Regulatory Bulletin

RB 2-1 was rescinded 10/21/91 by Time Frame elapsed.

Handbook: Thrift Activities
Subjects: Investment Securities; Equity Risk Investments; Capital Adequacy

Section: 220, 230, 320
RB 2-1

November 23, 1988

Acceptance of Exchange Offer for New FHLMC Preferred Stock

RESCINDED

Summary: This bulletin requires supervisory agents to ensure that RAP insolvent and MCP institutions participate in the FHLMC Preferred Stock exchange offer expiring on November 30, 1988.

For Further Information Contact:
The FHLBank District in which you are located or the Policy Division of the Office of Regulatory Activities, Washington, D.C.

Regulatory Bulletin 2-1

Background

The Federal Home Loan Mortgage Corporation has organized an exchange offer for its existing preferred stock, which is presently restricted as to its transferability outside the thrift industry, in order to replace it with new unrestricted preferred stock. Existing shares of preferred stock can be exchanged on a 4-to-1 basis (4 shares of new stock for 1 share of existing preferred stock) through November 30, 1988. Participation in the exchange offer requires that an institution invest a $7.00 capital contribution per old share of preferred stock. Institutions exchanging their old preferred stock for new shares after November 30 will only receive 3 1/2 new shares of preferred stock for every existing share.

On August 18, 1988, the Office of Regulatory Activities issued Regulatory Bulletin 2 (RB 2) establishing guidelines to implement FHLBB Resolution No. 88-583 dated July 20, 1988. The resolution provided, among other things, that no insured institution failing to meet its minimum regulatory capital requirement could buy or sell FHLMC preferred stock without obtaining the prior approval of its Principal Supervisory Agent, subject to the concurrence of this office. The guidelines clarified that insolvent institutions were generally prohibited from either purchasing or selling such stock. These guidelines contained in RB 2 remain in effect.

It is permissible for undercapitalized and insolvent institutions to participate in the exchange offer, because the offer would not be treated as a "purchase" or a "sale" under Regulatory Bulletin 2.

Benefits of Participating in the Exchange Offer

There are a number of significant economic incentives for insured institutions to participate in the exchange offer prior to November 30, 1988. First, the institution will receive 4 shares of new stock for every existing share rather than 3 1/2 shares after the exchange. Second, if two-thirds of the existing stockholders participate in the exchange offer, the FHLMC will have the right to issue a "clean-up call" for the remaining shares as soon as 90% or more of the existing shares are tendered. This would force the exchange of the old preferred stock shares or render them worthless. Third, the new stock will have priority in any liquidation process. Fourth, the allocation of dividends between the new and old classes of preferred stock may favor the new senior preferred class of stock. Finally, due to the reduced size of the issue and trading volume, the New York Stock Exchange may drop the old preferred stock from its listing in the future, significantly reducing its liquidity and marketability.

Policy

The Office of Regulatory Activities is now requiring, to the extent possible in the remaining weeks, that supervisory personnel should ensure that RAP insolvent and MCP institutions participate in the exchange offer prior to November 30, 1988 in order to maximize the value of their existing holdings.

This Office also strongly recommends that all other insured institutions, particularly those institutions failing their minimum regulatory capital requirement, participate in the exchange offer by November 30, 1988. The improved marketability and liquidity and higher value of the new preferred stock demonstrate the desirability of maximum participation by insured institutions in the exchange offer. There is no requirement for PSA approval or Office of Regulatory Activities concurrence on this matter.

Darrel W. Dochow

— *Darrel Dochow, Executive Director*