing home or home care expenses for the aged or disabled, major medical expense, and Medicare supplemental insurance.

(D) *Individual and group annuity insurance products* means insurance business that consists of contracts that accumulate and disburse retirement benefits to individual policyholders or to companies for their employees, hold pension deposit funds or distribute and hold funds under guaranteed interest contracts.

(E) *Disability income insurance products* means insurance business that consists of contracts that pay income periodically to insureds who are unable to work as a result of sickness or injury.

(F) *Property insurance products* means insurance business that consists of policies where the majority of premiums go to cover losses to real property, automobiles or similar tangible assets.

(G) *Liability insurance products* means insurance business that consists of policies that cover losses arising from actions taken by individuals or companies, including losses from litigation or mutual agreements as to the amount of a claim such as product liability, medical malpractice and worker's compensation.

(ii) *Overall minimum performance ratios.—*(A) *Premium to surplus ratio.*

(1) *Calculation.* Divide net premiums written by total capital and surplus.

(2) *Standard.* The applicant's net premiums may not exceed three times the level of capital and surplus.

(B) *Change in net premiums written ratio.—*(1) *Calculation.* Divide the change in net premiums written between the two most recent consecutive calendar years by the total net premiums written in the first year.

(2) *Standard.* The applicant's ratio must be between -10 percent and +50 percent.

(C) *Surplus relief ratio.—*(1) *Calculation.* Divide the net of commissions and expenses generated by reinsurance ceded and assumed by total capital and surplus.

(2) *Standard.* The applicant's ratio must be less than 30 percent.

(D) *Adequacy of investment income ratio.—*(1) *Calculation.* Divide net investment income by the sum of total tabular interest required on life insurance, accident and health reserves, and total interest credited on funds held on deposit.

(2) *Standard.* The applicant's net investment income must provide no less than 1.25 times the coverage on total funds held in reserves to pay interest on contractual obligations and funds held on deposit.

(E) *Change in capital and surplus ratio.—*(1) *Calculation.* Divide the net change in capital and surplus between the two most recent consecutive calendar years, by total capital and surplus in the first year.

(2) *Standard.* The applicant's ratio must be between -10 percent and +50 percent.

(iii) *Solvency ratios.—*(A) *Highly liquid ratio.—*(1) *Calculation.* Divide highly liquid assets by annuity and deposit fund reserves less reserves with no withdrawal privileges, separate accounts and reinsurance.

(2) *Standard.* The applicant's ratio must be no less than:

(i) 75 percent on traditional life insurance products;

(ii) 85 percent on interest sensitive life insurance products;

(iii) 85 percent on individual annuity insurance products;

(iv) 100 percent on group annuity insurance products;

(v) 79 percent on property and liability insurance products;

(vi) 75 percent on accident and health insurance products; and

(vii) 50 percent on disability income insurance products.

(B) *Current ratio.—*(1) *Calculation.*

Divide liquid assets by annuity, ordinary life, and deposit fund reserves, less reserves with no withdrawal privileges, separate accounts, reinsurance, and policy loans.

(2) *Standard.* The applicant's ratio must be no less than:

(i) 60 percent on traditional life insurance products;

(ii) 75 percent on interest sensitive life insurance products;

(iii) 75 percent on individual and group annuity insurance products;

(iv) 87 percent on property and liability insurance products;

(v) 75 percent on accident and health insurance products; and

(vi) 50 percent on disability income insurance products.

(C) *Adjusted liabilities to adjusted surplus ratio.*—(1) *Calculation.* Divide adjusted liabilities by adjusted surplus.

(2) *Standard.* The applicant's ratio must not exceed:

(i) 10 to 1 on traditional life insurance products;

(ii) 10 to 1 on interest sensitive life insurance products;

(iii) 10 to 1 on individual and group annuity insurance products;

(iv) 3 to 1 on property and liability insurance products;

(v) 3 to 1 on accident and health insurance products; and

(vi) 5 to 1 on disability income insurance products.

§ 933.17 Rebuttable presumptions.

(a) *Overcoming presumptive compliance.* The presumption that an applicant meeting the standards described in §§ 933.7 to 933.16 of this part is in compliance with the Act and § 933.6(a) of this part, may be overcome if the Bank obtains compelling evidence to the contrary.

(b) *Overcoming presumptive noncompliance.* An applicant that does not meet all of the standards in §§ 933.7 to 933.16 of this part, or that is unable to provide the information required to evaluate whether or not it meets those standards, shall be deemed not to be in compliance with the Act and § 933.6(a) of this part unless the applicant rebuts the presumption, as described in this section, and the Bank determines that the applicant has complied with the Act and § 933.6(a) of this part.

(c) *Noncompliance with financial condition standards.*—(1) *Compelling written justification.* For each variance from the minimum regulatory examination rating required by § 933.11(b)(3) of this part, an applicant shall prepare a written justification that provides compelling evidence that the applicant is in the financial condition required by § 933.6(a)(4) of this part, notwithstanding the variance.

(2) *Substantial written justification.* For each variance from a performance criterion required by § 933.11(b)(3), of this part, the applicant shall prepare a written justification pertaining to that performance criterion that provides substantial evidence that the applicant is in the financial condition required by § 933.6(a)(4) of this part, notwithstanding the variance.

(d) *Noncompliance with character of management standards.*—(1) *Enforcement actions.* If an applicant or any of its directors or senior officers is

subject to or operating under an enforcement action, the applicant shall provide:

(i) *Regulator confirmation.* Written confirmation from the applicant's appropriate regulator that the applicant or its directors or senior officers are in substantial compliance with all aspects of the enforcement action; or

(ii) *Written analysis.* A written analysis stating each action the applicant or its directors or senior officers is required to take by the enforcement action, the actions actually taken by the applicant or its directors or senior officers, and whether the applicant regards this as substantial compliance. If the Bank is uncertain whether the applicant has substantially complied with all aspects of the enforcement action, the Bank shall consult the applicant's appropriate regulator.

(2) *Certain criminal, civil or administrative proceedings.* If an applicant or any of its directors or senior officers is subject to criminal, civil or administrative proceedings that reflect on creditworthiness, business judgment or moral turpitude since the last examination, the applicant shall provide:

(i) *Regulator confirmation.* Written confirmation from the applicant's primary regulator that the proceedings will not likely result in enforcement action; or

(ii) *Written analysis.* A written analysis of the severity of the pending charges and any mitigating action taken by the applicant or its directors or senior officers. If the Bank is uncertain whether the proceedings will result in enforcement action, the Bank shall consult the applicant's primary regulator.

(3) *Material monetary liabilities.* If there are any material known or potential civil, criminal or administrative monetary liabilities, pending law suits, or unsatisfied judgments against the applicant or its directors or senior officers as of the most recent quarter-end, the applicant shall provide:

(i) *Regulator confirmation.* Written confirmation from the applicant's primary regulator that the matter will not likely cause the applicant to fall below its minimum capital requirements; or

(ii) *Written analysis.* A written analysis of each matter, the likelihood of the applicant or its directors or senior officers prevailing and the financial consequences if the applicant or its directors or senior officers do not prevail. If the Bank is uncertain whether the matter will cause the applicant to

fall below its minimum capital requirements, the Bank shall consult the applicant's primary regulator.

(e) *Noncompliance with home financing policy standards.* If an applicant received a "substantial non-compliance" rating on its most recent CRA performance evaluation, two consecutive "needs to improve" CRA ratings, or has not received a CRA performance evaluation within four years from the date of the membership application, the applicant shall provide:

(1) *Regulator confirmation.* Written confirmation from the applicant's primary regulator of the applicant's recent satisfactory CRA performance, including any corrective action that substantially improved upon the deficiencies cited in any recent CRA performance evaluation; or

(2) *Written analysis.* A written analysis demonstrating that the CRA rating is unrelated to housing finance, or providing substantial evidence that the applicant's home financing credit policies and lending practices (if applicable) are consistent with the Bank System's housing finance mission.

§ 933.18 Determination of appropriate Bank district for membership.

(a) *Eligibility.* (1) An institution eligible to become a member of a Bank under the Act and this part may become a member only of the Bank of the district in which the institution's principal place of business is located, except as provided in paragraph (a)(2) of this section.

(2) An institution eligible to become a member of a Bank under the Act and this part may become a member of the Bank of a district adjoining the district in which the institution's principal place of business is located, if demanded by convenience and then only with the approval of the Board.

(b) *Principal place of business.* Except as otherwise designated in accordance with this section, the principal place of business of an institution is the state in which the institution maintains its home office established as such in conformity with the laws under which the institution is organized.

(c) *Designation of principal place of business.* (1) A member or an applicant for membership may request in writing to the Bank in the district where the institution maintains its home office that a state other than the state in which it maintains its home office be designated as its principal place of business. Within 90 days of receipt of such written request, the board of directors of the Bank in the district where the

institution maintains its home office shall designate a state other than the state where the institution maintains its home office as the institution's principal place of business, provided all of the following criteria are satisfied:

- (i) At least 80 percent of the institution's accounting books, records and ledgers are maintained, located or held in such designated state;
- (ii) A majority of meetings of the institution's board of directors and constituent committees are conducted in such designated state; and
- (iii) A majority of the institution's five highest paid officers have their place of employment located in such designated state.

(2) Written notice of a designation made pursuant to paragraph (c)(1) of this section shall be sent to the Bank in the district containing the designated state, the Board and the institution.

(3) The notice of designation made pursuant to paragraph (c)(1) of this section shall include the state designated as the principal place of business and the resulting Bank to which membership will be transferred.

(4) If the board of directors of the Bank in the district where the institution maintains its home office fails to make the designation requested by the member or applicant pursuant to paragraph (c)(1) of this section, then the member or applicant may request in writing that the board make the designation.

(d) *Transfer of membership.* (1) No transfer of membership from one Bank to another Bank shall take effect until the Banks involved reach agreement on a method of orderly transfer.

(2) In the event that the Banks involved fail to agree on a method of

orderly transfer, the Board shall determine the conditions under which the transfer shall take place.

(e) *Effect of transfer.* A transfer of membership pursuant to this section shall be effective for all purposes including directorial representation under section 7(c) of the Act, 12 U.S.C. 1427(c), and § 932.11 of this chapter, but shall not be subject to the provisions on termination of membership set forth in section 6 of the Act, 12 U.S.C. 1426, or §§ 933.26, 933.27 and 933.29 of this part, including the restriction on reacquiring Bank membership set forth in § 933.30 of this part.

8. In the list below, for each section indicated in the left column, remove the reference indicated in the middle column from where it appears and add the reference indicated in the right column:

Section	Remove	Add
933.20(b)(1)	§§ 933.2(c) or 933.3	§ 933.3
933.20(b)(2)	§ 933.2(d)	§ 933.4(a)
933.22(b)(1)	§ 933.2(d)	§ 933.4(a)
933.23	§ 933.7(a)	§ 933.20(a)
933.24(a)(2)	§ 933.18(d)	§ 933.31(d)
933.24(b)(2)	§ 933.7(a)	§ 933.20(a)
933.25(c)	§ 933.7(a)	§ 933.20(a)
933.25(d)(2)(ii) (A) and (B)	§ 933.16	§ 933.29
933.25(d)(3)	§ 933.2	Subpart B
933.26(c)	§ 933.7(a)	§ 933.20(a)
933.27(e)	§ 933.16	§ 933.29
933.28(b)	§ 933.16	§ 933.29
933.29(a)(1)	§ 933.16	§ 933.29
933.30 introductory text	§§ 933.13, 933.14 or 933.15	§§ 933.26, 933.27 or 933.28
933.30(a)	§§ 933.11(b) or 933.12(d)(3)	§§ 933.24(b) or 933.25(d)(3)
933.30(b)	§ 933.13	§ 933.26
933.31(d)	§ 933.5	§ 933.18
	§ 933.2(d)	§ 933.4(a)
	§ 933.9(b)(1)	§ 933.22(b)(1)

Dated: October 5, 1995.
 By the Federal Housing Finance Board.
 Bruce A. Morrison,
Chairman.
 [FR Doc. 95-25823 Filed 10-26-95; 8:45 am]
 BILLING CODE 6725-01-U

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Office of the Assistant Secretary for Public and Indian Housing
24 CFR Part 882
[Docket No. FR-3709-C-02]
RIN 2577-AB48
Section 8 Moderate Rehabilitation; Rent Adjustments; Annual and Special Adjustments; Comparability Studies; Rent Reductions; Technical Correction
AGENCY: Office of the Assistant Secretary for Public and Indian Housing, HUD.
ACTION: Proposed rule; technical correction.
SUMMARY: On October 2, 1995 (60 FR 51658), HUD published a proposed rule

that would revise the current regulations on adjusting Section 8 Moderate Rehabilitation Contract Rents. The rule proposed to modify the method used by Public Housing Agencies (PHAs) to determine the amount of the annual increase in the Contract Rents by providing for PHAs to conduct comparability studies for Moderate Rehabilitation projects to prevent the application of the Annual Adjustment Factors from resulting in a material difference between rents charged for assisted units and similar unassisted units.
 The purpose of this document is to correct certain technical errors that appeared in the October 2, 1995 proposed rule.
DATES: Comment Due Date: December 1, 1995.