

INTERPRETIVE LETTER NO. 96-2 (MARCH 18, 1996)

Purchases of stock in the Federal National Mortgage Association ("FNMA") are not subject to investment limits. However, the Agency may still have safety and soundness concerns based on concentrations or lack of diversification of the bank's investments.

This letter is being issued in response to your inquiry sent to the Commissioner of Banks and Trust Companies ("Agency") dated *. You ask whether a state bank is permitted to purchase Federal National Mortgage Association ("FNMA") stock and whether there is a limitation on the amount of stock purchased. For the reasons set forth below, state banks are allowed to invest in FNMA stock and that investment is not subject to a legal investment limitation.

The Agency's Interpretive Letter 87-2 concluded that the Agency has no objection to the investment in FNMA stock or Student Loan Marketing Association ("Sallie Mae") stock in excess of 20% of capital and surplus. That interpretation was based on the fact that national banks may invest in FNMA stock without limitation under Section 24(Seventh) of the National Bank Act, 12 U.S.C.A. ' 24(Seventh) (West 1994). Therefore, Interpretive Letter 87-2 reasoned that Section 5(11) of the Illinois Banking Act, 205 ILCS 5/5(11), would permit state banks to invest, without limitation, in the obligations of FNMA to preserve parity with national banks. A copy of Interpretive Letter 87-2 is enclosed for your review.

The Agency is issuing this letter concerning bank ownership of FNMA stock because Interpretive Letter 87-2 does not address concerns of the Agency which are unrelated to whether the bank's investment in FNMA stock complies with the bank's legal investment limit. A bank's investment in FNMA stock without limitation may raise several safety and soundness concerns. Investments in FNMA stock should be made in accordance within the authority granted by the board of directors as provided for in the investment policy. Bank directors and officers should be aware that FNMA stock is not guaranteed by the United States Government in any way and that as a publicly traded corporation, the price of the stock fluctuates and therefore possesses significant market risk. In accordance with these concerns, an amount of FNMA stock representing a large percentage of total capital may not violate legal investment limits, but may be considered unsafe and unsound because of an excessive concentration or lack of diversification in the bank's investment portfolio. Finally, a bank's investment into FNMA obligations will be assessed along with the balance of a bank's investment portfolio for compliance with policy guidelines and investment goals, asset quality and effect on earnings.

¹While this letter specifically addresses investments in FNMA stock, the same interpretation applies to investments in Sallie Mae stock.