



REGULATORY INTERPRETATION 2002-RI-07

Date: November 19, 2002

Subject: Classification of Fannie Mae Multifamily Assured Schedule Payment Trust Certificates (MAST bonds)

Request Summary:

A Federal Home Loan Bank (Bank) has requested a regulatory interpretation that would classify the Bank's proposed purchase of Fannie Mae MAST bonds as an unsecured extension of credit to a government sponsored enterprise (GSE) under 12 C.F.R. § 932.9(c)(1), rather than an investment in MBS, CMOs or REMICs under section II.C.2. of the Financial Management Policy (FMP).

Conclusion:

Fannie Mae MAST bonds are REMICs and, therefore, must be included in a Bank's calculation of MBS, CMOs or REMICs under section II.C.2. of the FMP.

Background:

Section II.C.2. of the FMP provides that:

A Bank may enter into agreements to purchase MBS, CMOs, REMICs, and eligible asset-backed securities so long as such purchases will not cause the aggregate book value of such securities held by the Bank to exceed 300 percent of the Bank's capital.

This limit applies to all such securities purchased by a Bank, whether or not the securities are issued or guaranteed by a GSE.

Section 932.9(c)(1) of the Finance Board regulations establishes special limits for unsecured credit exposure to GSEs. Generally, unsecured extensions of credit by a Bank to a GSE that arise from the Bank's on- and off-balance sheet and derivative transactions may not exceed the lesser of the Bank's total capital or the GSE's total capital.

A Bank has requested that the Finance Board issue a Regulatory Interpretation that would allow the Bank to characterize its proposed purchase of Fannie Mae MAST bonds as an unsecured extension of credit to a GSE under 12 C.F.R. § 932.9(c)(1), rather than an investment in MBS, CMOs or REMICs under section II.C.2. of the FMP. Under such an interpretation, MAST bonds would be subject to the regulatory limit on unsecured extensions of credit to a GSE, rather than to the FMP limit on securities that cannot, in the aggregate, exceed 300 percent of the Bank's capital.

The Bank states that because Fannie Mae guarantees timely payment of principal and interest on the bonds, which are paid according to their original payment schedule regardless of any prepayment or foreclosure of the underlying mortgages, the bonds have substantially the same credit and payment characteristics as an agency debenture. The Bank also indicates that in the event of “full or partial prepayment of any underlying mortgage loans due to casualty, condemnation or certain other prepayments,” any such prepayments would be delivered to Fannie Mae in exchange for Fannie Mae debt obligations. The Bank contends that because any such Fannie Mae debt obligations would be unsecured, the MAST bonds also would become partially unsecured if that were to occur. Thus, the Bank believes that an investor likely would depend on Fannie Mae for full payment on the bonds, notwithstanding that the underlying Fannie Mae MBS would tend to make the MAST bonds a better credit than agency debentures that are entirely unsecured.

Discussion:

A review of a representative prospectus for the Fannie Mae MAST bonds indicates that the bonds are REMICs. Fannie Mae’s website describes the bonds as multiple-class, call-protected securities that restructure interest and principal payments from mortgage-backed securities into distinct tranches. Since September 2000, Fannie Mae has issued more than \$3.7 billion of MAST securities.

Although Fannie Mae guarantees the timely payment of principal and interest on the bonds, which are paid according to their original payment schedule regardless of any prepayment or foreclosure of the underlying securities, this is an added protection provided by Fannie Mae and does not cause the bonds to be reclassified as Fannie Mae debentures rather than REMICs. Moreover, the Bank’s statement that an investor likely would depend on Fannie Mae for full payment of the bonds applies to any MBS, CMO or REMIC issued by Fannie Mae, as investors generally rely on the Fannie Mae guarantee when purchasing such securities. Allowing bonds that clearly are REMICs to be considered as other instruments for the purpose of applying the 300 percent of capital limit would not be consistent with the plain language of the FMP. Therefore, an investment in such MAST bonds is subject to the 300 percent of capital limit on MBS, CMO, REMICs and eligible asset-backed securities in section II.C.2. of the FMP.

<p>A <u>Regulatory Interpretation</u> applies only to the particular transaction or activity proposed by the requestor, may be relied upon only by the requestor, and is subject to modification or rescission by action of the Board of Directors of the Finance Board. 12 C.F.R. part 907.</p>
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