

Restructuring the Senior Preferred Stock Purchase Agreements

A Report by

The New Paradigm Society

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Abstract

Until January 1, 2018, Treasury cannot take certain actions without legislative action by Congress. This is why a sequential approach is necessary. There are a number of actions that Treasury and FHFA can take in 2017. Where action in 2017 has been blocked by Congress, Treasury and the FHFA can study those issues during 2017, with implementation by Treasury, FHFA and/or Congress to follow in 2018.

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Introduction

Until January 1, 2018, Treasury cannot take certain actions with respect to restructuring the senior preferred stock purchase agreements (SPSPAs) and the related senior preferred stock certificates without legislative action by Congress. The statutory language that was included in the fiscal 2016 omnibus budget bill states that:

Notwithstanding any other provision of law or any provision of the Senior Preferred Stock Purchase Agreement, until at least January 1, 2018, the Secretary may not sell, transfer, relinquish, liquidate, divest, or otherwise dispose of any outstanding shares of senior preferred stock acquired pursuant to the Senior Preferred Stock Purchase Agreement, unless Congress has passed and the President has signed into law legislation that includes a specific instruction to the Secretary regarding the sale, transfer, relinquishment, liquidation, divestiture, or other disposition of the senior preferred stock so acquired.¹

This is why a sequential approach is necessary. There are a number of actions that Treasury and FHFA can take in 2017. In addition, Treasury and the FHFA can study the issues related to the outstanding shares of senior preferred stock in 2017, with action to follow in 2018.

Congress has provided clear guidance on what Treasury and FHFA can and cannot do in 2017. The purpose of this report is to set forth a recommended action plan for the restructuring of the SPSPAs.

Sequential Steps

The Plan has the following sequential steps:

Phase I (2017):

-A 4th Amendment would end the net worth sweep and lower the dividend rate on the \$189 billion of senior preferred stock from 10 percent to five percent.

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- Going forward, there would be a \$120 billion [?] collateral-based line of credit from Treasury to the GSEs, with an interest rate of 25 basis points [?] above the 30-day Treasury Bill rate plus an annual commitment fee of 12 basis points [?]. There would not be an explicit or implicit "guarantee," but rather a collateral-based line of credit.

-The FHFA would authorize the re-listing of the GSE common and preferred stocks on the NYSE.

-To facilitate the attraction of new book equity capital, the dividends on the GSE preferred stocks would be restored and a common stock dividend would be reestablished.

Phase II:

-Treasury would acknowledge that it has been fully repaid and the senior preferred stock certificates and the warrants would be cancelled. In exchange, Treasury would get a golden share, which would give it veto power in certain corporate governance situations.

-Subject to oversight by the FHFA, financial recapitalization of the GSEs' would begin.

-Once the financial recapitalization has been accomplished, the conservatorships and the SPSPAs would end.

The Plan

TREASURY AND FHFA AGREE TO A 4TH AMENDMENT THAT WOULD, GOING FORWARD, REVERSE THE NET WORTH SWEEP AND LOWER THE SENIOR PREFERRED STOCK DIVIDEND RATE TO FIVE PERCENT.

Treasury and FHFA would agree to end the net worth sweep and the 10 percent dividend. Treasury and FHFA can cancel the net worth sweep and can lower the dividend rate on the already-existing senior preferred stock to five percent. Thus:

1. Senior preferred stock dividends are terminated as of the date of the modification and Treasury shall not accrue further dividends.

2. The draws on the Treasury that occurred during the 2008-2013 period shall be treated as loans originated on the date of the last draw for each applicable year. The principal shall be equal to the aggregate amount of draws. The term shall be 30 years. The interest rate shall be five percent. The loan shall be fully amortized over the term of the loan and shall be repaid by the GSEs based on the amortization schedule established for the loan.

3. Treasury and FHFA can decide whether Treasury shall reimburse the GSEs for payments that are in excess of those required to fully pay down the \$189 billion of senior preferred stock.

4. The current arrangements would be replaced by a collateral-based line of credit of \$120 billion [?] that would be priced at a 25 basis point [?] premium to the applicable 30-day Treasury Bill rate. The GSEs would each pay a 12 basis point [?] commitment fee to Treasury each year for the option to draw on the Treasury if necessary. The collateral-based line of credit would stay in place until 2028.

5. Subject to approval by the FHFA, the GSE common and preferred stocks would be re-listed on the NYSE.

Treasury and FHFA would agree that Treasury has been fully repaid and the warrants would be cancelled

The SPSPAs would remain in place until such time as the GSEs have been adequately recapitalized and are fully self-supporting.

The senior preferred stock and the warrants to own 79.9 percent of the GSEs would be cancelled.

Treasury would be considered to be fully repaid for the draws on the Treasury.

Deciding these issues will involve considerable study and analysis prior to a decision by Treasury, with input from the FHFA, the GSEs (if they are allowed to participate), and other parties and interested persons.

Treasury, acting on behalf of taxpayers, would need to decide whether taxpayers have been adequately repaid for Treasury's support of the GSEs during the financial crisis period. Because the SPSPAs do not provide explicit terms specifying how Treasury is to determine whether Treasury has been adequately repaid, Treasury will need to make a determination on this question.

Treasury would also need to decide whether or not to exercise the warrants to own 79.9 percent of the common stock of the GSEs.

Treasury is responsible for deciding these two questions. FHFA involvement would be needed if Treasury decides that changes to the SPSPAs are needed in order to implement its decision.

THE FHFA WILL THEN NEED TO BEGIN THE PROCESS OF DECIDING ON FINANCIAL RECAPITALIZATION OF THE GSES

FHFA would decide the issues related to financial recapitalization. It is likely, however, that Treasury and other interested persons (including GSE equity investors) would want to participate in the FHFA's decision making process.

Decisions by the FHFA are subject to veto by a vote of a 2/3rds of the voting members of the Financial Stability Oversight Council (FSOC).

¹ See: Title VII, § 702(b) for the language.
<https://www.congress.gov/114/plaws/publ113/PLAW-114publ113.pdf>