October 2, 2008

MEMORANDUM TO: Board of Directors

FROM: Sandra L. Thompson
Director

SUBJECT: Interagency Notice of Proposed Rulemaking on Capital Treatment of Certain Claims on or Guaranteed By, the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac)

Proposal: That the Board of Directors (Board) of the Federal Deposit Insurance Corporation (FDIC) approve the publication of the attached Notice of Proposed Rulemaking (NPR) on Capital Treatment of Certain Claims on or Guaranteed By, the Federal national Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac)
for public comment. If approved, the NPR would be published in the *Federal Register* on an interagency basis by the FDIC, the Board of Governors of the Federal Reserve System, the Office of Thrift Supervision, and the Office of the Comptroller of the Currency (together, the Agencies) with a 30-day comment period.

Under the Agencies' general risk-based capital rules, a banking organization may assign a risk weight of 20 percent to claims on or guaranteed by U.S. government-sponsored agencies. In light of the additional financial support that the U.S. Treasury has committed to provide under the senior preferred stock purchase agreements (the Agreements) with the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), agency staffs believe that the credit risk associated with claims on, or guarantees of, these organizations has diminished.

The NPR solicits comment on all aspects of the proposed rule.

Recommendation: That the Board approve publication of this NPR for a public comment period of 30 days.

Concur:

____

Sara A. Kelsey
General Counsel

Discussion

Background

On September 7, 2008, the U.S. Department of Treasury (Treasury) entered into the Agreements with Fannie Mae and Freddie Mac. Under the terms of the Agreements, Treasury has committed $100 billion to Fannie Mae and Freddie Mac, respectively, which can be drawn upon a determination by the Federal Housing Finance Agency that liabilities exceed assets under generally accepted accounting principles (GAAP). In return, Treasury received a $1 billion interest in Fannie Mae and Freddie Mac, respectively, in the form of senior preferred stock, as well as warrants for the purchase of common stock (representing a 79.9 percent equity interest in each entity). Treasury also will receive annual dividends at 10 percent per annum and, beginning on March 31, 2020, quarterly commitment fees to fully compensate the Treasury for its explicit support under the Agreements. These Agreements effectively provide protection to the holders of senior debt, subordinated debt, and mortgage-backed securities (MBS) issued or guaranteed by Fannie Mae and Freddie Mac.

Under the Agencies' general risk-based capital rules, a banking organization may risk weight claims on or guaranteed by U.S. government-sponsored agencies at 20 percent.[1]

Proposed Rule

Agency staffs believe that the equity support provided by the Agreements significantly reduces the credit risk associated with the debt and guarantees issued by Fannie Mae and Freddie Mac. As such, the agency staffs have developed an NPR that would propose to permit a banking organization to assign a 10 percent risk weight for claims on and guaranteed by Fannie Mae and Freddie Mac. Claims include all credit exposures, such as senior and subordinated debt and counterparty credit risk exposures, but do not include preferred or common stock. The 10 percent risk weight would apply to these exposures as long as the Agreements remain in effect. The NPR would also solicit comment on all aspects of the proposal.

In some cases, banks may hold an insignificant amount of Fannie Mae and Freddie Mac debt or guaranteed exposures. In these cases, FDIC staff believes that a requirement to lower the risk weight of these exposures may increase burden as operational costs could outweigh the regulatory capital benefits of a decrease in risk weight. Therefore, the proposed rule would allow a bank to continue to risk weight claims on or guaranteed by Fannie Mae and Freddie Mac at 20 percent.

[1] 12 CFR part 325, Appendix A (FDIC).

The proposed rule would only affect the manner in which risk-based capital is calculated for claims on or guaranteed by Fannie Mae and Freddie Mac. The proposal would not affect the calculation of the leverage ratio with respect to these exposures.

RECOMMENDATION

Staff recommends that the Board of Directors of the Federal Deposit Insurance Corporation approve the publication of the attached NPR for a public comment period of 30 days.

DSC Contacts:	Bobby Bean (ext. 83575)
Legal Division Contacts:	Mark Handzlik (ext. 83990) Michael Phillips (ext. 83581)