

November 9, 2004

Re: Interpretive Letter 1-2004: Request under Section 362.106(4), RSMo. Activity requested - Bank Investment in Non-Cumulative Preferred Stock of the Federal Home Loan Mortgage Corporation

In a October 13, 2004 letter presented by your attorney, the bank requested a determination by the Missouri Division of Finance that a Missouri state-chartered bank be authorized to invest in Non-Cumulative Preferred Stock of the Federal Home Loan Mortgage Corporation to the same extent as national banks. You cited 12 USC sec. 24, seventh, and Letter No. 931 issued by the Office of the Comptroller of Currency (OCC) authorizing this investment for national banks.

Under Section 362.106(4), RSMo, Missouri's "Super Wildcard Law", state-chartered banks may exercise specific powers that are requested in a notice and writing submitted to the director of finance if within the notice period the director determines that the proposed activity is not unsafe or unsound and that the bank meets the prescribed federal standards for national banks. The director may either take no action or issue an interpretive letter that specifically describes the activity permitted and any limitations on the activity.

Determination

The Division of Finance determines that a Missouri state-chartered bank may invest in Non-cumulative Preferred Stock of the Federal Home Loan Mortgage Corporation to the same extent and under the same standards as national banks under 12 USC Sec. 24, seventh. The Division of Finance finds that the proposed activity is not

unsafe or unsound provided prudential controls as described in Interpretive Letter No. 931 are implemented by the bank. Examples of prudential controls include implementation of appropriate diversification principles; adoption of concentration limits on the securities of anyone issuer; and, consideration of the investment in regard to the bank's overall interest rate and liquidity risk profiles. Note that the Division does not view this investment as falling under exceptions to the bank's legal loan limit thus an investment in excess of the bank's legal loan limit would be an unsafe and unsound practice.

Findings

Under Section 362.106(4), as relevant to this request, upon the approval of the Director of the Division of Finance, a Missouri bank may conduct any activity that a national bank is authorized to conduct if it meets prescribed standards applicable to a national bank in exercising such power and satisfies any limitations imposed regarding such activity. In granting approval, the Director must also determine that the proposed activity is not an unsafe or unsound practice and that the bank meets the prescribed standards for conducting such activity.

12 USC Section 24, seventh, allows national banks to purchase "investment securities" under such limitations and restrictions as the Comptroller of the Currency may prescribe by regulation. Investment securities are defined as marketable obligations, evidencing indebtedness of any person, co-partnership, corporation or association in the form of bonds, notes or debentures commonly known as investment securities and under such further definition of the term "investment securities" as may by regulation be prescribed by the Comptroller of the Currency.

Interpretive Letter No. 931, dated April 2002, issued by the Office of the Comptroller of the Currency addresses whether perpetual preferred stock issued by the Federal Home Loan Mortgage Corporation may be held by a national bank as an investment security under 12 USC Section 24, seventh. According to Letter No. 931, 12 USC Section 24, seventh, authorizes a national bank to hold preferred stock of the Federal Home Loan Mortgage Corporation without quantitative limit, other than safety and soundness considerations. The Comptroller subjected this investment authority to the requirement that a bank implement appropriate prudential controls.

Considerations in evaluating whether a national bank has implemented prudential controls in making an investment include (i) implementation of appropriate diversification principles, (ii) adoption of concentration limits on the securities of any one issuer and (iii) consideration of the impact of the bank's overall interest rate and liquidity risk profile.

The threshold requirement under Section 362.106(4) is satisfied since the proposed activity – investment in the Preferred Stock – is authorized by law for national banks. Your bank will be subject to the same limitations as imposed on national banks in that prudential controls are required to manage the bank’s investment portfolio. The relevant requirements of Section 362.106(4) are satisfied.

The only further determination required of the Division is that the proposed activity does not present an unsafe and unsound practice. The Preferred Stock purchased by the bank is highly rated “aa3” by Moody’s Investors Service, Inc. and “AA-” by Standard and Poor’s Credit Market Services. The stock has a fixed rate dividend paid quarterly but dividends are non-cumulative and are paid when and if declared by the Federal Home Loan Mortgage Corporation’s Board of Directors. The Preferred Stock has no conversion rights, preemptive rights or voting rights. The Preferred Stock has no fixed maturity but may be redeemed by the issuer on March 31st of each year beginning in 2011 for \$50 per share plus any accrued dividends.

If the Federal Home Loan Mortgage Corporation dissolves or is liquidated, holders of the preferred stock will be scheduled to receive \$50 per share plus any accrued dividends. The preferred stock has priority over the common stock and any other junior stock with regards to dividend payments and upon liquidation.

The Preferred Stock is issued by an “agency” of the United States Government¹. The investment is liquid since it is listed on the New York Stock Exchange, and, if necessary, the Bank could sell its investment in the Preferred Stock.

The Preferred Stock has characteristics that resemble debt rather than a more speculative equity investment in that a set rate of return is provided and the holder of the Preferred Stock has preference to receive dividends and a preference in liquidation over the common shareholders.²

The Preferred Stock has the market risk and investment characteristics that are common to debt securities typically held and managed in a bank’s investment portfolio. Thus, prudent investment in these securities is not an unsafe an unsound banking practice.

¹ 12 USC 11A Section 1452 (f)(1) states that the Federal Home Loan Corporation shall be deemed to be an agency included in Sections 1345 and 1442 of Title 28.

² Note that the preferred stock also has some characteristics of an equity investment such as perpetual duration and non-cumulative dividends partially negating the security’s debt-like fixed rate of return. These characteristics must be taken into account by the bank in managing this investment.

The bank's request indicates it has policies to assure maintenance of a diversified investment portfolio. Our determination is not intended as an evaluation of the adequacy of the bank's present investment policies. This would be a matter better addressed in our regular supervision and examination process.

The Division finds that the investment authority requested is authorized by federal law for national banks. The Division further finds that the characteristics of the investment securities are such that a bank may safely and soundly invest in these securities provided appropriate prudential controls are implemented and followed by the bank.

This letter will be filed today with the Office of the Missouri Secretary of State and posted on the public internet website of the Division of Finance. It will become effective 10 days after filing with the Secretary of State. If you have any questions regarding this matter please contact Keith Thornburg, our chief counsel.

Very truly yours,

D. Eric McClure
Commissioner of Finance

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