



Unwinding the GSE Conservatorships

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GSE Conservatorship

- ✓ Johnson-Crapo GSE reform bill failed to make it to Senate floor this year making any overhaul of the GSEs highly unlikely for foreseeable future
- ✓ However, provisions in the Housing and Economic Recovery Act of 2008 (HERA) do grant FHFA broad powers to “reorganizing, rehabilitating, or winding up the affairs of a regulated entity.”
- ✓ Section 6.3 of HERA though is critical as the Senior Preferred Stock Purchase Agreements under which their profits are now 100% swept to Treasury may be amended as long as changes do not adversely affect investors in GSE securities.

GSE Dividend and Profit Sweep Activity

- ✓ The preferred share agreements between the government and the GSEs were designed to provide a mechanism for the federal government to meet any deficit should either of the agencies become insolvent by exchanging capital infusions for the preferred stock.
- ✓ These arrangements have come with specific strings attached in the form of dividend payments made by each GSE to Treasury.
- ✓ Initially quarterly dividends were set at 10% on these investments. However, in 2012, this was modified to include all profits from the GSEs that would be sent to Treasury.

GSE Conservatorship

✓ Where do taxpayers stand in terms of backstop versus payments by the GSEs since 2008?

Item	Fannie	Freddie
Treasury Preferred Stock Investment	-\$117.2	-\$73.0
Dividends and Profits Paid	\$121.1	\$88.2
Preferred Share Value	\$120.0	\$90.0
Net	\$124.0	\$105.2

All figures in \$B

- ✓ So far Treasury has injected about \$190B via preferred share stock purchases into both GSEs
- ✓ Dividends and profit sweeps by the GSEs to Treasury account for about \$209B
- ✓ Valuing the preferred shares of Treasury in the GSEs generates another \$210B and warrant value adds between about \$8-34B
- ✓ Treasury according to these figures then has well more than made up for the investments made to backstop both agencies
- ✓ Note that taxpayers continue to have exposure to the approximately \$6.5T in outstanding MBS

Is Unwinding the Conservatorships Possible?

- ✓ Yes, but a recapitalization plan would need to end future profit sweeps and cancel the Treasury's senior preferred stock, by declaring it "paid back" through re-characterizing past payments of the profit sweep less the 10% dividend sweep as a pay down of principal that would retire the Treasury stock.
- ✓ The value from that cancellation would flow up through to the remaining common stock, benefitting the Treasury as owner of 80% of the common stock through the warrants that they still would hold.
- ✓ Ongoing profitability of the GSEs makes it less attractive to unwind the GSE conservatorships since these are essentially "free" funds to the federal government