T R O U B L E D   C O M P A N Y   R E P O R T E R

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FANNIE MAE & FREDDIE MAC: A Third Look at the Implicit Guarantee

We reported in yesterday's newsletter, Fannie Mae and Freddie Mac preferred shareholder Joshua J. Angel appeared in In re Third Amendment Litigation, MDL No. 2713 (J.P.M.L.), last week, with a collection of government documents supporting his contention that:

(A) the government's implicit guarantee of preferred shares has always been in place;

(B) that implicit guarantee did not change when the GSEs were placed into conservatorship; and

(C) the guaranty is still in place today.

It's important to understand that Mr. Angel does not challenge or contest the imposition of the conservatorship in 2008 nor does he want to unwind the Net Worth Sweep imposed in 2012. The conservatorship and Third Amendment make no difference to Mr. Angel. He wants the government to honor its promises. He wants Fannie and Freddie's directors to do their jobs and fulfill their fiduciary duties to preferred shareholders, and he's preparing to sue them individually if they don't.

Today, we step through the documents Mr. Angel's unearthed.

Mr. Angel's starting point is a Board of Governors of the Federal Reserve System Internal Discussion Paper (IFDP 1045) dated Mar. 2012. That paper -- available at http://goo.gl/O26TsE -- explores how hundreds of U.S. banks owned GSE preferred stock and that they were allowed to treat those riskless securities as Tier I capital. Without the government's implicit guarantee of the GSEs' preferred stock, the Tier I classification would be impossible.

Mr. Angel then turns to the GSEs' sale of $22 billion of preferred stock within a year of entering conservatorship and a sale of $4.8 billion less than four months prior to entering conservatorship. But for the government's implicit guarantee, the GSEs' ability to sell, at par, twice as much preferred stock as it had outstanding a year earlier would have been impossible.

Mr. Angel examines price movements of Fannie Mae's Series T Preferred shares as the housing finance giant marched toward conservatorship.

The securities maintained 60% of their value as Treasury Secretary Paulson announced the conservatorship plan -- prices reflecting the government's implicit guarantee of GSE preferred securities.

Mr. Angel observes that after Fannie Mae entered conservatorship, it timely made Treasury-directed payments totaling $413 million to certain holders of its preferred shares. This is the "Animal Farm equality, where all preferred shareholders are equal, but some are more equal than others," to which Mr. Angel refers and was mentioned in yesterday's newsletter.

Mr. Angel also points to a Treasury-issued news release -- see https://goo.gl/ZO00N4 -- dated Sept. 11, 2008, that affirmed the implicit guarantee when it said, "[T]he U.S. Government stands behind the preferred stock purchase agreements and will honor its commitments. Contracts are respected in this country as a fundamental part of rule of law."

As every corporate restructuring professional knows, the government's warrants for 79.9% of the GSEs' common stock have no value whatsoever unless and until the GSEs honor their obligations to the companies' pre-conservatorship preferred shareholders. No rational person at the U.S. Treasury Department would allow those warrants to expire out of the money when there are a handful of tried and true ways to realize hundreds of millions of dollars of value on their account.

Mr. Angel's decades of corporate restructuring experience tell him there's significant economic value in the GSEs' preferred securities and speculative FIfth Amendment taking value in the GSEs' common stock. And Mr. Angel isn't speaking hypothetically or otherwise pontificating. He has his own money invested in Fannie and Freddie's preferred securities and he expects the U.S. government to honor its contractual obligations.

On Mar. 1, 2016, Mr. Angel sent letters to each of Fannie and Freddie's directors urging them to "seek and obtain clarification from outside counsel regarding your duties and liabilities . . . and to begin taking steps to behave as an informed, active board." Mr. Angel's received nothing in response -- not even FHFA general counsel's one-page form letter saying HERA prohibits shareholder lawsuits.

At http://gselinks.com/pdf/Govt_Perfidy_Angel.pdf is a copy of Mr. Angel's paper entitled "Government Perfidy and Mismanagement of the GSEs in Conservatorship" released in late-Feb. 2016 and provided by Mr. Angel to each current GSE director on Mar. 1.

As we said yesterday, it is interesting to us that Mr. Angel is the only party focused on the government's implicit guarantee of the GSEs' preferred shares. But one of our readers told us we shouldn't be surprised because Mr. Angel is the first corporate restructuring professional to arrive at a courthouse.

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Monday's edition of the TCR delivers a list of indicative prices for bond issues that reportedly trade well below par. Prices are obtained by TCR editors from a variety of outside sources during the prior week we think are reliable. Those sources may not, however, be complete or accurate. The Monday Bond Pricing table is compiled on the Friday prior to publication. Prices reported are not intended to reflect actual trades. Prices for actual trades are probably different. Our objective is to share information, not make markets in publicly traded securities. Nothing in the TCR constitutes an offer or solicitation to buy or sell any security of any kind. It is likely that some entity affiliated with a TCR editor holds some position in the issuers public debt and equity securities about which we report.

Each Tuesday edition of the TCR contains a list of companies with insolvent balance sheets whose shares trade higher than $3 per share in public markets. At first glance, this list may look like the definitive compilation of stocks that are ideal to sell short. Don't be fooled. Assets, for example, reported at historical cost net of depreciation may understate the true value of a firm's assets. A company may establish reserves on its balance sheet for liabilities that may never materialize. The prices at which equity securities trade in public market are determined by more than a balance sheet solvency test.

On Thursdays, the TCR delivers a list of recently filed Chapter 11 cases involving less than $1,000,000 in assets and liabilities delivered to nation's bankruptcy courts. The list includes links to freely downloadable images of these small-dollar petitions in Acrobat PDF format.

Each Friday's edition of the TCR includes a review about a book of interest to troubled company professionals. All titles are available at your local bookstore or through Amazon.com. Go to http://www.bankrupt.com/books/ to order any title today.

Monthly Operating Reports are summarized in every Saturday edition of the TCR.

The Sunday TCR delivers securitization rating news from the week then-ending.

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S U B S C R I P T I O N   I N F O R M A T I O N

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