Preferred stock:

* Why JB thought maybe interesting thing to look at:
  + One is that it fits right between equity and junior debt
  + Also very thin layer of capital generally, of whatever equity the bank has, if it is JPM it maybe 10% preferred stock, other banks maybe less.
  + The point is that if you thought about the extreme case where they only had $1 of preferred stock, the chance that the preferred stock would be the same as if you run out of equity. That’s the basic idea which has to be justified by showing that there is a small amount of preferred stock.
  + The second thing is that we think it is something that will not be bailed out. Even in the last crisis, people who owned preferred had to take some losses. Not every company preffred lost money – i.e. GS and WF never lost quite so much money that pref stock had to take losses, but Citi preffered did take substantle losses. That’s important because with CDS we have this compingling issue of bailout probabilitiy.
  + Then the third thing that pref stock has that is important not captured in equity is in CDS, is if new money is raised on the way down, the preferred stock is helped because if more equity is raised, that prevents the preferred stock from losing money, just like if more stock is raised it helps the bondholders from losing money. Preferred stock is kind of good on that.
* Then we get to the issue, two things about the preferred stock:
  + (1) Absolute yield that it is offering – which indicates something about the safety today.
  + (2) To compare it with preferred 10 years ago.
* What we are trying to do here is to figure out the ways to get at these two things.
  + First, I may try to get info that is relevant to both of these issues. At the end of the day, where I can probably help is think through what kind of info we can have that might speak through these issues.
  + In terms of the absolute yield, one thing that I could imagine doing is looking at the new issues of preferred stock by the major banks (let’s say JPM and whoever else is issuing in the last few years) and then what you can do is make the following comparision – is if you can find non-financial companies that are also issuing some preferred stock, companies that we don’t think will get bailed out. We may see the yield on their preferred stock. One example of the kind of thing that may be interesting, let’s say non-financial company also had preferred stock and yielding an amount similar to JPM (or maybe a little less) and look at that same company and what their subordinated debt sold for or what their CDS was, so you could say well based on the theory we were discussing there is this risk to preferred, what happens if they lose an amount roughly equal to the amount of equity, and then we say well the issue with the CDS is trying to substract out the bailout piece, well let’s say non-financial company where we cdon’t have the bailout piece look at that CDS, and that CDS is much lower, maybe it means that they are safer. If CDS for non-financial was higher, then you can say why would that be, if theoretically the preferred stock already reflects the fact that there may be new capital to come in to buttress both the bonds and the preferred stock, then you can say difference in CDS, given same preferred yield, maybe is an indication of the implicit bailout part. One thing that maybe is derivable at looking CDS and preferred stock, just looking at the most recent stuff as opposed to comparing 10 years ago.
* Then we need to think about the comparison with 10 years ago
  + I thought in the previous draft of the paper, a little bit of confusion because of understanding how the call options work.
  + There are basically these two kinds of preferred stock that these institutions issue: (1) floating rate; (2) fixed rate. Flaoting rate 10 years ago that are a little different than issues now.
  + Flaoting 10 years ago would work the following way – receive is the max of 275 bp or Libor + 75. And then what would happen is there would be this call provision enable to buy back the bond after a number of years. What is gooda bout these floating rates for our purposes is that in fact those bonds have not been called back. Would expect with interest rates having gone down is if the riskiness of the banks stayed the same, should be able to issue replacement dress at a lower yield. And the fact is that even w/ LIBOR down very close to 0, a lot of these preferred stocks are still selling 10-15% below par value and if they get called have to pay at least par value, and so even though the call provision is worth something and presumably is holding down the price of the bond a little bit, it is probably not holding it down very much on those securities, because the only way they will ever get called given that the interest rates can’t really go any further down is if the company becomes safer. If the company were as safe as 10 years ago, we want to make the argument that those bonds would have been called. NOT being called and seem to be significantly below being called.
  + The problem with the fixed rate bonds is when they are selling above par, a lot of them that are issued 10 years ago are in fact selling a bit above par, and can’t really go much above par. And so the fact that those prices are still what they were ten years ago and say should be much higher because the interest rates have gone down you can’t say that.
  + Now there are a couple of bonds that some banks have issued –
  + Treasury securities are not-callable of course.
* One commen tis how to find a third bank is BAML took over Merrill is that there is some preferred that maybe is under BML
* The other thing is I think something like 85% of preffered stocks are issued by financial instutions. There’s some kind of preferred stock index. PFF ETF. But it doesn’t go back 10 years. Does go back to March 2007. That index is higher.
* At some level you want to separate out the financial securities and even though 85% is a lot it is not really 100%.
* PRbobaly can quickly figure out the yield on the financials is probably on average higher – maybe in part because the doesn’t give us comparision with respect to 10 years ago.
* My instinct:
  + Is to kind of start with the compelling examples, as a theorist I like to start with a numerical example that I think can persuade people, if persuaded by the numerical example, if I have something more complicated if not sure it is right – well I know there is something there because example is so compelling.
  + There are these limited number of bonds all that are still outstanding issued by these 6. Here is what is happened to these.
  + And you can point to what is going on with the new issues.
  + Whether there is some way to use more aggregate data I’m not sure – first we would have to find the index (non-financial from the financial).
  + If I am looking at fixed rate, I would limit myself to some selling at some reasonable discount of the call, which may eliminate all of them. With interest rates so low – may kill it.
  + Maybe would enable to say as of 2 years ago before the last big declines something was going on, but I think. JPM, considered as CDS to be as safe as any commercial bank other than WF, there new preferred stock is 3.3% premium to LIBOR that seems like a fairly substantial risk premium and if there is a way to find some non-fnancial that do have preferred outsanding that is great and notice that with the non-financials there is theoretically since not subject to the regulatory system in a way it is questionable maybe less compelled to raise money when the market goes down to protect creditors and thus the preferred stock, theoretically the point of the regulatory system, though possible with so much of debt guaranteed that maybe it goes the other way maybe the banks can delay and delay and elay, no pressure from creditors whereas the non-financials.
* **Bank creditors protected both because more equity and required to raise more equity on the way down, you would say if they are better prtotected than non-financials, why are we seeing this big risk premium??** 
  + Start out trying to work through these specific securities of which there are a fairly limited number and then it may be that is as far as you can go on the preferred stock, and it may be that you and Larry will be able to think of something whereas somehow can tease out something from a preferred stock index. The basic point: IS if these banks are so safe, why is this preferred stock yielding so much money, it theoretically no 100% because of non-cumulative nature should be [retty much behind all equity and there is not that much of it so not that much of a buffer relative to the unsecured debt. And so the fact that those yields are high is a little disturbing, you could say sort of high absolute and the fact that these floating rate preferreds haven’t been called makes them seem like if anything risk premium has – why wouldn’t these issue those preferred still LIBOR + 75 but a lower base, for example, right now it is.
  + Add the BML preferred if haven’t already. It could be that the floating rate preferred was more of an investment bank thing.
* Provide some information about how the preferred stock is this thin laywer so that someone leading the paper would understand what you are thinking about. If 50% of the equity capital, someone maybe would say you could lose something on preferred doesn’t means you will lose on the debt because a huge buffer, but if there is only a little bit of preferred stock then unlikely that losses just such that preferred stock would bear.
  + If they had 250 in regular equity and 25 in preferred and all completely senior then lose btwn 0-250 all on equity, 250-275 on equity and preferred, it is equity preferred and debt if 275+ that is a narrow range, the less preferred stock there is, the less likely there is that situation where lose on preferred but not on the debt. So I think you need to make sure some place, could even be just in a footnote, you want ot write out exactly why this, some wll understand this and I some. Not hard to find out, juist have to look at their balance sheets.