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## Pension funds suffer after Fannie, Freddie takeover

Virginia retirement system not hit as hard as some

**T**he government takeover of mortgage giants Fannie Mae and Freddie Mac had at least a short-term effect on multi-billion pension funds that own their common stock.

The pension fund for Virginia's public-sector employees, Virginia Retirement Systems, while not deeply exposed to the losses caused by the government takeover, did own common stock of the two companies when it last reported its holdings on June 30.

As of that date, the retirement system owned 274,625 shares of Freddie Mac common stock and 433,377 shares of Fannie Mae common stock.

With shares of Fannie and Freddie trading as of press time at \$0.74 and \$0.66 respectively, the system's combined 708,002 shares had gone from being worth approximately \$12.95 million on June 30, to \$501,950 by Sept. 10, a decline of nearly \$12.5 million in a little over a month.

And the Virginia system is one of the lucky ones, having not invested too deeply in the companies. Public-sector employee pension funds in other states took significantly harder hits when the market put the shares out of favor.

The California Public Employees Retirement System, referred to as CALPERS, owned as of June 30, 5.82 million shares combined of Fannie and Freddie stock. It has since watched its stake drop in value more than \$101 million, having been worth approximately \$105.94 million on June 30, only to fall to \$4.11 million as of Sept. 10.

State funds in New York, Ohio, Kentucky, Texas, New Mexico, and even some in Canada, took similar hits.

"Any pension funds holding common stock in Fannie or Freddie just took it on the chin," said Jim Flinchum, managing principal of Virginia Beach-based Bay Capital Advisors.

"Frankly, I'd be surprised if many pension funds held much common stock in Fannie and Freddie, because their problems have been apparent for months," Flinchum said.

The Wall Street Journal reported that the millions of Fannie and Freddie shares held by pension funds are largely in "passively managed investments," meaning that those particular assets are managed by firms outside the pension funds' organizations.

And as of late August, when government intervention seemed imminent, a spokesman for CALPERS, one of the largest pension funds in the nation, told The Wall Street Journal it was still holding on to its shares of the troubled firms.

Holding on to the shares is a gamble. Some argue that if the companies are reorganized and run properly, Fannie and Freddie common and preferred shares could at some point come back into favor.

Flinchum isn't convinced.

"While conceivable they may eventually benefit, I don't believe it for a second," he said.

Based on their past performance, it will be difficult for shares to return to their past glory. Freddie traded as high

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as \$65 a share over the last year and Fannie peaked at \$68 a share.

While direct ownership of these shares has an obvious effect on pension funds, the funds' bigger investments are also taking hits because of the dive in price of Fannie and Freddie shares. Most pension funds fill a large percentage of their portfolios with stock from the financial sector. Virginia's system, for example, said in its most recent annual report that 22.4 percent of its holdings are in the financial sector.

Many of the large financial firms that pension funds buy into such as JPMorgan Chase, Wells Fargo and Lehman Brothers, own even larger stakes of Fannie and Freddie common and preferred stocks.

So as those firms take a hit, their stock prices also can tumble, affecting the value of pension funds even further.

Bank of America, for example, 1.87 million shares of which are owned by the Virginia Retirement Systems, owned more than 10.28 million Freddie and Fannie shares as of June 30. The hits BofA endures for those losses ultimately could influence its stock prices. This could trickle down to pension funds that invest in it.

And the large asset management firms that help manage funds from pensions have long used Fannie and Freddie as at least a percentage of their investment strategies.

But it's not all doom and gloom for the pension funds. Public employees likely don't need to wonder

if their funds will go up in smoke any time soon. While at first glance these losses seem large, they are but a drop in the bucket for pension funds that collectively are worth trillions of dollars.

Virginia Retirement Systems' assets are valued at \$58.3 billion, according to its 2007 annual report. And CALPERS is valued at \$235 billion.

Some confidence remains in investing in certain Fannie and Freddie assets, particularly their mortgage-backed bonds.

The organizations own or guarantee more than half of the nation's mortgages, stakes held largely through bundling mortgages into packed securities.

## Banking & Finance

### The Fannie-Freddie fallout for pension funds

	Shares	Value 6/30	Value 9/10
<b>Virginia Retirement Systems</b>	708,002	\$12.95M	\$501,950
<b>California Public Employees Retirement system</b>	5.82M	\$105.94M	\$4.11M
<b>Public Employees Retirement System of Ohio</b>	2.97M	\$171.76M	\$6.64M
<b>New York State Common Retirement Fund</b>	9.37M	\$54.64M	\$2.11M

• Holdings of Fannie/Freddie common stock as of June 30.

Those investments remain safe for now.

"With explicit federal government credit behind them, the bonds of Fannie and Freddie are just fine," Flinchum said.

The Virginia system, according to its annual report, held hundreds of millions of dollars worth of Fannie Mae mortgage-backed securities.

Flinchum argues, however, that the attraction between the long-term investment strategies of pension funds and the long-term yields of mortgage-backed securities are part of the reason for the present events.

"Taking a long view, the pension funds are indirectly responsible for

the whole credit mess we face today," he said.

Flinchum argues that because pension funds have obligations to pay out over many years, "long-dated assets" in the form of 30-year mortgage backed securities "were perfect."

The massive pension funds needed more long-term fuel for the fire, perhaps helping create the need for investment bankers to find ways for more mortgages to flow through the market.

"In other words, pension funds innocently created the demand for more mortgage-backed securities and therefore needed more mortgages to collateralize those bonds," he said, "even subprime ones." ■