



Questions & Answers

GSE Conservator Powers under the Housing and Economic Recovery Act

MBA staff has reviewed the powers granted to a GSE conservator by the Housing and Economic Recovery Act. While the goal of a conservator is to revive the financial viability of a financially troubled GSE, the conservator has a broad range of powers that might have a significant impact on MBA members' business activities and relationships with the GSEs. We have identified key provisions and provided a summary analysis below. Additional information and insight will be distributed to MBA members as it becomes available.

Q. What is a conservator?

A. An enterprise is placed into conservatorship when its regulator believes it is in critical financial condition. A conservator assumes the operations and management of the enterprise and attempts to restore it to viability for it to run on its own again. A conservator is different than a receiver because a receiver is charged with winding down the affairs of the enterprise in order to “close up shop.”

Q. What activities can a conservator perform?

A. For all practical purposes, a conservator becomes the new management of the enterprise. Like any manager, the conservator oversees the enterprise's day-to-day operations. Admittedly, this is an awkward scenario because the Federal Housing Finance Agency (FHFA) is charged with supervising the entity it is managing, although the FHFA could appoint another entity to serve as conservator. Specific powers of the conservator include:

- Access to all corporate books and records;
- Assumption of the rights, obligations and powers of the entity's officers, directors and shareholders;
- Authority to outsource activities related to running the organization;
- Authority to transfer the organization's assets and liabilities to another entity on its own discretion; and
- Authority to repudiate (cancel) contracts.

Q. What standards must the conservator follow in taking action?

A. The conservator must attempt to:

- Maximize the net present value of the enterprise's assets;
- Minimize losses; and
- Ensure adequate and fair competition.

Q. Can the conservator cancel contracts related to the enterprise's secondary market operations?

A. Yes. However, the Housing and Economic Recover Act provides special treatment for "Qualified Financial Contracts (QFC)." Under the act, QFCs include residential MBS, residential repurchase agreements, residential swap agreements and a variety of other financial-related contracts. Under the law, the conservator can cancel all or none of the QFCs of a contracting party. The law also provides special treatment for credit enhancements, and cannot "avoid any transfer of money or property in connection with a QFC." The scope of this language is ambiguous and needs clarification by FHFA. Unless the conservator affirmatively includes them, commercial property MBS etc. do not qualify for QFC status.

Q. Do loan servicing and administration agreements receive any special protections?

A. The HERA provides that "service contracts" can be canceled at any time. However, an "interest in a mortgage" qualifies for QFC status. MBA is working with the regulatory agencies to ensure agreements related to loan processing, servicing and administration will be treated in a way that minimizes disruptions in housing finance.

Q. What is the priority for handling claims?

A. The HERA requires the payment of claims and expenses in the following order of priority:

- Administrative expenses;
- General or senior liabilities of the enterprise;
- Obligations subordinated to general creditors; then
- Shareholder obligations.

Q. What rights do contracting parties have?

A. HERA prohibits a contracting party from repudiating a contract on the grounds that the enterprise is insolvent. HERA also states that, unless repudiated by the conservator, a party must perform its contractual obligations even if the contract includes a "walkaway" clause which would otherwise nullify the party's performance obligations. Claims arising under contractual provisions are eligible for compensatory damages only; i.e. punitive, pain and suffering, lost profits and other damages are not permitted. HERA also prohibits MBS-related funds to be used to pay off other creditors.

Q. How will I be notified if a contract is canceled or transferred?

A. The law requires the conservator to notify the party of the contract's cancellation or transfer by 5 p.m. (eastern time) on the business day following the cancellation/transfer.

Q. What happens to property sales contracts?

A. The conservator can repudiate property sales contracts or assign and sell them to another entity. However, a purchaser in possession of the property and not in default can remain in possession of the property so long as the purchaser continues to make payments due under the contract. In this situation, the conservator must deliver title to the property according to the terms of the contract.

This information provides a general overview and does not constitute legal advice. It is important for your organization to obtain input from legal counsel prior to taking a course of action with respect to the conservatorship of Fannie Mae and/or Freddie Mac.