

Message

From: DeLeo, Wanda [/O=OFHEO/OU=OFHEO/CN=RECIPIENTS/CN=WDELEO]
Sent: 10/14/2008 3:01:38 PM
To: Satriano, Nicholas [nicholas.satriano@ofheo.gov]
Subject: FW: Information Request for the GSEs - Sent on Behalf of Lee Errickson

The info request I mentioned

From: Clark, Anne [mailto:Anne.Clark@gt.com]
Sent: Monday, October 13, 2008 4:39 PM
To: DeLeo, Wanda; Stauffer, Lawrence
Cc: Al.Runnels@do.treas.gov; James.Lingebach@do.treas.gov; Donald.Geiger@do.treas.gov; swhiting@kpmg.com; jdsilverman@kpmg.com; csupernaw@kpmg.com; dkovlak@kpmg.com; GroverJ@oig.treas.gov; FitzgeraldM@oig.treas.gov; Errickson, Lee; Beaton, Neil; Dufendach, David; Pustorino, Paul; Goode, Larry
Subject: Information Request for the GSEs - Sent on Behalf of Lee Errickson

Wanda and Larry,

We have summarized below our initial considerations for the valuation of each component of the keepwell agreement to set the stage for our questions and information requests.

Common Stock Warrants

Because of the nominal exercise price, we see the warrant effectively representing a grant of stock. Regardless of the model utilized for valuation, we don't expect alternative assumptions as to period to exercise or volatility as having any material effect on value. Under any model, the delta would be very close to 1. Therefore, our concern focuses on whether the stock price at September 30, 2008 fully and appropriately considered the dilutive effect of the warrants.

Senior Preferred Stock

Absent the direct consideration for the Commitment under which the GSEs could fund a deficit of book assets to book liabilities, we have the following considerations for valuation inputs:

- Do we expect a 10 percent cash payment or a 12 percent accrual at each payment point? If we have no set policy based on the intent of the parties, how do we model what form of payment occurs?
- The amount of additions to the liquidation preference that occur over time for (a) drawdowns on the commitment and (b) for accrued dividends.
- The amount of any reductions (redemptions) of liquidation preference, considering the need to pay back any advances under the Commitment.
- The appropriate initial discount rate and the possible adjustments to that discount rate given model assumptions of a changing risk profile over time. (We believe that consideration must be given to the hypothetical players in an exit market and their tax status.)

- The investment horizon based on practical expected business life or the effect of redemptions of the senior preferred, including the effect of varying interest rate structures on the financial guarantee liabilities, the overall net asset book position, and the activities under the Commitment.

The Commitment

We have the following additional considerations:

- Projecting the future relationships between total book assets and total book liabilities. (We note that the keepwell agreement is pegged to GAAP, which may change over time.)
- The effect of alternative future interest rate structures on the financial guarantee liabilities, the overall net asset book position.

Questions for both GSEs:

All questions concern the GSEs' opinions as of September 30, 2008.

1. What is their opinion of common stock volatility (a) over the year beginning September 30, 2008 and (b) for the long term thereafter? What is the foundation for their assessment of stock price volatility?
2. What is their opinion of whether the market priced the dilution of the warrants after the announcement of September 7, 2008? Can they point to any support for their opinion either way? If so, what?
3. If the answer to question 2 is yes, when did the market price it and do they believe it was adequately priced?
4. Did the GSEs intend to pay cash at 10 percent or accrue at 12 percent as a matter of policy?
5. If the answer to question 4 is that they have, or had, no set policy, what variables would be considered in making the decision between paying cash or accruing?
6. What did they believe the appropriate market yield on the senior preferred stock would be?
7. What did they believe the appropriate market yield on a subordinated bond issue would be?
8. How would the yield (referenced in question 6) reconcile to the strong credit rating and low yield on the worst bond issue compared to the comparatively poor credit rating and high yield we observe for the best performing preferred stock?
9. Did the GSEs anticipate any re-rating of their bond issues or preferred stock in the near term as a consequence of the keepwell agreement?
10. Do the models requested below incorporate, or otherwise address, the \$700 billion bailout package? If so, how?

Please provide, or arrange for our collection of, the following Financial Information and Models from both GSEs:

1. Projected balance sheets for any and all future dates

2. Cash flow forecasts for the year from September 30, 2008a and for all periods thereafter
3. Anticipated timing and amount of drawdowns on the Commitment related to the senior preferred stock
4. Financial guarantee liability model structure, inputs (assumptions), and results
5. Estimates of the fair value of financial guarantee liability for the last twenty-four months
6. Last three year's performance history of financial guarantees
7. Accounting and/or risk management policy(ies) on the use of derivatives
8. Policy statement and procedures for asset/liability management
9. Asset/liability model structure inputs (assumptions) and results
10. Duration and duration gap analyses for the last twenty-four months
11. Draft of the September 30, 2008 financial statements
12. Update (including valuation method and key assumptions and in-process values) on the September 30, 2008 valuations of senior preferred stock, the Commitment, and the common stock warrants being prepared by independent valuation specialists

We are open to your suggestion of additional materials that you believe we will need, and, obviously, additional requests may be forthcoming and, given the short time frame to complete our work, we will have to make requests as we discover the need for additional information rather than aggregating requests to limit their frequency.

Best,

Lee