
**Office of the Comptroller of the Currency
Board of Governors of the Federal Reserve System
Federal Deposit Insurance Corporation
Office of Thrift Supervision**

**Interagency Statement on the Regulatory Capital Impact of Losses on Fannie Mae
and Freddie Mac Preferred Stock**

October 24, 2008

As a result of the significant declines in value of Federal National Mortgage Association (“Fannie Mae”) and Federal Home Loan Mortgage Corporation (“Freddie Mac”) perpetual preferred stock after these entities were placed into conservatorship on September 7, 2008, and other factors related to these actions, banks, bank holding companies, savings associations, and savings and loan holding companies (collectively, banking organizations) holding these investments for purposes other than trading are presumed to have incurred other-than-temporary impairment losses if the cost basis of these investments is well in excess of the current market price of the stock. In addition, some banking organizations have realized losses on sales of their holdings of Fannie Mae and Freddie Mac perpetual preferred stock on or before September 30, 2008. These losses, whether from other-than-temporary impairments or sales, and the associated current or deferred tax effects must be recognized in earnings for financial reporting purposes and in the regulatory reports for September 30, 2008.¹

Prior to enactment of the Emergency Economic Stabilization Act of 2008 (EESA) on October 3, 2008, gains and losses on sales or exchanges of Fannie Mae and Freddie Mac perpetual preferred stock by banking organizations generally were considered capital gains and losses for federal income tax purposes. For banking organizations that sold or exchanged Fannie Mae or Freddie Mac perpetual preferred stock at a loss on or after January 1, 2008, and before September 7, 2008, or held such stock on September 6, 2008, and later sell or exchange it at a loss, Section 301 of EESA provides tax relief by treating these losses as ordinary losses rather than capital losses for federal income tax purposes.

Under Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* (FAS 109), a banking organization may not record the effect of this tax change until the

¹ For banks, Schedule RI of the Consolidated Reports of Condition and Income (Call Report); for bank holding companies, Schedule HI of the Consolidated Financial Statements for Bank Holding Companies (FR Y-9C); and for savings associations, Schedule SO of the Thrift Financial Report.

Banking organizations that have elected S Corporation status for federal income tax purposes generally are not subject to federal income taxes and do not report federal income taxes in their regulatory reports. Therefore, the tax issues discussed in this Interagency Statement generally are not applicable to S Corporation banking organizations.

period in which the law is enacted,² *i.e.*, the fourth quarter of 2008.³ Absent an ability to carry back the capital loss on its sale or exchange of Fannie Mae or Freddie Mac preferred stock or to generate capital gains to offset the loss on the sale or exchange of this preferred stock, a banking organization would likely need to reflect a valuation allowance against the deferred tax asset arising from this capital loss in the balance sheet of its regulatory report for each reporting period through the third quarter of 2008.⁴ The continuing need for this valuation allowance should be evaluated in the fourth quarter of 2008 in response to the enactment of Section 301 of EESA.⁵

The federal banking agencies⁶ recognize that a deferred tax asset valuation allowance related to a loss on Fannie Mae or Freddie Mac preferred stock that a banking organization reflects in its regulatory report balance sheet for the third quarter of 2008 may now be temporary. The agencies also recognize that, as a result of the legislation, some banking organizations that sold their preferred stock at a loss between January 1 and September 30, 2008, may be able to eliminate or substantially reduce the valuation allowance for the deferred tax asset associated with the loss in the fourth quarter of 2008 and may also be able to reduce a current income tax payable or record a current income tax receivable in the fourth quarter. Similarly, some banking organizations that recognized losses on their Fannie Mae or Freddie Mac preferred stock in their regulatory reports, but have not sold the stock, also may be able to eliminate or substantially reduce this valuation allowance in the fourth quarter of 2008.

Therefore, for purposes of their third quarter 2008 regulatory capital calculations, the federal banking agencies are allowing banking organizations to adjust the tax effects associated with losses on Fannie Mae and Freddie Mac preferred stock as if Section 301 of EESA had been enacted in the third quarter 2008.⁷ The federal banking agencies believe that this regulatory capital treatment is consistent with the intent of Congress to allow

² See paragraph 27 of FAS 109, which says: “Deferred tax liabilities and assets shall be adjusted for the effect of a change in tax laws or rates. The effect shall be included in income from continuing operations for the period that includes the enactment date.”

³ For banking organizations with fiscal years other than a calendar year, references in this Interagency Statement to the third and fourth quarters mean the three months ending September 30 and December 31, 2008, respectively.

⁴ Under FAS 109, a valuation allowance must be established for the portion of a deferred tax asset (which may be the entire deferred tax asset) for which it is more likely than not that a tax benefit will not be realized.

⁵ A banking organization affected by this legislation that issues financial statements for a reporting period ending on September 30, 2008, should disclose the change in tax treatment of the gain or loss on Fannie Mae and Freddie Mac preferred stock as a subsequent event in the notes to its financial statements, to the extent it is material.

⁶ The Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of Thrift Supervision.

⁷ Because the EESA was enacted in the fourth quarter of 2008, this regulatory capital adjustment is only applicable to the regulatory reports for September 30, 2008.

banking organizations to recognize the economic benefit of Section 301 in the third quarter of 2008. Banking organizations that elect to adjust their third quarter 2008 regulatory capital calculations must still follow generally accepted accounting principles (GAAP) for purposes of third quarter regulatory report balance sheets and income statements. Thus, to determine the amount, if any, of this regulatory capital adjustment, a banking organization should calculate the amount by which the equity capital, total assets, and net deferred tax assets reported in accordance with GAAP on its September 30, 2008 regulatory report balance sheet would have increased as of that date (for example, from the elimination or reduction of a deferred tax asset valuation allowance, the reduction of a current income tax payable, or the recognition of a current income tax receivable) if the banking organization's loss on the preferred stock had been treated as an ordinary loss rather than a capital loss. However, a banking organization that makes this third quarter 2008 regulatory capital adjustment remains subject to the limits on the amount of deferred tax assets includable in Tier 1 capital under the applicable regulatory capital standards.⁸

The attached appendices provide detailed guidance on reporting the effect of the change in the tax treatment of losses on Fannie Mae and Freddie Mac preferred stock in the regulatory capital schedule of the September 30, 2008, regulatory reports for banks, bank holding companies, and savings associations. Banking organizations should refer to the appendix appropriate to their regulatory reports. Banking organizations that have already filed their regulatory reports for the third quarter of 2008 may elect to submit amended regulatory reports.

⁸ See 12 C.F.R Part 3, Appendix A, section 2(c)(1)(iii) for national banks; 12 C.F.R. Part 208, Appendix A, section II.B.4 for state member banks; 12 C.F.R. Section 325.5(g) for insured state nonmember banks; 12 C.F.R. Part 225, Appendix A, section II.B.4 for bank holding companies; and Thrift Bulletin 56 (TB 56), "Regulatory Reporting of Net Deferred Tax Assets" (January 20, 1993), and proposed 12 C.F.R. § 567.12(h) (73 Federal Register 56762, September 30, 2008) for savings associations.