From: lilhertz@aol.com
Sent: Tuesday, September 07, 2010 2:16 PM
To: !FHFA REG-COMMENTS
Subject: RIN 2590-AA23

Attachments: Barney_Frank_August_26_2010_C.doc; March_10J_Copyright_dated_March_10.pdf

Dear Mr. Pollard:

My comments to the proposed regulations are only that the draft regulations attempt to legalize what has been a fraud perpetrated on legitimate investors who answered the call of our national leaders in December 2007, including the President of the U.S., the Secretary of the Treasury, the Chairman of the House Financial Services Committee, the Chairman of the Federal Reserve and others, that the subprime crisis was manageable within the economy and that our institutions were financially strong and solvent. Our investment and trust in Fannie and Freddie was supported by the view of their regulator that they were welll capitalized and by the view of the ratings agencies that they were solid investment grade institutions and that the Preferred Shares being tendered were of investment grade (at least AA).

Nine months later we were told that the GSEs were bankrupt organizations needing potentially hundreds of billions of dollars of federal funds in order to carry out the nation's housing policy. Since that time those of us who invested in Fannie and Freddie Preferred Shares have been trashed as having earned higher than ordinary profits on our investments. Having written off 100 percent of the principal that I invested in good faith in December 2007 after recieving only one dividend payment, I am not sure how that view applies to me.

When on September 6, 2008 Secretary Paulsen said that "Fannie and Freddie Preferred Shares are not like other Preferred Shares" he must have meant that the nation's security laws do not apply to them -- but, that is not what was stated in the Prospectuses of Fannie and Freddie. When Secretary Paulsen stated on September 6, 2008 that the large banks could work to recover the damage done by the seizure of Fannie and Freddie and smaller banks could work with their regulator to find solutions to the massive loss caused by the zeroing out of nearly $30 billion of Tier 1 Capital on bank balance sheets, he did not mention the approximately $6 Billion of Preferred Shares held by individuals like me. I guess somewhere in the U.S. Treasury it is OK to treat a single class of shareholders differently and to totally forget about the smallest members of that single class. Well, for those of us who got taken by this Madoff like ripoff, we have been violated under law and now your proposed regulation can only be viewed as an attempt to cover it up so that we can not seek damages.

On a more positive note, please find attached my August 26 letter to Chairman Frank (House Financial Services Committee) which proposes a very smart and decent way for Fannie and Freddie to work out the Preferred Shares mess in a way that could actually help the nation through this miserable recession. This letter and the attached study are made part of these comments and should be included as part of this comment in the record of this proceeding.

There is a way to work out this mess that is honorable. It is attached to this e-mail comment. Your proposed regulation does nothing more than to further violate the rights of those of us who invested in good faith and are now being told to shut up.

Sincerely,
Richard H Hertzberg
Telephone: 858-792-5505

A Plan To Stabilize Banks, Expand Credit Markets and Restore Investor Confidence

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March 10, 2009

As an American investor I really want to help because I believe, as does our President, we are all in this economic mess together. I want to find ways to invest to help all of us stabilize the housing market, relieve the credit crunch and put the economy on a long term sustainable course that will help all Americans. But, having been badly burned by the U.S. Government's poorly architected conservatorship of its Government Sponsored Entities, Fannie and Freddie, my capital languishes on the sidelines devalued and non-functional. Yet, I believe that there is a relatively simple and essentially risk free way for the U.S. Government to put millions of American investors' capital (including my own) to work to finance and advance the home stabilization program announced by President Obama last week; and, at the same time, strengthen the balance sheets of the nation's banks reducing the cost of bank failures to the FDIC and stemming the tide of bank failures.

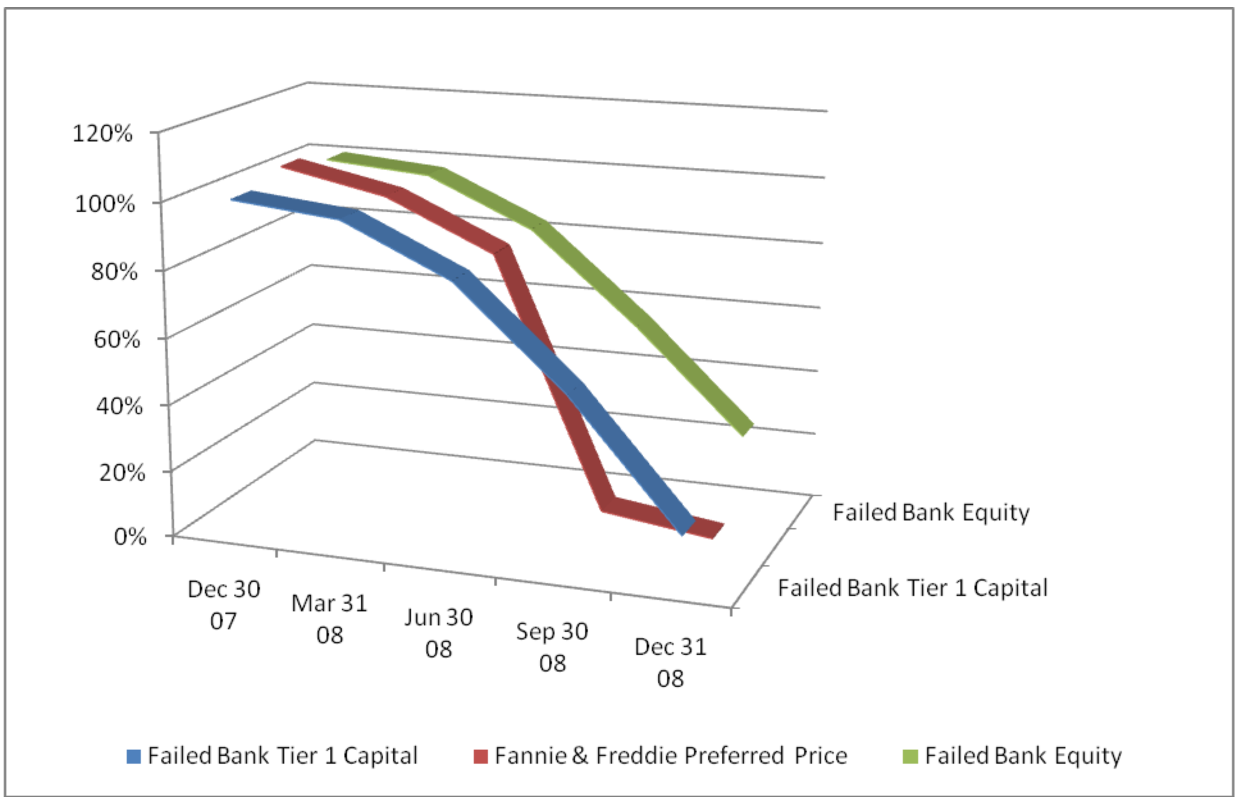
Specifically, I propose that the U.S. Government guarantee the principal value of the outstanding preferred stock of Fannie and Freddie while at the same time requiring that the newly issued preferred shares bear a lower dividend rate than the original shares so that the capital can be used efficiently by the GSEs to underwrite the bold program for housing stabilization advanced by the Obama Administration. This program has the potential of restoring as much as thirty-six billion dollars ($36 B) of equity to the nation's banks' balance sheets resulting in the creation of three hundred and sixty billion dollars ($360 B) of credit to the housing markets. This credit can be tailored to ensure that it is utilized by the nation's banks to modify mortgages and financially engineer programs to help stem the downward housing market spiral and keep people in their homes with affordable payments. And, it will not place any new burden or risk on American taxpayers because they are already paying the price for the Government's foolish action which devalued the preferred stock of Fannie and Freddie to near zero leading to bank failures and increased costs to the FDIC in settlements related to the bank failures.

Right or wrong, past policy allowed the nation's banks to include on their balance sheets as Tier 1 Capital the preferred stock of Fannie and Freddie. In fact, some bankers will tell you that they were encouraged to buy the preferred stock of the GSEs if they were going to be players in the guaranteed Fannie and Freddie markets –kind of a Madoff like Ponzi scheme where the capital being used to underwrite the loans being made by the GSEs was purchased by the entities that were doing the business under the Government's guaranteed program. So by the time the Government placed Fannie and Freddie under conservatorship in September 2008, out of a total of thirty-six billion dollars ($36 B) of Fannie and Freddie Preferred Stock sold to the investment community as much as thirty-billion dollars ($30 B) of it, according to some estimates, sat as Tier 1 Capital on institutional balance sheets. At lending ratios of approximately 10 to 1 the Fannie and Freddie preferred stocks provided our nation's financial institutions with the necessary equity to provide for approximately three hundred billion dollars ($300 B) of home loans. The rest was held by individuals in retirement accounts or investments underpinning college expenses or other personal needs. But, in early September all of this vanished, thirty billion dollars ($30 B) of equity slipped off financial institution balance sheets, private investors essentially lost six billion dollars ($6 B) invested in retirement funds and personal accounts and more than three hundred billion dollars ($300 B) of credit dried up.

When Treasury Secretary Paulson announced his plan to recapitalize Fannie and Freddie in September 2008 he stated: " The federal banking agencies believe that, while many institutions hold common or preferred shares of these two GSEs, only a limited number of smaller institutions have holdings that are significant compared to their capital. The agencies encourage depository institutions to contact their primary federal regulator if they believe that losses on their holdings of Fannie Mae or Freddie Mac common or preferred shares, whether realized or unrealized, are likely to reduce their regulatory capital below "well capitalized." The banking agencies are prepared to work with the affected institutions to develop capital restoration plans consistent with the capital regulations." When the market digested the Secretary's remarks it nearly zeroed out the value of the Fannie and Freddie preferred stocks thereby reducing the cumulative balance sheets of our financial institutions by approximately thirty billion dollars ($30 B) and reducing their cumulative capacity to make loans by approximately three hundred billion dollars ($300 B) – one of the major reasons that credit dried up in the fall of 2008. And, the chilling effect of this wipe out lingers as investors are afraid to put capital at risk in the nation's banks knowing that it could be zeroed out by similar government actions.

But, true to his word the Secretary busily went about attempting to shore up this gaping hole by using TARP money to shore up big bank balance sheets enfeebled in part by the total evaporation of the value of the Fannie and Freddie preferred shares. For smaller banks stung by the GSE preferred share devaluation, special legislative fixes emerged because to quote Congressman Barney Frank "I did feel that it was important to frankly try and save them since it was federal action that put them into the dumper. .. I thought it would have been a social tragedy if the one minority bank in Massachusetts that has been working so hard and had been overextended into housing was to be wiped out by a federal action, the Fannie-Freddie preferred [shares] thing, and that's why I think it was important to try to help them." (source: WSJ, January 22,2009 page A14) Individual investors in Fannie and Freddie were left holding only the bag having bought GSE preferred shares sold by Fannie and Freddie well into the spring of 2008, and underwritten by the same banks and brokers that would soon get TARP funds, believing that they were safe investments in line with government policy.

Time has told a different story than that which was anticipated in the Treasury Secretary's September announcement and the actions by concerned legislators. Since January 1, 2009 seventeen (17) banks have failed at an estimated cost of nearly two billion dollars to the Federal Deposit Insurance Corporation (FDIC). An analysis of information available on the FDIC web site indicates that during the year 2008 the Total Equity in these banks decreased by more than seventy-five percent (75%) or five hundred and twelve million dollars ($512 MM) as the Tier 1 Capital on their balance sheets declined by approximately eighty-five percent (85%) or five hundred and forty million dollars ($540 MM). At the same time, the value of the preferred shares of Fannie and Freddie held on the books by these banks as Tier 1 Capital fell by nearly one hundred percent (100 %) from nearly twenty-six dollars ($26) per share to approximately seventy-five cents ($0.75) per share. The following graph visually portrays the correlation between the decline in price of the GSE preferred shares and loss of Total Equity and Tier 1 Capital suffered during 2008 by the seventeen banks that have failed so far in 2009.



Falling Price of Fannie and Freddie Preferred Stock Tracks Losses By Failed Banks
Preferred Stock Price, Failed Bank Tier 1 Capital and Failed Bank Equity
All As Percent of Values on Dec 31, 2007

It is fairly obvious from the FDIC data that by not preserving the market value of the GSE preferred shares when they were placed under conservatorship, the Treasury Department created a death spiral for smaller banks and investors. Now, with FDIC Chairman Bair indicating that the FDIC could run out of money this year, this death spiral is already becoming a burden to the very agency that is entrusted to insure the deposits of Americans. If the GSE shares held by the seventeen failed banks as Tier 1 Capital had been equal to their pre-conservatorship values, the cost of the failures to the FDIC would have been reduced by more than thirty percent (30%) or a total of five hundred and forty million dollars ($540 MM). This is truly significant and could become more meaningful as additional bank failures occur or are avoided altogether if the Tier 1 Capital can be restored.

With regards to the larger financial institutions, the big banks, there is a slightly different way that the Treasury is covering the fact that it wiped out significant balance sheet equity and lending capacity when it decimated the value of the GSE preferred shares. An examination of two banks now in the news because of their involvement in the TARP program is indicative of the asset swapping going on as the Treasury Department both gives and takes away. Wells Fargo had nearly five hundred million dollars ($500 MM) of GSE preferred shares on its books and JP Morgan Chase over one billion dollars ($ 1 B) on its books when the conservatorship was invoked in September 2008. While "not significant" related to the total capitalization of these banks, according to Secretary Paulson's announcement, the loss of value of this combined total of more than one and one half billion dollars ($ 1.5 B) of Tier 1 Capital directly reduced the capacity of these banks to make more than fifteen billion dollars ($ 15 B) of loans in the economy based upon a ten to one (10/1) equity to loan regulatory requirement. But, we will probably never see this loss of equity show up in the FDIC failure category and asset purchase values because these sums have been covered over by the generous provision of TARP funds to these banks (even though Wells Fargo did not want the TARP funds). For every dollar of Tier 1 Capital preserved by guaranteeing the GSE preferred shares, the amount of TARP funds supplied to participating institutions could have been reduced by one dollar. It is clear, from both the small bank failure data from the FDIC and the case study of two big banks, that the wiping out of Tier 1 Capital has had an extraordinarily negative impact on the capacity of banks to function and their ability to loan.

Something else very important suffered when the GSE preferred shares were wiped out by the well intended but poorly conceived GSE conservatorship. The Government's credibility and our belief in its capacity to manage a crisis have eroded. Those of us who had invested in the GSEs in late 2007 and the spring of 2008 read the appropriate investment documents, believed the ratings agencies that rated the securities as AA or better, took comfort in the quality of the lead underwriters (including firms like Morgan Stanley), and listened to statements by the officers of the GSEs and leading figures in Congressional committees and the Bush Administration indicating that the GSEs were well capitalized and solvent. In fact, Morgan Stanley, a lead underwriter of preferred shares, was hired by the Secretary of the Treasury in the late spring of 2008 to analyze the financial health of the GSEs and its opinion that the GSEs were virtually insolvent was a major reason that the Secretary of the Treasury decided to seek legislation and place the GSEs under conservatorship by the end of the summer. Investors in the GSEs were blindsided, to say the least, and many feel that the treatment they suffered in the near total loss of thirty-six billion dollars ($36 B) of investment in the government sponsored entities was similar to the manipulations uncovered recently in massive fraudulent investment schemes. It defies credulity to believe that the same senior government officials who encouraged investment in the GSEs and the sophisticated investment bank that was a lead underwriter of a multibillion dollar offering of GSE preferred stock in December 2007 could reverse their positions and indicate that the entities that they were controlling and underwriting became nearly insolvent within six months. What did the lead underwriters and our government officials really know about the financial health of the GSEs in early 2008 when they were all involved in activities aimed at obtaining investor funds to recapitalize Fannie and Freddie? In the Madoff case such action would be actionable in the courts, while in the GSE case the legislation authorizing the conservatorship makes litigation nearly impossible. Maybe that is what Secretary Paulson was alluding to when he stated in announcing the conservatorship "Preferred stock investors should recognize that the GSEs are unlike any other financial institutions and consequently GSE preferred stocks are not a good proxy for financial institution preferred stock more broadly".

While Americans who took Fannie and Freddie loans with monthly payments that are now too expensive on homes that are now underwater are being offered relief by Fannie and Freddie, investors in the Fannie and Freddie preferred shares are being told to bear responsibility for the losses suffered in their retirement and personal savings accounts. Yet, in many cases, especially for those who invested in the entities during the period 2007 to 2008, there is considerable reason to believe that the GSE investment offerings were based on either cooked books or erroneous information. Somehow there appears to be something terribly wrong with this turn of events. Perhaps it brings new meaning to the concept of moral hazard. But, the intent here is not to find fault but to propose a way to get this capital back to work to help to restore our economy, help to salvage the equity of home owners and provide a compromised and equitable return to investors whose only mistake was to invest in Fannie and Freddie.

Adoption of my proposal to extend the explicit Federal guarantee enjoyed by the debt of Fannie and Freddie to the preferred shares of the GSEs will have a broad and beneficial impact by putting thirty-six billion dollars ($36 B) of capital back into play allowing for as much as three hundred and sixty billion dollars ($360 B) of credit to flow back into our banking system for use by American homeowners and consumers under the program initiated by the Obama Administration. It can be done at a lower cost of funds rate than originally bargained for by investors giving our nation's banks low cost capital to put to work to solve our housing crisis. It can strengthen struggling bank balance sheets helping to stem the tide and potential cost of future bank failures. And, it will go a long way to helping restore investor confidence in our great Government and the financial institutions that are necessary to our way of life.

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August 26, 2010

Honorable Barney Frank
Chairman, House Financial Services Committee

Dear Chairman Frank:

Thank you for taking the time over dinner to discuss with me an innovative and powerful way of putting the approximately thirty-six billion dollars ($36 billion) of Preferred Equity investment in the failed Government Sponsored Entities (GSEs) Fannie Mae and Freddie Mac back to work in support of the nation's stimulus efforts, including energy related projects and jobs under the PACE program, credit in support of small businesses (as advocated earlier this evening over dinner by Senator Boxer) and infrastructure improvement projects. This can be done in a manner that will improve the nation's banks balance sheets (especially those smaller banks that have been failing at a very high rate over the last two years because of the zeroing out of much of their Tier 1 Capital by the destruction of value imputed to the GSE Preferred Shares) and at no additional risk or cost to taxpayers.

There remains a class of individuals that have been forgotten as we reform the financial system and attempt to shore up and salvage American homeowners from too much debt through mortgage relief programs. The group is those individuals who are holding nearly worthless preferred stock issued by the Government Sponsored Entities (GSEs) Fannie Mae and Freddie Mac. The conservatorship imposed by the United States on these entities rendered worthless the honest investment of approximately thirty-six billion dollars ($36,000,000,000) made by individuals and institutions in support of the national housing policy objectives enunciated and supported by the U.S. Government since the establishment of the GSEs in the Great Depression and their privatization in the 1960s.

While big banks holding this paper were able to recover their losses through the generous funding of the TARP program, many individuals have been left with nothing based upon the instantaneous devaluation of approximately six billion dollars of Preferred Shares thought to be held by individuals in September 2008. In addition, a primary cause of the more than 100 smaller bank failures over the last two years was the destruction of the extraordinary amount of Tier 1 Capital held in the form of GSE Preferred Shares by the draconian and insensitive conservatorship imposed by edict of Secretary Paulson in September 2008. And, along with this honestly invested capital there vanished a cumulative total of more than $300 billion worth of credit because of the loss of Tier 1 Capital on the books of banks when the conservatorship was invoked.

Those of us who lost money on this have been forced to sit on the sidelines while the U.S. Government force feeds the GSEs to keep them on life support while using them to reduce the cost of funds and mortgage terms to the mortgagees who took on too much debt using both honest and deceitful methods to qualify for the mortgages that now strangle them and the nation. Somehow in our new morality, those who invested in what were allegedly solvent organizations sponsored by the U.S. Government are left to suffer loss while those who borrowed too much are welcomed as wards of the U.S. Government to reduce their debt and cover their losses.

I believe that there is a way to make the Preferred Shareholders whole while at the same time benefiting the nation at large. I have advocated for nearly two years the notion of having the U.S. Government extend the guarantee it provides to GSE debt to the Preferred Shares with an agreement by the Preferred Shareholders to reduce the cost of funds to the U.S. These newly converted Preferred Shares could be used by banks as Tier 1 Capital and would provide a basis for shoring up the balance sheets of many suffering banks in a way that would directly and beneficially reduce the number of failing banks while at the same time providing low cost capital that can be used for credit for specific programs. While my thought has been supported by many it has never gained traction – but, now there is a very specific way to incorporate this idea into a beneficial program that could help to supply jobs and provide for the public good by supporting home improvements related to energy conservation and renewable energy.

Specifically, I am recommending that the GSE's be authorized and directed to allow for the voluntary conversion of GSE Preferred Shares into, for lack of a better word, U.S. Economy Finance Underwriting Loans (USEFUL) that will be administered under a joint program, by the Federal Housing Finance Agency and other appropriate U.S. Government entities including but not limited to the U.S. Department of Energy, the Small Business Administration and the U.S. Department of Agriculture, to provide financing for the programs that were previously envisioned in the now dormant PACE programs (Property Assessed Clean Energy Programs), additional stimulus programs such as the thirty billion dollar ($30 billion) stimulus package now being debated in the Congress that was mentioned by Senator Boxer this evening, and other infrastructure programs that may be advanced by the President . These new loans would be made to advance the growth of the U.S. economy using strict underwriting guidelines to ensure low failure rates and if necessary would be junior to existing mortgages (for example this would solve one of the most daunting problems related to the PACE program). Because of the low coupon rate associated with the converted Preferred Shares the loans could be priced at a low cost. Collateral for the loans would be based upon strict guidelines and underwriting requirements would be strictly enforced. The principal of the loan could either benefit from a U.S. guarantee, if deemed appropriate by the Congress and Administration, or would be at risk financing supported by no Federal Guarantees. To the extent that a federal guarantee existed the cost of funds to the borrower might be lower. In either case, since conversion of existing GSE Preferred Shares to USEFUL loans would be voluntary -individual Preferred Share holders can make their own choice as to whether or not to convert from the abysmal position they now hold to a risky, but at least USEFUL position that has some potential for repayment. For example, since communities with pilot PACE programs report less than one percent non-payment rates, I would elect to put the money that I have tied up in the GSE Preferreds into the USEFUL loan program.

During our dinner conversation on August 26 you indicated that the Preferred Shares are worthless and therefore could not be used to support the program envisioned by my suggestion. I believe that you are both correct and incorrect in your judgment of the value of the Preferred Shares. You are correct that the market now values these shares at essentially zero because they are covered by more than $100 million of tax payer owned senior preferred shares provided to the

GSEs under the imposed conservatorship and they are not paying scheduled dividends. But, what if they were recognized as the capital in support of the USEFUL program and paid a dividend (even only a low dividend) with the principal being recovered over a reasonable period? Wouldn't the market then impute some value to these USEFUL financial instruments?

No financial instrument has intrinsic value except for that which is imputed to it based upon its usefulness or social contract value. For instance, the Fannie and Freddie Preferred Shares that I bought were worth twenty-five dollars ($25) par value when I bought them in December 2007 when they were deemed to be valuable because of the social good they underwrote (U.S. housing policy), the statements of national leaders including the President of the United States, the U.S. Secretary of the Treasury and the Chairman of the House of Representative s Financial Services Committee (that would be yourself), the implicit guarantee of the debt of the GSEs (which was not described as being senior to the position of the Preferred Shares in the Prospectuses associated with the sale of the shares in December 2007) and the U.S. regulator of the GSEs view that they met their regulatory capital requirements into the foreseeable future. Within a few months these pieces of paper were selling for more than par value, but later they were nearly halved in value because of market concern about the depth of the subprime crisis. At the end of August 2008 the market perception was that the U.S. Government would not wipe out the preferred shareholders because of the havoc the action would take with the nation's banks which had significant GSE holdings on their books as Tier 1 Capital. Once the Secretary of the Treasury took the action in September 2008 to declare the GSEs insolvent (in the face of contradictory public statements of the GSEs, the Administration, you and the regulator) the Preferred shares plummeted to near zero in value.

I submit the value of the Preferred Shares is totally based upon market perception influenced by the value of the cash flow stream that supports their coupon and the ultimate repayment of the principal value. Just as there is no intrinsic value to gold and it fluctuates in a market based upon perception of its value relative to other assets, there is no intrinsic value to the GSE Preferred Shares but rather a perceived value based upon the underlying cash flow supporting the dividend and principal. When, in fact, a U.S. Government conservatorship is thrust upon the GSEs in a manner that floods them over with a deluge of taxpayer money in support of the implicit guarantee associated with the GSE debt obligations and in providing new capital to bail out homeowners through cheap loans, the market perception of course is to assign zero value to the Preferred Shares because they have been made junior to the massive influx of capital now being provided by taxpayers through the GSE mechanism (a risk that was not described in the prospectuses accompanying the original sale of the Preferred Shares).

But, what would be the value of the Preferred Shares if the capital represented by their original par value was assigned to be the underlying capital that would support bank credit for a new national program that would at no additional risk to the U.S. Government create jobs and provide for example for the implementation of renewable energy projects and conservation efforts in support of our nation's long term need for energy security? I submit that the value of the GSE Preferred Shares would then not be zero (as they now are) but would instead be based upon the market's perception of the value of the underlying loans that the GSE Preferreds (now in the form of the USEFUL financing instruments described above) were enabling as Tier 1 capital on bank balance sheets. If the U.S. were to guarantee the USEFUL instrument, the perceived valuation would be greater, but at a risk to the U.S. taxpayer; if the U.S. does not guarantee the USEFUL paper the valuation would be totally dependent upon the underlying credit worthiness of the financings supported by the USEFUL Tier 1 capital. That is the way the market works.

Senator Barbara Boxer mentioned at the dinner that we attended together that she and Congressional Democrats are pushing for thirty billion dollars of new tax payer money to support a second round of stimulus efforts this fall. You indicated over dinner that you supported this effort to appropriate thirty billion dollars of new stimulus funds this fall in order to support job growth in this economy. But, why would you put thirty billion dollars of taxpayer funds at risk now when with the voluntary conversion of GSE Preferred Shares to USEFUL financing instruments significant capital can be restored to the balance sheets of community and large banks in a manner that would require them to make prudent loans in support of Congressional and Administration goals to achieve energy security, finance small businesses, improve the nation's infrastructure and create jobs now?

This can work and it can support major national objectives. This is low risk to the U.S. Government and it can resolve legal issues that exist due to both the way Fannie and Freddie marketed the Preferred Shares within months of their collapse and the way they are now operated without concern for or protection of the legitimate investments now trapped in this train wreck. It can make Fannie and Freddie positive forces in support of the national goals incorporated into the PACE program, that was scuttled because of the objections of the Federal Housing Finance Agency. It is a workout that allows honest investment to be recovered and hard earned money put back into the economy in a way that supports our nation's current needs and objectives without further risk to taxpayers.

I am more than willing to help you work through the details of this idea. Please help me to put my investment back to work in rebuilding our country. That is why I invested in the first place.

Sincerely,

Richard H Hertzberg