The Mechanics of a Receivership for Fannie Mae and Freddie Mac*

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This article explains how the receivership provisions in the Housing and Economic Recovery Act of 2008 apply to Fannie Mae and Freddie Mac (the Enterprises), and how those provisions intersect with the U.S. Treasury's commitment to provide financial support for the Enterprises under the Preferred Stock Purchase Agreements.

I. Summary

The article concludes that the Federal Housing Finance Agency could place either Enterprise into receivership at any time based upon a lack of capital or consent. This would trigger a liquidation of the Enterprise, and the establishment of a limited-life regulated entity that would succeed to the charter of the Enterprise and assume some of the assets and liabilities of the Enterprise. Treasury's commitment to provide financial support to the Enterprise would continue, but remain with the obligations in the receivership. The limited-life regulated entity could be sold by FHFA, and continue to facilitate a secondary market for conventional mortgage loans, but would not be backed by Treasury's financial commitment.

II. The Receivership Provisions in HERA

FHFA has discretionary and mandatory receivership powers.

The Housing and Economic Recovery Act of 2008 (HERA) gives the Federal Housing Finance Agency (FHFA) the authority to place the Enterprises into conservatorship or receivership upon

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certain grounds.[1] A little more than a month after the enactment of HERA, the Director of FHFA exercised this authority and placed the Enterprises into conservatorship, where they remain today.[2] FHFA has two alternative paths for moving the Enterprises from conservatorship into receivership: a discretionary receivership and a mandatory receivership.[3]

At the discretion of the Director, FHFA may place an Enterprise into receivership if any following grounds exist:[4]

(1) the assets of the Enterprise are less than its obligations;

(2) the Enterprise is experiencing substantial dissipation in its assets or earnings as a result of a violation of law or an unsafe or unsound practice;

(3) the Enterprise is in an unsafe or unsound condition;

(4) the Enterprises have willfully violated an outstanding cease and desist order;

(5) the Enterprise has concealed books, papers or records from an examiner;

(6) the Enterprise is likely to be unable to pay obligations or meet demands of creditors in the normal course of business;

(7) the Enterprise has incurred, or is likely to incur, losses that will deplete all or substantially all of its capital and there is no reasonable prospect for the Enterprise to become adequately capitalized[5];

(8) a violation of law or unsafe or unsound practices is likely to cause the insolvency of an Enterprise, the substantial dissipation of its assets or earnings, or weaken its condition;

(9) the Enterprise consents to the appointment;

(10) the Enterprise is undercapitalized[6] or significantly undercapitalized[7] and has no reasonable prospect of becoming adequately capitalized;

(11) the Enterprise is critically undercapitalized[8]; or

(12) the Attorney General of the United States notifies the Director of FHFA that the Enterprises have been found guilty of money laundering.

[1] P.L. 110-289. HERA also authorized FHFA to regulate and supervise the Federal Home Loan Banks and the Office of Finance.

[2] ***Statement of FHFA Director James B. Lockhart at News Conference Announcing Conservatorship of Fannie Mae and Freddie Mac, Sep. 7, 2008.***

[3] 12 U.S.C. §4617(a)(2) (discretionary receivership), 12 §U.S.C. 4617(a)(4) (mandatory receivership).

[4] These are the same grounds for placing an Enterprise into conservatorship.

[5] An Enterprise is adequately capitalized if its capital equals or exceeds both the applicable risk-based capital requirements and a core capital requirement, see 12 U.S.C. §4614(a)(1).

[6] An Enterprise is undercapitalized if it cannot meet the applicable risk-based capital requirement, but can meet the minimum core capital requirement, see 12 U.S.C. §4614(a)(2).

[7] An Enterprise is significantly undercapitalized if it cannot meet either the applicable risk-based capital requirement or the core capital requirement, but meets a critical core capital level, see 12 U.S.C. §4614(a)(3) and 12 U.S.C. §4613.

[8] An Enterprise is critically undercapitalized if it cannot meet the applicable risk-based capital requirement and the critical capital level, see 12 U.S.C. §4614(a)(4).

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Alternatively, HERA requires the Director to place an Enterprise into receivership if, for a period of 60 days: (1) the assets of an Enterprise are less than its obligations, or (2) the Enterprise has not been paying its debts as they come due.[9] This is a mandatory receivership.

Treasury's financial commitment to the Enterprises has avoided a mandatory receivership.

Since the establishment of the conservatorship, the Enterprises have avoided mandatory receivership as a result of the U.S. Treasury's commitment to maintain the solvency of the Enterprises. HERA gave Treasury temporary authority to purchase securities issued by the Enterprises in order to stabilize financial markets and prevent disruptions in the availability of mortgage finance.[10] Treasury exercised this authority on the same day that the Enterprises were placed into conservatorship by executing a Senior Preferred Stock Purchase Agreement (PSPA) with each Enterprise.[11]

Under the PSPAs, Treasury purchased Senior Preferred Stock from each Enterprise and, subject to certain dollar limits, committed to provide funds to each Enterprise at the end of each calendar quarter to maintain a positive net worth for the Enterprise and avoid the imposition of a mandatory receivership.[12] Initially, Treasury's financial commitment was limited to $100 billion for each Enterprise. This limit was increased to $200 billion for each Enterprise in May 2009, and then increased again in December 2009 to $200 billion plus the cumulative amount of financial support provided by Treasury to each Enterprise between 2010 and 2012.

As of December 31, 2016, Fannie Mae had received a total of $117.1 billion in financial support from Treasury, and has $117.6 billion in remaining funding available.[13] As of December 31, 2016, Freddie Mac had received $72.3 billion, and the amount of remaining funding available to Freddie Mac is $140.5 billion.[14]

[9] FHFA has notified the Enterprises that the measurement period for any mandatory receivership determination with respect to assets and liabilities would begin no earlier than the SEC public filing deadline for quarterly or annual financial statements and would continue for 60 calendar days thereafter.

[10] 12 U.S.C. §1719(g) (Fannie Mae), 12 U.S.C. §1431(l) (Freddie Mac). While Treasury's authority to purchase securities and obligations issued by the Enterprises expired on December 31, 2009, its financial commitments under the PSPAs are not subject to any expiration date. Section 2.5 in the PSPAs (Termination of Purchaser's Obligations) provides that those commitments expire only upon one of the following events: (1) Treasury has provided its full commitment to an Enterprise; (2) the Enterprise is liquidated; or (3) the Enterprise has repaid all of its mortgage guarantee obligations and debts. Additionally, Section 5.4 in the PSPAs (Transfer of Assets) prohibits the Enterprises from buying back the Senior Preferred Stock, and the Consolidated Appropriations Act of 2016 (P.L. 114-113) limits the ability of the Treasury to sell, transfer, liquidate, or divest its holdings of the Senior Preferred Stock through January 1, 2018.

[11] FHFA signed the PSPAs for each Enterprise in its capacity as a conservator. The PSPAs subsequently were amended and restated on September 26, 2008, and amended again on May 6, 2009, December 24, 2009, and August 17, 2012. ***Copies of these agreements may be found here.***

[12] Section 3.1 of the PSPAs (Initial Commitment Fee) provides for each Enterprise to issue and sell to Treasury one million shares of Senior Preferred Stock (with an initial liquidation preference of $1,000 a share) as a fee in exchange for Treasury's commitment to provide financial support to the Enterprises. Section 3.3 of the PSPAs (Increase of Senior Preferred Stock Liquidation Preference as a Result of Funding under the Commitment) provides for the liquidation preference for these shares to increase dollar for dollar with the amount of financial support provided to each Enterprise by Treasury. As part of the PSPAs, each Enterprise also gave Treasury a warrant to purchase, for a nominal price, up to 79.9 percent of common stock in the Enterprise.

[13] Fannie Mae 2016 Form 10K.

[14] Freddie Mac 2016 Form 10K.

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The Congressional Budget Office (CBO) recently concluded that the probability of the Enterprises experiencing losses that exceed Treasury's remaining financial support is low.[15] CBO based this conclusion, in part, on the results of FHFA's 2016 stress tests for the Enterprises, which showed that both Enterprises have sufficient unused support from Treasury to withstand another housing crisis. Assuming CBO's assessment is accurate, a mandatory receivership of the Enterprises remains highly unlikely.[16]

However, additional draws on Treasury's financial commitment are possible. The PSPAs require the Enterprises to eliminate all remaining capital by the end of this year.[17] Thus, after December 31, an operating loss that causes an Enterprise to record a net worth deficit at the end of a quarter would necessitate a draw on the Treasury in order to avoid mandatory receivership. Moreover, Fannie Mae has acknowledged that a significant reduction in the corporate tax rate as a result of tax reform legislation could result in a significant operating loss based upon the value of the company's deferred tax assets and trigger a draw on Treasury:

Under applicable accounting standards, a significant reduction in the U.S. corporate income tax rate would require that we record a substantial reduction in the value of our tax deferred assets. Thus, if legislation significantly lowering the U.S. corporate income tax rate is enacted, we expect to incur a significant net loss and net worth deficit for the quarter in which the legislation is enacted and we could potentially incur a net loss for that year. As noted above, if we experience a net worth deficient in a future quarter, we will be required to draw additional funds from Treasury under the senior preferred stock purchase agreement in order to avoid being placed into mandatory receivership.[18]

FHFA has grounds for a discretionary receivership.

While a mandatory receivership is unlikely, the Director, at any time, could use the Director's discretionary authority to place the Enterprises into receivership. As noted above, the Director may place an Enterprise into receivership for a number of reasons, including if an Enterprise is critically undercapitalized or if it is undercapitalized or significantly undercapitalized and has no reasonable prospect of becoming adequately capitalized. With the Enterprises required to eliminate all remaining capital by the end of this year, the Director has sufficient grounds for a discretionary receivership based upon the capital position of the Enterprises.

In addition, the Director could place the Enterprises into conservatorship by consent, through the resolution of its board of directors, or its shareholders. Since FHFA, as conservator, has all of the rights of the directors and shareholders of each Enterprise,[19] FHFA could use this authority to consent to the appointment of a receiver, so long as such action could be justified under the

[15] Congressional Budget Office, ***The Effects of Increasing Fannie Mae's and Freddie Mac's Capital***, Oct. 2016.

[16] In its 2016 Form 10K (page 34), Fannie Mae notes that a mandatory receivership could be triggered if the government exhausts its borrowing authority or if there is a government shutdown and, as a result, Treasury cannot meet its financial commitment under the PSPA.

[17] Paragraph 2(c) of the Senior Preferred Stock Certificate, as amended by the third amendment to the PSPAs.

[18] Fannie Mae 2016 Form 10K, page 10.

[19] 12 U.S.C. §4617(b)(2).

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conservator's fiduciary obligations and statutory duties.[20] In any case, judicial review of a decision to appoint a receiver is limited, and only an Enterprise has clear standing to challenge the appointment.[21]

A receivership automatically terminates the conservatorship.

The appointment of FHFA as a receiver for an Enterprise immediately terminates the conservatorship of the Enterprise.[22] FHFA then succeeds, by operation of law, to all rights, titles, policies, and privileges of the Enterprise, its shareholders, officers and directors.[23] The receivership also terminates all rights and claims of shareholders and creditors against the assets or charter of the Enterprise, other than claims that are permitted by HERA (see discussion of claims below).[24]

When acting as a receiver, FHFA is not subject to the direction or supervision of any other federal or state agency[25], and, as a general rule, no court can restrain or affect the exercise of the FHFA's powers as a receiver.[26] However, as noted above, an Enterprise that is placed into receivership may seek judicial review of the appointment, and the reviewing court may dismiss the challenge or direct FHFA to remove itself as the receiver.[27]

In a receivership, FHFA is required to liquidate an Enterprise and organize a limited-life regulated entity to assume some of its assets and liabilities.

As the receiver, FHFA is required to liquidate the Enterprise and to transfer such assets and liabilities of the Enterprise, as the FHFA determines to be appropriate, to a limited-life regulated entity (LLRE).[28] An LLRE organized by FHFA automatically succeeds to the Congressional charter of an Enterprise.[29] Thus, the LLRE mechanism ensures some continuity of the operations of an Enterprise. However, an LLRE may not assume any obligation to any shareholder of an Enterprise, and no shareholder or creditor has any claim against the charter once it has been assumed by a LLRE.[30]

In a receivership all shareholders, other than Treasury, are likely to be wiped out, and payments to holders of MBS could be affected.

[20]The conservator is authorized to take actions to preserve and conserve the assets and property of the Enterprises, 12 U.S.C. §4617(b)(2)(B)(iv), or take any other action determined to be in the best interests of the Enterprises, 12 U.S.C. §4617(b)(2)(J).

[21]12 U.S.C. §4617(a)(5) and 12 U.S.C. §4617(b)(10)(D).

[22]12 U.S.C. §4617(a)(4)(D). Termination of the conservatorship in connection with a receivership does not require Treasury's consent under the PSPAs.

[23]12 U.S.C. §4617(b)(2)(A).

[24]12 U.S.C. §4617(b)(2)(K).

[25]12 U.S.C. §4617(a)(7).

[26]12 U.S.C. §4617(f).

[27]12 U.S.C. §4617(a)(5).

[28]12 U.S.C. §4617(b)(2)(E), 12 U.S.C. §4617(i)(1)(A)(ii).

[29]12 U.S.C. §4617(i)(2)(A).

[30]12 U.S.C. §4617(i)(2)(B).

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The administration of claims on assets held in receivership is based upon the procedures the Federal Deposit Insurance Corporation (FDIC) follows in resolving failing banks. Like the FDIC, FHFA must: (1) maximize the net present value return on the sale of assets; (2) minimize losses; and (3) ensure adequate compensation and fair and consistent treatment of creditors.[31] FHFA also is required to treat creditors that are similarly situated the same, and ensure that all similarly situated creditors receive no less than they would receive in a liquidation.[32]

The priority for resolving claims is as follows: (1) the administrative expenses of the receiver; (2) general secured creditors; (3) general creditors subordinated to secured creditors; and (4) shareholders.[33] The certificates for the Senior Preferred Securities held by Treasury provide that those securities rank prior to all other preferred and common shares issued by the Enterprises for purposes of dividends and distributions upon the dissolution, liquidation or winding up of the Enterprises.[34] Given these priorities, Fannie Mae has stated that in the event of a liquidation there would not be sufficient proceeds to make any distribution to holders of our preferred stock or common stock, other than possibly to Treasury as a holder of the Senior Preferred Securities.[35]

In a receivership, general creditors and holders of guaranteed MBS will be able to rely on the remaining unused funding commitments under the PSPAs.[36] Since the process of placing the Enterprises into liquidation may depress asset prices, there could be a concern that the remaining amount of the funding commitment may not be enough to fully protect all creditors. Further, the receivership process could cause delays in the payment of creditors and MBS holders which could have a disruptive market impact. This concern was raised by both Enterprises in recent securities fillings:

> If we are placed into receivership and do not or cannot fulfill our guaranty to the holders of our Fannie Mae MBS, there may be significant delays of any payments to our MBS holders, and the MBS holders could become unsecured creditors of ours with respect to claims made under our guaranty to the extent the mortgage collateral underlying the Fannie Mae MBS is insufficient to satisfy the claims of the MBS holders.[37]
>
> The GSE Act provides that, if we were placed into receivership, the receiver would hold the mortgages underlying our mortgage-related securities (and the payments thereon) for the benefit of the holders of those securities. However, payments on the mortgages underlying our mortgage-related securities might not be sufficient to make full payments of principal and interest on the securities. In that event, if we were unable to fulfill our guarantee, the holders of our mortgage-related securities would experience delays in receiving payments on the securities because the relevant systems are not designed to

[31] 12 U.S.C. §4617(b)(11)(E). For comparison with FDIC standards, see 12 U.S.C. §1821(d)(13)(E).

[32] 12 U.S.C. §4617(c)(2).

[33] 12 U.S.C. §4617(c)(1). For comparison with the priority FDIC follows in administering failing banks, see 12 US.C. §1821(d)(11)(A).

[34] ***Certificate of Designation of Terms of Variable Liquidation Preference Senior Preferred Stock, Series 2008-2.***

[35] Fannie Mae 2016 Form 10K, page 37.

[36] It may be noted that mortgages held by an Enterprise in a trust, custodial, or agency capacity cannot be used to satisfy claims in a liquidation. 12 U.S.C. §4617(b)(19)(B). Also, FHFA cannot disallow claims for loans to an Enterprise from a Federal Reserve Bank, a Federal Home Loan Bank, or the U.S. Treasury, see 12 U.S.C. §4617(b)(5)(D)(iii)(I).

[37] Fannie Mae 2016 Form 10K, page 34.

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make partial payments.[38]

III. The Status and Treatment of the PSPAs in a Receivership

The PSPAs are probably qualified financial contracts.

Under HERA, special receivership rules apply to "qualified financial contracts."[39] These contracts include "securities contracts," defined to include contracts for the purchase, sale or loan of a security.[40] This definition is derived from the Bankruptcy Code, which defines the term "securities contract" in a similar manner.[41] As one bankruptcy court recently explained, the definition of a securities contract "is very broad in its application and encompasses virtually any contract for the purchase or sale of securities ... and a wide array of related contracts. . . ."[42] The original PSPA was clearly a contract for the sale of preferred shares, and the amendatory agreements are clearly related. Therefore, although there is no guidance directly on point, we assume that the PSPAs would be viewed as qualified financial contracts for purposes of the receivership provisions in HERA.

The receiver has the legal authority to transfer the PSPAs to an LLRE, but is unlikely to do so.

The PSPAs state that the commitment to fund the Enterprises is not transferrable, including to any "entity to which the charter of the Seller may be transferred, to any LLRE or to any other successor to the assets, liabilities or operations of the Seller."[43] The Seller refers to the seller of the preferred shares, i.e., the Enterprises. The PSPAs further state that "It is the expectation of the parties that, in the event the [Enterprise] were placed into receivership and an LLRE formed to purchase certain of its assets and assume certain of its liabilities, the Commitment would remain with [the Enterprise] for the benefit of the holders of the debt of the [Enterprise] not assumed by the LLRE."[44]

Notwithstanding these contractual provisions, the receiver has the right, under HERA, to transfer qualified financial contracts to another entity, including the LLRE, if such transfer is consistent with the statutory objectives of the receivership.[45] The PSPA agreements acknowledge that the terms of the agreements may be limited by applicable "bankruptcy laws, insolvency laws, reorganization laws, moratorium laws or other laws of general applicability affecting creditors' rights generally."[46] Thus, as a legal matter, the receiver could transfer the PSPAs to the LLREs. However, as a practical matter, it would be unlikely that the FHFA, acting as a receiver, would ignore the provisions in the PSPA that it agreed to as a conservator. Further, transferring the commitment to

[38] Freddie Mac 2016 Form 10K, pages 183-184.
[39] 12 U.S.C. §4617(d)(8).
[40] 12 U.S.C. §4617(d)(8)(D)(ii).
[41] 11 U.S.C. §741(7).
[42] In re Lehman Bros. Holdings Inc., 469 B.R. 415, 438 (Bankr. S.D.N.Y. 2012).
[43] Section 6.2. of the PSPAs (Non-Transferrable; Successors).
[44] Id.
[45] 12 U.S.C. §4617(d)(9) provides the rules for the receiver to transfer qualified financial contracts.
[46] Section 4.3 of the PSPAs (Authorization and Enforceability).

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maintain the solvency of each Enterprise to the LLREs would cause significant financial disruption since it would be contrary to the market expectation of Treasury support for the obligations of the existing Enterprises.

We, therefore, conclude that although the receiver would have the legal authority to transfer the PSPAs to the LLRE, it would not do so as a practical matter, and the commitments and payment obligations will remain with the Enterprises.

The receiver could repudiate the PSPAs, but is unlikely to do so.

HERA provides the authority for the receiver to repudiate contractual obligations, which in this case would be the obligations to pay dividends and fees to the Treasury under the PSPAs.[47] However, the receivership would be liable for "direct compensatory damages" that result from the repudiation.[48] Damages cannot exceed the amount that would be received as a result of the liquidation of all assets.[49] Further, repudiation would likely terminate the Treasury's obligation to maintain the solvency of the Enterprises, which could cause significant market disruption. Moreover, since the dividends are based on the net profits of the Enterprises, and since the receiver will be winding up the affairs of the Enterprises, there may be minimal, if any, required dividend payments during the receivership proceeding. We, thus, conclude that it would be highly unlikely that the receiver would repudiate the PSPA dividend obligations.

The receiver cannot terminate the PSPAs.

Under HERA, a party to a qualified financial contract with a regulated entity may enforce a contractual provision giving that party the right to terminate a contract in the event a conservator or receiver is appointed for the regulated entity.[50] However, this statutory provision only permits the counterparty to terminate the agreement if that right is contained in the agreement. Since the PSPAs do not provide a termination right triggered by the appointment of a conservator or receiver, the agreements may not be terminated based on this statutory section.

The PSPAs were intended to continue in a receivership.

It is clear that the parties to the PSPAs contemplated the continuation of Treasury's commitment during a receivership. The PSPA's provide that Treasury may not terminate its funding commitment solely by reason of an Enterprise being placed into conservatorship, receivership or other insolvency proceeding.[51] The PSPAs also provide that commitment expires only upon one of the following events: (1) Treasury has provided its full commitment to an Enterprise; (2) the Enterprise is

[47] 12 U.S.C. §4617(d)(11). In order to repudiate a contract, FHFA must find that performance of the contract is burdensome and repudiation will promote the orderly administration of the Enterprise. HERA also gives FHFA the right to affirm existing contracts, see 12 U.S.C. §4617(d)(13).
[48] 12 U.S.C. §4617(d)(3).
[49] 12 U.S.C. §4617(e).
[50] 12 U.S.C. §4617(d)(8)(E).
[51] Section 2.5 of the PSPAs (Termination of Purchaser's Obligation).

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liquidated; or (3) the Enterprise has repaid all of its mortgage guarantee obligations and debts.[52] Furthermore, the PSPA's provide for a different calculation of the so-called deficiency amount Treasury is committed to pay to the Enterprises in the event of a receivership or liquidation.[53]

Additionally, as noted above, Treasury's continuing commitment under the PSPAs runs only to the obligations that remain in the receivership estate, not to the LLRE. This limitation obviously provides some financial security to the holders of mortgage backed securities issued by an Enterprise that remain in the receivership, but leaves new securities issued by an LLRE without any federal support. While FHFA, as a receiver, has the legal authority to reverse this outcome and transfer the commitment to the LLRE, we do not believe that is a likely outcome for the reasons given above.

IV. Functions and Activities of the LLREs

If the FHFA places an Enterprise into receivership, the agency is required to establish an LLRE that would continue the functions of the Enterprise.[54] An LLRE would succeed to the charters of the Enterprise, and operate in accordance with, and subject to, the Enterprises' chartering acts, and other laws to which the Enterprises are subject.[55]

The LLRE would assume such assets and liabilities of the Enterprise that the FHFA deems appropriate.[56] Presumably, FHFA would use this authority to transfer "good" assets and liabilities to the LLRE and leave the "bad" assets and liabilities in the receivership. However, as noted above, an LLRE may not assume any obligation to any shareholder of an Enterprise, and no shareholder or creditor has any claim against the charter once it has been assumed by an LLRE.[57]

After an LLRE is established, FHFA may transfer other assets and liabilities of an Enterprise to the LLRE as the agency deems appropriate, and without any further approval under federal or state law.[58] In doing so, FHFA must treat all creditors in a similar manner unless the Director determines that a deviation from this requirement is necessary to maximize the value of the assets of the Enterprise or minimize the loss on assets and creditors do not receive less than they would in a liquidation.

An LLRE would be managed by a board of directors selected by FHFA.[59] The LLRE would have all of the corporate powers available to the Enterprise to which it relates, except the FHFA could remove the directors of the LLRE, fix the compensation of the directors and senior management,

[52] Id.

[53] Section 1 of the PSPAs (Definition of Deficiency Amount). Currently, the deficiency amount is the amount by which the total liabilities of an Enterprise exceed its assets. These payments, when needed, maintain the solvency of an Enterprise and avoid a mandatory receivership. In the case of a receivership or liquidation, the deficiency amount would be the difference between total claims against the receivership and the total assets of the receivership.

[54] 12 U.S.C. §4617(i)(1)(A)(ii).

[55] 12 U.S.C. §4617(i)(2)(A).

[56] 12 U.S.C. §4617(i)(1)(B).

[57] 12 U.S.C. §4617(i)(2)(B).

[58] 12 U.S.C. §4617(i)(7).

[59] 12 U.S.C. §4617(i)(2)(D).

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and indemnify the officers, directors, employees and agents of the entity.[60]

FHFA has no obligation to capitalize an LLRE, but may permit an LLRE to issue capital stock or other securities in such amounts and on such terms as the Director determines to be appropriate.[61] The LLRE also would have an enhanced ability to accumulate capital based upon earnings since it would be exempt from federal, state and local taxes.[62]

Additionally, an LLRE may obtain unsecured credit and issue unsecured debt.[63] If an LLRE is unable to obtain unsecured credit or issue unsecured debt, the Director may authorize the obtaining of credit or the issuance of debt that has a priority over other obligations of the LLRE or is secured by a lien on the property of the LLRE.[64]

As a general rule, FHFA must wind up an LLRE no later than 2 years after it is established. However, FHFA may extend the life of an LLRE for up to 3 additional 1 year periods. Thus, an LLRE has a maximum life of 5 years.[65]

FHFA may transfer the ownership and control of an LLRE to private parties through the sale of the stock of an LLRE. Upon the sale of 80 percent or more of the stock to one or more persons, the status of the entity as an LLRE automatically terminates. After the termination of the status of the entity as an LLRE, FHFA must sell off the remaining stock in the entity within 1 year, but may extend this period for an additional 2 years if the Director determines it would be in the public interest.[66] HERA prohibits FHFA from revoking, annulling or terminating the charter of an Enterprise that is transferred to an LLRE.[67] Thus, if an LLRE is sold, the charter would transfer as part of the sale. The resulting entity, therefore, would be able to operate just as the Enterprises did prior to conservatorship.

V. Summary

In summary, FHFA could place an Enterprise into receivership at any time based upon its lack of capital or through consent. This would trigger a liquidation of the Enterprise, and the mandatory establishment of LLREs to assume some of the assets and liabilities of the Enterprise. Treasury's commitment to provide financial support to the obligations left in the receivership would continue. The LLRE could be sold by FHFA, and continue to facilitate a secondary market for conventional mortgage loans, but would not be backed by Treasury's financial commitment.

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[60] 12 U.S.C. §4617§(i)(9).
[61] 12 U.S.C. §4671(i)((3).
[62] 12 U.S.C. §4617(i)(5).
[63] 12 U.S.C. §4617(i)(3) and (11).
[64] 12 U.S.C. §4617(i)(11). If the lien on the property would be senior or equal to an existing lien on property (other than the mortgages that collateralize the mortgage-backed securities issued or guaranteed by an Enterprise), the Director would be required to make this determination following notice and a hearing and a demonstration that the LLRE is otherwise unable to obtain such credit or issue such debt and that there is adequate protection of the interests of the holder of the existing lien on the property.
[65] 12 U.S.C. §4617(i)(6).
[66] 12 U.S.C. §4617(i)(6)(C).
[67] 12 U.S.C. §4617(k).

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