



Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

March 15, 2002

Interpretive Letter #931
April 2002
12 USC 24(7)

Re: Purchases of Perpetual Preferred Stock by [] (“Bank”)

Dear []:

This responds to the Bank’s request that the OCC determine whether a national bank may hold two issues of perpetual preferred stock as investment securities under 12 C.F.R. Part 1. For the reasons described below, we conclude that a national bank may invest in perpetual preferred stock issued by the Federal National Mortgage Association (“Fannie Mae”) and by the Federal Home Loan Mortgage Corporation (“Freddie Mac”) without limit, subject to safety and soundness considerations.

I. Background

The Bank is interested in holding Fannie Mae and Freddie Mac perpetual preferred stock. Both securities are rated A or better by two nationally recognized statistical rating organizations (“NSROs”). Both issuers may declare dividends quarterly, out of funds legally available. The holders of both issues do not participate or share in the profits of the issuers. Rather, their return is limited to stated dividends. Both securities are noncumulative. If the issuers do not declare a dividend in a quarter, holders do not have a right to receive that quarter’s dividend in the future. Both issues are redeemable by their issuers, starting in 2006, at \$50 per share plus accrued dividends for the quarter. Both preferred issues are senior to the issuers’ common stock. The issuers may not declare a dividend on common stock in a particular quarter without first paying a dividend on the preferred stock. In the event of a dissolution or liquidation, holders of both issues will receive out of assets available for distribution up to \$50 per share plus a pro-rata share of the dividend for the quarter before any distributions to common shareholders. The preferred shares are nonvoting, except that Fannie Mae preferred shareholders may vote on limited matters regarding preferred stock.

II. Discussion

The plain language of section 24(Seventh) authorizes national banks to purchase and hold preferred stock of Freddie Mac and Fannie Mae without quantitative limits.

Section 24(Seventh) permits national banks to hold “mortgages, obligations, or other securities which are or ever have been sold by [Freddie Mac] pursuant to section 305 or section 306 of the Federal Home Loan Mortgage Corporation Act” (emphasis added).¹ Section 306(g) of the Federal Home Loan Mortgage Corporation Act empowers Freddie Mac to issue “preferred stock on such terms and conditions as the Board of Directors shall prescribe.”² Freddie Mac preferred stock is a “security”³ that national banks may hold under section 24(Seventh).

Section 24 (Seventh) also authorizes banks to purchase and hold Fannie Mae perpetual preferred stock. Section 24(Seventh) permits national banks to hold “obligations, participations, or other instruments of or issued by” Fannie Mae. Since the term “instrument” is commonly defined to include securities,⁴ we believe this language affords a basis for national banks to purchase and hold Fannie Mae perpetual preferred stock.

Section 24(Seventh) generally restricts national banks’ dealing, underwriting, purchasing and selling securities. Section 24(Seventh) exempts Freddie Mac “securities” and Fannie Mae “instruments” from these restrictions. Thus, banks’ holdings of Freddie Mac and Fannie Mae preferred securities are not subject to quantitative limits, other than safety and soundness considerations. Examples of the prudential controls the OCC would expect to see in a bank investing in these instruments include: implementation of appropriate diversification principles, adoption of concentration limits on the securities of any one issuer and consideration of the impact on the bank's overall interest rate and liquidity risk profiles.

III. Conclusion

Accordingly, a national bank may invest in perpetual preferred stock issued by Fannie Mae and by Freddie Mac. This investment is not subject to quantitative limits on the amount of such stock that the bank may hold, but the amount is subject to safety and soundness considerations, including the prudential controls noted above. If you have any questions, please contact me at 202-874-5210.

Sincerely,

/s/

Nancy Worth
Counsel

¹ Indeed, the OCC previously relied on this same language in section 24(Seventh) in concluding that national banks may purchase and hold preferred stock of Freddie Mac. Interpretive Letter No. 577, *reprinted in* [1991-1992 Transfer Binder] Fed. Banking Law. Rep. (CCH) ¶ 83,347 (April 6, 1992).

² 12 U.S.C. 1455(f).

³ Interpretive Letter No. 577, *supra*.

⁴ Black’s Law Dictionary, 5th ed. (West 1979).

Securities and Corporate Practices Division