BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

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U.S. Department of Housing and Urban Development
Room 9254
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Dear Mr. Lasner:

Thank you for meeting with my staff and the staffs of the Office of the Comptroller of the Currency ("OCC"), the Federal Deposit Insurance Corporation, ("FDIC"), and the Office of Thrift Supervision ("OTS"), regarding the ability of insured depository institutions that issue securities that are guaranteed by the Government National Mortgage Association ("GNMA") to enter into cross-default agreements on behalf of their affiliates that also issue GNMA securities.

It is my understanding that GNMA requires GNMA issuers that are related entities to enter into cross-default agreements whereby the default by one GNMA issuer constitutes a default by all related GNMA issuers. In the case of a default, GNMA and the defaulted issuer generally enter into negotiations to correct the default through an interim moratorium or other arrangements that are mutually agreeable to each party. Under the cross-default agreement, however, GNMA also is permitted to perfect its rights in the pooled mortgages and custodial accounts of the defaulted issuer and as well as related issuers. In addition, GNMA can pursue other remedies against the defaulted issuer and the related issuers. The Board and other federal regulatory banking agencies believe that a cross-default agreement whereby an insured depository institution guarantees the performance of an uninsured affiliate and the insured depository institution's assets are permitted to be used to support the obligations of an uninsured affiliate is subject to the limitations imposed by section 23A of the Federal Reserve Act.[1/]

[1/] 12 U.S.C. § 371c. In general, transactions between affiliated banks are exempt from section 23A. 12 U.S.C. § 371c(d)(1). Transactions between most affiliated savings

(continued...)

Section 23A seeks to protect insured depository institutions from abuses that the statute presumes may result from affiliation by restricting, and in some cases prohibiting, financial transactions between insured depository institutions and their affiliates.[2/] In general, section 23A provides that certain transactions between an insured depository institution and a single affiliate are limited to 10 percent of the institution's capital and surplus, and transactions between an insured depository institution and all of its affiliates are limited to 20 percent of the institution's capital and surplus.[3/] In addition, certain transactions, such as guarantees or letters of credit issued on behalf of an affiliate, must be secured by collateral having a market value equal to between 100 and 130 percent of the dollar amount of that transaction, depending on the type of collateral used as security.[4/]

Board staff believes that the execution of a cross-default agreement by an insured depository institution on behalf of its affiliate coupled with the cross-collateralization provisions present here is the equivalent of the issuance of a guarantee that is subject to the quantitative and collateral requirements of section 23A. Accordingly, insured depository institutions may not enter such cross-default agreements with respect to an uninsured related entity where the potential liability of the agreement would exceed the insured institution's quantitative limits that are imposed by section 23A. In addition, any such cross-default agreement by an insured depository institution on behalf of an affiliate would need to be secured by collateral in the amounts set forth in the statute. The guarantee also may be a problem for some insured depository

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[1/](...continued)
associations are subject to the limitations imposed by section 23A, however, until 1995. 12 U.S.C. § 1968(a)(2)(A).

[2/] In general, an "affiliate" is a company that controls the insured depository institution, a company that is controlled by a company that controls the insured depository institution, or a company that is controlled by shareholders that control 25 percent or more of the insured depository institution and the company. 12 U.S.C. § 371c(b)(1).

[3/] 12 U.S.C. § 371c(a)(1). Although section 23A, by its literal terms, only applies to member banks (including national banks), the Federal Deposit Insurance Act and the Home Owners' Loan Act apply section 23A to state chartered nonmember banks and thrift institutions. See 12 U.S.C. §§ 1828(j) and 1468.

[4/] 12 U.S.C. § 371c(c).

institutions inasmuch as insured depository institutions may be prohibited in certain circumstances from guaranteeing the obligations of others.

The staffs of the Board, FDIC, OCC and OTS recognize GNMA's concerns regarding its needs to protect its resources against losses that result when an institution defaults on its obligations, and the agencies are willing to work with GNMA in order to ensure that the institutions under each agency's supervision are operating consistent with safe and sound banking practices and in compliance with applicable law and regulation. The agencies are also willing to cooperate with GNMA and the insured institutions to help identify contractual arrangements dealing with default situations that create problems under section 23A and to help resolve problems that may result from the default of a related entity.

The staff of the agencies are available to discuss these matters with your staff at anytime. Please feel free to contact Ms. Pamela G. Nardolilli (202/452-3289) of my staff if you have further questions.

Sincerely,

(signed)
J. Virgil Mattingly, Jr.

cc: Ms. Aline Henderson, OTS
Ms. Peggy Hesse, OCC
Ms. Pamela LeCren, FDIC