

FEDERAL HOUSING FINANCE AGENCY

12 CFR Part 1237

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Office of Federal Housing Enterprise Oversight

12 CFR Part 1777

RIN 2590-AA23

Conservatorship and Receivership

AGENCIES: Federal Housing Finance Agency; Office of Federal Housing Enterprise Oversight.

ACTION: Notice of proposed rulemaking; request for comment.

SUMMARY: The Federal Housing Finance Agency (FHFA) is proposing a regulation to establish a framework for conservatorship and receivership operations for the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, and the Federal Home Loan Banks, as contemplated by the Housing and Economic Recovery Act of 2008 (HERA). HERA amended the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (Safety and Soundness Act) by adding, among other provisions, section 1367, Authority Over Critically Undercapitalized Regulated Entities. The proposed rule will implement this provision, and is designed to ensure that these operations advance FHFA's critical safety and soundness and mission requirements. As

proposed, the rule seeks to protect the public interest in the transparency of conservatorship and receivership operations for the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac) (collectively, the Enterprises), and the Federal Home Loan Banks (Banks) (collectively, the regulated entities).

DATES: Comments on the proposed rule must be received in writing on or before [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: You may submit your comments on the proposed regulation, identified by regulatory identifier number (RIN) 2590-AA23, by any one of the following methods:

- E-mail: Comments to Alfred M. Pollard, General Counsel, may be sent by e-mail at RegComments@FHFA.gov. Please include “RIN 2590-AA23” in the subject line of the message.
- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments. If you submit your comment to the Federal eRulemaking Portal, please also send it by e-mail to FHFA at RegComments@fhfa.gov to ensure timely receipt by the Agency. Please include “RIN 2590-AA23” in the subject line of the message.
- Hand Delivered/Courier: The hand delivery address is: Alfred M. Pollard, General Counsel, Attention: Comments/RIN 2590-AA23, Federal Housing Finance Agency, Fourth Floor, 1700 G Street, NW., Washington, DC 20552. The package should be logged at the Guard Desk, First Floor, on business days between 9 a.m. and 5 p.m.

- U.S. Mail, United Parcel Service, Federal Express, or Other Mail Service:

The mailing address for comments is: Alfred M. Pollard, General Counsel,
Attention: Comments/RIN 2590-AA23, Federal Housing Finance Agency,
Fourth Floor, 1700 G Street, NW., Washington, DC 20552.

FOR FURTHER INFORMATION CONTACT: Frank Wright, Senior Counsel,
Federal Housing Finance Agency, Fourth Floor, 1700 G Street, NW., Washington, DC
20552, (202) 414-6439 (not a toll-free number). The telephone number for the
Telecommunications Device for the Deaf is (800) 877-8339.

SUPPLEMENTARY INFORMATION:

I. Comments

FHFA invites comments on all aspects of the proposed regulation and will take all comments into consideration before issuing a final regulation. Copies of all comments will be posted on the internet web site at <https://www.fhfa.gov>. In addition, copies of all comments received will be available for examination by the public on business days between the hours of 10 a.m. and 3 p.m., at the Federal Housing Finance Agency, Fourth Floor, 1700 G Street, NW., Washington, DC 20552. To make an appointment to inspect comments, please call the Office of General Counsel at (202) 414-6924.

II. Background

The Housing and Economic Recovery Act of 2008 (HERA), Public Law No. 110-289, 122 Stat. 2654, amended the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4501 et seq.) (Safety and Soundness Act), and the Federal Home Loan Bank Act (12 U.S.C. 1421-1449) to establish FHFA as an

independent agency of the Federal government.¹ FHFA was established as an independent agency of the Federal Government with all of the authorities necessary to oversee vital components of our country’s secondary mortgage markets – the regulated entities and the Office of Finance of the Federal Home Loan Bank System.

The Safety and Soundness Act provides that FHFA is headed by a Director with general supervisory and regulatory authority over the regulated entities and over the Office of Finance,² expressly to ensure that the regulated entities operate in a safe and sound manner, including maintaining adequate capital and internal controls; foster liquid, efficient, competitive, and resilient national housing finance markets; comply with the Safety and Soundness Act and rules, regulations, guidelines, and orders issued under the Safety and Soundness Act and the authorizing statutes (i.e., the charter acts of the Enterprises and authorizing statutes of the Banks); and carry out their respective missions through activities and operations that are authorized and consistent with the Safety and Soundness Act, their respective charter acts, authorizing statutes, and the public interest.³

In addition, this law combined the staffs of the now abolished Office of Federal Housing Enterprise Oversight (OFHEO), the now abolished Federal Housing Finance Board (FHFB), and the Government-Sponsored Enterprise (GSE) mission office at the Department of Housing and Urban Development (HUD). By pooling the expertise of the staffs of OFHEO, FHFB, and the GSE mission staff at HUD, Congress intended to strengthen the regulatory and supervisory oversight of the 14 housing-related GSEs.

¹ See Division A, titled the “Federal Housing Finance Regulatory Reform Act of 2008,” Title I, Section 1101 of HERA.

² See §§ 1101 and 1102 of HERA, amending sections 1311 and 1312 of the Safety and Soundness Act, codified at 12 U.S.C. 4511 and 4512.

³ See 12 U.S.C. 4513(a)(1)(B).

The Enterprises, combined, own or guarantee nearly \$5.5 trillion of residential mortgages in the United States (U.S.), and play a key role in housing finance and the U.S. economy. The Banks, with combined assets of \$ 965.7 billion, support the housing market by making advances (i.e., loans secured by acceptable collateral) to their member commercial banks, thrifts, and credit unions, assuring a ready flow of mortgage funding.

Because the Agency’s mission is to promote housing and a strong national housing finance system by ensuring the safety and soundness of the Enterprises and the Banks, HERA amended the Safety and Soundness Act to make explicit FHFA’s general regulatory and supervisory authority. To this end, section 1311(b)(1) of the Safety and Soundness Act expressly makes each regulated entity “subject to the supervision and regulation of the Agency,” thus amplifying the broad supervisory authority of the Director. See 12 U.S.C. 4511(b)(1). Moreover, the Safety and Soundness Act underscores the breadth of this authority by expressly conveying “general regulatory authority” over the regulated entities to the Director. See 12 U.S.C. 4511(b)(2); see also 12 U.S.C. 4513(a)(1)(B).⁴ In addition, the Safety and Soundness Act, as amended by HERA, provides that “[t]he Agency may prescribe such regulations as the Agency determines to be appropriate regarding the conduct of conservatorships or receiverships.” 12 U.S.C. 4617(b)(1).

⁴ Moreover, other provisions in the Safety and Soundness Act recognize the independence and general regulatory authority of the Director. Section 1311(c) of the Safety and Soundness Act provides that the authority of the Director “to take actions under subtitles B and C [of Title I of HERA] shall not in any way limit the general supervisory and regulatory authority granted to the Director under subsection (b).” See 12 U.S.C. 4511(c). Similarly, section 1319G(a) of the Safety and Soundness Act provides ample, independent authority for the issuance of “any regulations, guidelines, or orders necessary to carry out the duties of the Director under this title or the authorizing statutes, and to ensure that the purposes of this title and the authorizing statutes are accomplished.” See 12 U.S.C. 4519G(a).

The Enterprises are currently in conservatorship. FHFA as Conservator has been responsible for the conduct and administration of all aspects of the operations, business, and affairs of both Enterprises since September 6, 2008, the date on which the Director placed Fannie Mae and Freddie Mac in conservatorship. As Conservator, FHFA is charged with taking such action as may be “necessary to put the regulated entity in a sound and solvent condition” and “appropriate to carry on the business of the regulated entity and preserve and conserve the assets and property of the regulated entity.” 12 U.S.C. 4617(b)(2)(D). Similarly, FHFA, as Conservator, may “transfer or sell any asset or liability of the regulated entity in default, and may do so without any approval, assignment, or consent with respect to such transfer or sale.” *id.* 4617(b)(2)(G).

The United States Department of the Treasury (“Treasury”) facilitated FHFA’s decision to utilize its statutory conservatorship powers in an effort to restore the Enterprises’ financial health by agreeing to make available hundreds of billions of taxpayers’ dollars to be used by the Enterprises pursuant to Senior Preferred Stock Purchase Agreements (“Treasury Agreements”).⁵ Pursuant to these Agreements, as subsequently amended, Treasury has made available, through the Conservator, capital (“Treasury Commitments”) to each of the Enterprises in return for senior preferred stock carrying a preference with regard to dividends and the distribution of assets of the Enterprise in liquidation. As Conservator, FHFA has already drawn on the Treasury Commitments several times to prevent a negative net worth position that would trigger mandatory receivership of each Enterprise.

⁵ The Treasury Agreements and their amendments are available to the public for review at <http://www.fhfa.gov/webfiles/1099/conservatorship21709.pdf> and <http://www.financialstability.gov/roadtostability/homeowner.html>.

Congress authorized the Treasury Agreements in section 1117 of HERA, which amended each of the Enterprises' authorizing statutes (Fannie Mae, 12 U.S.C. 1716 et seq.; Freddie Mac, 12 U.S.C. 1451 et seq.) to empower Treasury to purchase securities of the Enterprises subject to certain conditions. These conditions include that Treasury "protect the taxpayers" by taking into consideration, among other things, "[t]he need for preferences or priorities regarding payments to the Government" and "[r]estrictions on the use of corporate resources." Pursuant to this statutory mandate, the Treasury Agreements imposed several such preferences, priorities, and restrictions. For instance, while the Treasury Agreements authorize the Conservator to draw on the Treasury Commitment for funds equal to the amount by which an Enterprise's liabilities exceed its assets, excluded from this calculation are liabilities that the Conservator determines shall be subordinated, including "a claim against [an Enterprise] arising from rescission of a purchase or sale of a security issued by [an Enterprise] . . . or for damages arising from the purchase, sale, or retention of such a security." Treasury Agreements § 1, definition of "Deficiency Amount," subparagraph (iii). In other words, the Conservator may determine to subordinate such a liability, with the effect that funds could not be drawn under the Treasury Agreements to satisfy it. The Treasury Agreements also contain restrictions on the declaration or payment of dividends or other distributions with respect to the Enterprises' equity interests; redeeming, purchasing, retiring, or otherwise acquiring for value any of the Enterprises' equity interests; or selling, transferring, or otherwise disposing of all or any portion of the Enterprises' assets other than in the ordinary course of business or under other limited exceptions. Treasury Agreements §§ 5.1 and 5.4. In promulgating these regulations, the Agency is required to "ensure that the

purposes of . . . the authorizing statutes,” including the authorizing statutes’ provisions for stock purchases by Treasury and the preferences, priorities, and restrictions attendant to such purchases, “are accomplished.” 12 U.S.C. 4526(a).

III. Synopsis of the Proposed Regulation

Comments are requested on whether the proposed conservatorship and receivership regulation will provide clarity to the regulated entities, creditors, and the markets regarding the processes of conservatorship and receivership, and the relationship among various classes of creditors and equity-holders in the event of the appointment of a conservator or receiver. This proposed regulation is designed to describe, codify, and implement the changes to the statutory regime enacted by HERA, the authorities granted to FHFA, and to eliminate ambiguities regarding those changes. The proposed regulation is part of FHFA’s implementation of the powers provided by HERA, and does not seek to anticipate or predict future conservatorships or receiverships.

The proposed regulation includes provisions that describe the basic authorities of FHFA when acting as conservator or receiver, including the enforcement and repudiation of contracts. Reflecting the approach in HERA, the proposed regulation parallels many of the provisions in the Federal Deposit Insurance Corporation (FDIC) rules for receiverships and conservatorships. The proposed regulation necessarily differs in some respects, however, from the FDIC regulations, because the GSEs are not depository institutions, and their important public missions differ from those of banks and thrifts.

The proposed regulation establishes procedures for conservators and receivers and priorities of claims for contract parties and other claimants. These priorities set forth the order in which various classes of claimants would be paid, partially or in full, in the event

that a regulated entity would be unable to pay all valid claims. Conservatorship and receivership also raise complex issues regarding the types of contracts that should be repudiated or enforced and the circumstances under which such decisions are made, and these issues are addressed in the proposed regulation. The proposed regulation also recognizes and addresses the differences between the Banks and the Enterprises, where appropriate.

Additionally, FHFA seeks comment on several provisions in the regulation that would address whether and to what extent claims against the regulated entities by current or former holders of their equity interests for rescission or damages arising from the purchase, sale, or retention of such equity interests will be paid while those entities are in conservatorship or receivership. The potential impact of such claims is significant and may jeopardize FHFA's ability to fulfill its statutory mission to restore soundness and solvency to insolvent regulated entities and to preserve and conserve their assets and property.

The regulation would clarify that for purposes of priority determinations, claims arising from rescission of a purchase or sale of an equity security of a regulated entity, or for damages arising from the purchase, sale or retention of such a security, will be treated as would the underlying security to which the claim relates. In addition, the proposed regulation would classify a payment of these types of claims as a capital distribution, which would be prohibited during conservatorship, absent the express approval of the Director. Moreover, the regulation will provide that payment of Securities Litigation Claims will be held in abeyance during conservatorship, except as otherwise ordered by

the Director. In the event of receivership, such claims will be treated according to the process established by statute and, if adopted, this proposed regulation.

IV. Summary of Conservatorship and Receivership Provisions of the Safety and Soundness Act

The Safety and Soundness Act, as amended, provides the general circumstances for the discretionary appointment of a conservator or receiver. 12 U.S.C. 4617(a)(3). The Director has grounds for discretionary appointment of FHFA as a conservator or receiver if: (1) the assets of the regulated entity are less than the entity's obligations to its creditors and others; (2) the regulated entity has suffered substantial dissipation of its assets or earnings due to a violation of a provision of federal or state law or an unsafe or unsound practice; (3) the regulated entity is in an unsafe or unsound condition to transact business; (4) the regulated entity has committed a willful violation of a cease-and-desist order that has become final; (5) the regulated entity has concealed the books, papers, records, or assets of the regulated entity; (6) the regulated entity is unlikely to be able to pay its obligations or meet the demands of its creditors in the normal course of business; (7) the regulated entity has incurred or is likely to incur losses that will deplete all or substantially all of its capital; (8) a violation of law or unsafe or unsound practice by the regulated entity that is likely to cause insolvency, substantial dissipation of assets, earnings, or to weaken the condition of the regulated entity has occurred; or (9) the regulated entity consents to the appointment by resolution of its board of directors, its shareholders, or members. The Director may appoint FHFA as conservator or receiver if the regulated entity is critically undercapitalized, significantly undercapitalized, or undercapitalized and has no reasonable prospect of becoming adequately capitalized.

The Safety and Soundness Act provides FHFA, as conservator or receiver, with all the rights, titles, powers, and privileges of the shareholders, directors, and officers of a regulated entity under conservatorship or receivership. 12 U.S.C. 4617(b)(2)(A). In addition, the conservator or receiver is provided a number of additional powers, including authority to: (1) take over the assets of and operate the regulated entity; (2) collect all obligations and money due the regulated entity; (3) perform functions of the regulated entity consistent with appointment as conservator or receiver; and (4) preserve and conserve the assets and property of the regulated entity. *id.* 4617(b)(2)(B). The Safety and Soundness Act also provides FHFA with the power to avoid a fraudulent transfer of an interest to an entity-affiliated party or debtor of the regulated entity that was made within five years of the date on which FHFA was appointed conservator or receiver. *id.* 4617(b)(15).

Furthermore, the Safety and Soundness Act also provides the conservator with the power to take such action as may be necessary to put the regulated entity in a sound and solvent condition, appropriate to carry on the business of the regulated entity, and to preserve and conserve its assets and property. The Safety and Soundness Act also provides a receiver with the power to place a regulated entity in liquidation in such manner as FHFA deems appropriate. *id.* 4617(b)(2)(E). As amended, the Safety and Soundness Act bestows upon a receiver the power to determine claims in the process of liquidation or winding up the affairs of a regulated entity, including the allowance and disallowance of claims (12 U.S.C. 4617(b)(3)) and establishes the process and treatment for certain qualified financial contracts (12 U.S.C. 4617(d)(8)).

V. Section-by-Section Analysis of the Proposed Regulation

Section 1237.1 Purpose and Applicability.

This section explains that the provisions of this regulation would provide rules for the conduct of a conservator or receiver of a regulated entity.

Section 1237.2 Definitions.

This section would provide definitions of certain terms used in the regulation.

Section 1237.3 Powers of the Agency as Conservator or Receiver.

This section enumerates the powers of FHFA while acting as conservator or receiver for a regulated entity. This section states the powers of FHFA to continue the mission of a regulated entity in conservatorship or receivership as described by section 1313(a)(1)(B)(ii) of the Safety and Soundness Act, and ensure that the operations of such regulated entity foster liquid, efficient, competitive, and resilient national housing finance markets.

While in conservatorship, the Enterprises continue to operate under their charters, which provide that their purpose is to “provide stability in the secondary market for residential mortgages,” “respond appropriately to the private capital market,” “provide ongoing assistance to the secondary market for residential mortgages . . . ,” and “promote access to mortgage credit throughout the Nation . . .” (Fannie Mae Charter Act, section 301; Freddie Mac Corporation Act, section 301(b).) FHFA is obligated to regulate the Enterprises in conservatorship, as well as any Bank that should be placed into conservatorship, pursuant to FHFA’s mandate that “the operations of each regulated entity foster liquid, efficient, competitive, and resilient national housing finance markets (including activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned

on other activities).” Section 1313(a)(1)(B)(ii) of the Safety and Soundness Act. The proposed regulation carries forward those statutory mandates.

A focus on mission is especially appropriate for the Enterprises, currently in conservatorship, for several reasons. First, they are supported by the Treasury, funded by the American taxpayer, with ongoing capital infusions that would not be available to the Enterprises in the private capital market on similar terms, or probably on any terms. Second, the Enterprises were supported for many years by the implicit federal guarantee, which enabled them to operate with thinner capital cushions than their risk profiles merited and hence to generate larger returns for private investors than would have been possible at more appropriate capital levels. Inseparable from that implicit guarantee is the public mission of the Enterprises, which they must continue to pursue now that the government has made good on that guarantee by sustaining the Enterprises with the financial support of the Treasury. And finally, the Enterprises’ mission activity is necessary to preserve the value of their own businesses.

The Enterprises are not only participants in the national mortgage market; they are significant drivers of its performance. As purchasers of roughly three out of four residential mortgages currently being originated, the Enterprises’ mission activities, such as their participation in the administration’s loan modification and refinancing program that may help stabilize the nation’s home mortgage market, are critical to the Enterprises’ own recovery of financial health.

This section also states that FHFA, as conservator, has the broad power to take necessary action to put the regulated entity in sound and solvent condition and to take appropriate action to preserve and conserve the assets and property of a regulated entity.

Section 1237.4 Receivership Following Conservatorship; Administrative Expenses.

This section provides that the administrative expenses of a conservatorship shall also be deemed administrative expenses of a subsequent receivership if the receiver immediately succeeds the conservator.

Section 1237.5 Contracts Entered into Before Appointment of a Conservator or Receiver.

The section provides that the conservator or receiver shall have 18 months following its appointment to determine whether to exercise the rights of repudiation under 12 U.S.C. 4617(d). By statute, the determination of whether to exercise such rights should be made within a reasonable time following the appointment of the conservator and receiver. 12 U.S.C. 4617(d)(2). The experiences of FHFA during the conservatorships of Fannie Mae and Freddie Mac have shown that at least 18 months is required for the conservator to obtain all facts needed to make accurate determinations about its rights of repudiation.

Section 1237.6 Authority to Enforce Contracts.

This section states the authority of a conservator or receiver to enforce contracts that the regulated entity has entered, even if such contracts contain provisions for termination or default upon the appointment of a conservator or receiver.

Section 1237.7 Period for Determination of Claims.

This section states the period and timing of the determination by FHFA as receiver of claims against a regulated entity.

Section 1237.8 Alternate Procedures for Determination of Claims.

This section allows claimants to seek alternative dispute resolution for determination of claims in lieu of a judicial determination. The procedure for alternative dispute resolution may be determined by orders, policy statements, and directives to be issued by FHFA, similar to the practices of the FDIC.

Section 1237.9 Priority of Expenses and Unsecured Claims.

This section discusses the priority of unsecured claims against a regulated entity in receivership, or the receiver for that regulated entity, that have been proven to the satisfaction of FHFA as receiver. The order of claims begins with administrative expenses of the receiver followed by other general or senior liabilities of the regulated entity, then by obligations subordinated to general creditors, and finally by obligations to shareholders or members. The receiver would also be required by this section to provide similar treatment to all similarly situated creditors. Some creditors may benefit from better treatment than others, because the government or an acquirer may choose to assume or guarantee certain liabilities, but not others. However, each creditor will receive at least what that creditor would have received in a full liquidation of the regulated entity.

This section would also confirm that the lowest-priority category of claims in receivership, “[a]ny obligation to shareholders or members arising as a result of their status as shareholders or members,” refers to both current and former holders of equity interests and includes any claim arising from rescission of a purchase or sale of an equity security of a regulated entity or for damages arising from the purchase, sale, or retention of such a security. The Safety and Soundness Act relegates claims by equity-holders to a lower priority than is reserved for claims by general creditors or subordinated creditors.

12 U.S.C. 4617(c)(1)(D). Indeed, the Safety and Soundness Act bars shareholder claims from the status of claims of general creditors (12 U.S.C. 4617(c)(1)(B)) or subordinated creditors (12 U.S.C. 4617(c)(1)(C)). Claims for damages by shareholders could be considered to be creditor claims. But the statute specifically recognizes that shareholders may have claims arising from their status as shareholders that could be considered creditor claims and relegates them to the same status as other shareholder claims. The statute thus gives second priority to “[a]ny . . . general or senior liability of the regulated entity (which is not a liability described under subparagraph (C) [subordinated creditor claims] or (D) [shareholder claims]” (emphasis added)); and gives third priority to “[a]ny obligation subordinated to general creditors (which is not an obligation described under subparagraph (D) [shareholder claims]). The statute relegates shareholder claims to fourth priority, including those claims that in other circumstances could be considered creditor claims.

By permitting recovery by equity-holders only after creditors have been paid in full, section 1367(c) of the Safety and Soundness Act reflects the longstanding “general rule of equity” that “stockholders take last in the estate of a bankrupt corporation.” Gaff v. FDIC, 919 F.2d 384, 392 (6th Cir. 1990); see also In re Stirling Homex Corp. (Jezarian v. Raichle), 579 F.2d 206, 211 (2d Cir. 1978) (“[A]fter all creditors have been paid, provision may be made for stockholders. When the debtor is insolvent, the stockholders, as such, receive nothing.”). The rationale underlying this rule is that “[b]ecause, unlike creditors and depositors, stockholders stand to gain a share of corporate profits, stockholders should take the primary risk of the enterprise failing.” Gaff, 919 F.2d at 392. Moreover, creditors deal with a corporation “in reliance upon the protection and

security provided by the money invested by the corporation's stockholders -- the so-called 'equity cushion.'" Stirling Homex, 579 F.2d at 214.

These considerations apply not only to claims by equity-holders to share in the distribution of receivership assets directly by reason of their ownership of equity, but also to claims to compensate for having allegedly been defrauded into purchasing the equity. In either situation, the ownership of the equity security is a "but-for" element of the alleged entitlement to receivership assets and the claim arises out of that ownership. For any claim arising out of status as an equity-holder, it is fair and appropriate to base the claim's relative entitlement with respect to creditors to receive an allocation out of a limited fund on a comparison of the different types of risks equity-holders and creditors assumed when they dealt with the corporation. As courts and commentators have explained, while both equity-holders and creditors of a corporation assume the risk of corporate insolvency, only equity-holders assume the risk of fraud in the issuance or sale of the equity securities they purchased, and to treat their fraud claims on par with general creditors would improperly shift some of that risk to general creditors. See In re Geneva Steel Co., 281 F.3d 1173, 1176-77 (10th Cir. 2002) (citing John Slain & Homer Kripke, "The Interface Between Securities Regulation and Bankruptcy—Allocating the Risk of Illegal Securities Issuance Between Securityholders and the Issuer's Creditors", 48 N.Y.U. L. Rev. 261, 286-91 (1973)); In re Granite Partners, L.P., 208 B.R. 332, 336 (Bankr. S.D.N.Y. 1997).

For these reasons, the subordination of Securities Litigation Claims to creditors is a cornerstone of the Bankruptcy Code, which governs the liquidation and reorganization of the vast majority of publicly traded American corporations. Specifically, section

510(b) of the Bankruptcy Code provides in pertinent part that “a claim arising from rescission of a purchase or sale of a security of the debtor or of an affiliate of the debtor, [or] for damages arising from the purchase or sale of such a security . . . shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security, except that if such security is common stock, such claim has the same priority as common stock.” This provision has been applied to Securities Litigation Claims in some of the largest and most storied corporate bankruptcies ever. See, e.g., In re Enron Corp., 341 B.R. 141, 148-59 (Bankr. S.D.N.Y. 2006); In re WorldCom, Inc., 329 B.R. 10, 11-16 (Bankr. S.D.N.Y. 2005).⁶

The provisions of § 1237.9, confirming that a securities litigation claim has the same priority in receivership as the underlying security out of which it arises, would harmonize aspects of receiverships under the Safety and Soundness Act with the bankruptcy regime that applies to most other publicly traded corporations. The statute governing FHFA’s conduct of receiverships does not contain all of the details governing

⁶ In the Enron and WorldCom bankruptcies, among others, these principles were applied to subordinate Securities Litigation Claims brought by holders of stock options who claimed that corporate fraud rendered their options worthless. See Enron, 341 B.R. at 163-69 (option holders “would ‘share’ in the profits of the enterprise” and options “resemble a typical equity interest” because “the cash value of the options varied with the value of the Debtor’s stock”); In re WorldCom, Inc., No. 02-13533 (AJG), 2006 WL 3782712, *6 (Bankr. S.D.N.Y. Dec. 21, 2006) (“That the asserted damages flow from changes in the debtor’s share price is obvious evidence that the claim represents the equity interest of a security holder and should be subordinated.” (internal quotation marks and alterations omitted)).

By defining “equity security” to include options to purchase or sell equity interests of a regulated entity, this proposed regulation would likewise subordinate Securities Litigation Claims based on options. As discussed in Enron and Worldcom, the policy considerations justifying subordination of shareholder claims, such as allocating the consequences of insolvency between equity-holders and creditors based on the risk profile for which they originally bargained, apply with equal, if not greater, force to claims based on options, which are purely derivative of the underlying shares. For example, a purchaser of a call option (a right to purchase stock at a specified price during a certain period) assumes at least as much risk as a purchaser of the underlying stock. Not only does the value of the option vary with the stock, but if the price of the stock is below the exercise price, the option is worthless. See Enron, 341 B.R. at 168 (“call and put options are universally recognized as conditional, and by extension, risky”). Thus, it would be anomalous to subordinate the claims of actual holders of stock while allowing investors who merely acquired options to purchase or sell those same shares to recover on par with general creditors.

insolvent entities that the Bankruptcy Code does because Congress expected FHFA to fill in the gaps by “prescrib[ing] such regulations as FHFA determines to be appropriate regarding the conduct of conservatorships or receiverships.” 12 U.S.C. 4617(b)(1); see Chevron U.S.A., Inc. v. Natural Res. Def. Council, 467 U.S. 837, 843-44 (1984) (“The power of an administrative agency to administer a congressionally created . . . program necessarily requires the formulation of policy and the making of rules to fill any gap left, implicitly or explicitly, by Congress.” (quoting Morton v. Ruiz, 415 U.S. 199, 231 (1974))). When Congress enacted 4617(c), it was legislating against the backdrop of the statutory and common law discussed above treating Securities Litigation Claims derived from equity ownership as subordinated to or having the same priority as the underlying equity. In aligning the priority of Securities Litigation Claims in receivership with their treatment in bankruptcy, FHFA follows in the path of a number of federal circuit courts that have looked to the Bankruptcy Code for guidance on relative priorities of shareholder claims as well as other issues arising in receiverships of financial institutions. See, e.g., Gaff, 919 F.2d at 393-96; Office and Professional Employees Int’l Union v. FDIC, 962 F.2d 63, 68 (D.C. Cir. 1992) (Ruth Bader Ginsburg, J.); First Empire Bank-New York v. FDIC, 572 F.2d 1361, 1368 (9th Cir. 1978).

Finally, this section would provide that the receiver will determine the priority of claims based on their status as of the date of default, provided the claim was then in existence. “Default” is defined in the Safety and Soundness Act, and in this proposed regulation, as “any adjudication or other official determination by any court of competent jurisdiction, or by FHFA, pursuant to which a conservator, receiver, limited-life regulated entity, or legal custodian is appointed for a regulated entity.” 12 U.S.C. 4502(8). In the

event of a conservatorship followed by receivership, the date on which the conservator was appointed will be treated as the date of default for claims that were in existence on that date. This provision clarifies that claims cannot move from one priority category to another during conservatorship or receivership, potentially resulting in a different priority ranking depending on when priority is assessed. Like other aspects of this proposed regulation, this provision harmonizes the timing of the determination of priority in receivership with the longstanding “general rule in bankruptcy that the filing of the petition freezes the rights of all parties interested in the bankrupt estate.” Goggin v. Cal. Div. of Labor Law Enforcement, 336 U.S. 118, 126 n.7 (1949) (quoting 4 Collier on Bankruptcy 228-29 (14th ed. 1942)); see also United States v. Marxen, 307 U.S. 200, 207 (1939) (“the rights of creditors are fixed by the Bankruptcy Act as of the filing of the petition in bankruptcy. This is true both as to the bankrupt and amongst themselves.”); Everett v. Judson, 228 U.S. 474, 478-79 (1913) (“the purpose of the [bankruptcy] law was to fix the line of cleavage with reference to the condition of the bankrupt estate as of the time at which the petition was filed”).⁷

Section 1237.10 Limited-Life Regulated Entities.

This section discusses the process for setting the policies and procedures for organizing a limited-life regulated entity (LLRE) to assume or succeed to the assets and liabilities of a regulated entity in default or in danger of default. This section would also explain that the restriction on investments by a limited-life regulated entity under section

⁷ Courts have analogized conservators of financial institutions under the Financial Institutions Reform Recovery and Enforcement Act of 1989 to trustees in bankruptcy. See, e.g., Plymouth Mills, Inc. v. FDIC, 876 F. Supp. 439, 443 (E.D.N.Y. 1995) (conservator “akin to Chapter 11 trustee, in that both attempt to restore a financially burdened entity to viability”); Smith v. Witherow, 102 F.2d 638, 642 (3d Cir. 1939) (appointment of conservator “quite similar to the appointment of a trustee in a proceeding for the reorganization of a corporation under the Bankruptcy Act”).

1367(i)(4) of the Safety and Soundness Act would apply only to the liquidity portfolio of the LLRE. Section 1367(i)(4) states “[f]unds of a limited-life regulated entity shall be kept on hand in cash, invested in obligations of the United States or obligations guaranteed as to principal and interest by the United States, or deposited with FHFA, or any Federal reserve bank.” While a broad interpretation of this provision might suggest that an LLRE is barred from investing in a retained portfolio, such an interpretation would be inconsistent with the powers granted to FHFA under section 1367(i)(1)(B) to transfer assets of a failed regulated entity to an LLRE, subject only to the requirements that they at least be equal to the liabilities assumed. Since the retained portfolio of a failed Enterprise would be among the principal assets of the Enterprise, and the advances of a failed Bank would be among the principal assets of the Bank, it would make little sense to interpret the statute to allow transfer of assets to the LLRE but bar transfer of a regulated entity’s most significant assets. Interpreting section 1367(i)(4) to apply only to the liquidity portfolio, and not to the retained portfolio, would allow FHFA, as receiver, to reconcile the two provisions of the Safety and Soundness Act in a reasonable way.

Section 1237.11 Authority of Limited-Life Regulated Entities to Obtain Credit.

This section discusses the process by which a limited-life regulated entity may obtain credit, either by obtaining unsecured credit and issuing unsecured debt, or by obtaining the approval of the Director to issue debt with priority over any and all obligation of the LLRE, debt secured by a lien on the property of the entity, or debt secured by a junior lien on property of the entity already subject to a lien. The section also discusses how the Director may authorize an LLRE to obtain credit or issue debt that is secured by a senior or equal lien on property that is already subject to a lien only if the

entity is unable to otherwise obtain such credit or issue such debt on commercially reasonable terms, and there is adequate protection of the interest of the holder of the earlier lien on the property with respect to which the senior or equal lien is proposed to be granted. The section also offers a definition for the concept of adequate protection.

Section 1237.12 Capital Distributions while in Conservatorship.

This section would generally prohibit a regulated entity from making a capital distribution in conservatorship, except as permitted by the Director. The Safety and Soundness Act and the respective authorizing statutes restrict the ability of a regulated entity to make capital distributions that would cause the regulated entity to become undercapitalized or would otherwise decrease total or core capital of the regulated entity below certain levels. See 12 U.S.C. 1452, 1718, 4614, 4615, and 4616. Because capital distributions are generally inconsistent with FHFA's goal of putting the regulated entities in a sound and solvent condition, FHFA is implementing these provisions by providing that no capital distributions shall be made by a regulated entity while in conservatorship, except as permitted by the Director. Such capital distributions generally will not be permitted during conservatorship because they would be removing capital at precisely the time when the Conservator is charged with rehabilitating the regulated entity and restoring it to a safe and sound condition. Further, restrictions on capital distributions are most consistent with the need of a financial regulatory agency to rely on the books and records of a financial institution when assessing its capital adequacy. If capital investments could be withdrawn based upon claims not reflected in those books and records, the regulator's ability to assess the safety and soundness of the financial institution would be seriously impaired.

However, the Director may, in his or her discretion, permit the Conservator to make a capital distribution that the Director determines: (1) will enhance the ability of the regulated entity to meet the risk-based capital level and the minimum capital level for the regulated entity; (2) will contribute to the long-term financial safety and soundness of the regulated entity; (3) is otherwise in the interest of the regulated entity; or (4) is otherwise in the public interest.⁸ These factors include those that govern the Director’s exercise of his discretion to approve a capital distribution by a regulated entity that is classified as significantly undercapitalized. See 12 U.S.C. 4616(a)(2)(B). These factors would provide the Director with the flexibility to permit the regulated entity to make capital distributions that will ultimately enhance its ability to fulfill its mission in a safe and sound manner.

Similarly, the proposed regulation would amend the definition of the term “capital distribution” in the prompt corrective action regulations (12 CFR part 1777) issued by OFHEO⁹ and would incorporate that definition into this part. The amended definition would include any payment of any claim arising from rescission of a purchase or sale of an equity security of an Enterprise or for damages arising from the purchase, sale, or retention of such a security. The proposed regulation thereby both: (1) implements 12 U.S.C. 4502(5)(A)(i), which specifies that any distribution made with respect to any shares of an Enterprise, other than a dividend consisting only of shares of the Enterprise, is a “capital distribution”; and (2) reflects an exercise of the Director’s authority under 12

⁸ For example, the Director has approved payment of contractually required dividends on the Senior Preferred Stock held by Treasury pursuant to section 1117 of HERA because these extraordinary funding arrangements with Treasury are critical to the long-term financial safety and soundness of the Enterprises.

⁹ Regulations promulgated by OFHEO continue to be effective until FHFA issues its own regulations. See HERA section 1302.

U.S.C. 4502(5)(A)(iii) to determine by regulation that particular types of transactions are, in substance, the distribution of capital and therefore fall within the definition of “capital distribution.” FHFA considers payment of a claim arising from rescission of a purchase or sale of an equity security of an Enterprise or for damages arising from the purchase, sale, or retention of such an equity security to be, in substance, a distribution of capital because it results in the flow of capital out of the Enterprise to current or former equity-holders on account of their ownership of an equity interest of the Enterprise. From a regulatory standpoint, the economic consequences of such payment as they relate to the Enterprise’s safety and soundness and ability to meet capital requirements are indistinguishable from those posed by a payment taking the form of a dividend, repurchase, redemption, or retirement of stock. In any of those situations, the Enterprise is no longer able to use that capital to meet its obligations and maintain its fiscal health; rather, the benefit of that capital has been transferred to others on account of their ownership of equity in the Enterprise.

Section 1237.13 Payment of Securities Litigation Claims While in Conservatorship.

This section reflects that FHFA, as Conservator, will not pay Securities Litigation Claims against a regulated entity during conservatorship, except to the extent the Director determines appropriate. As Conservator, FHFA is charged with “put[ting] the regulated entity in a sound and solvent condition” and “preserv[ing] and conserv[ing] the assets and property of the regulated entity,” (12 U.S.C. 4617(b)(2)(D)) and may “take any action authorized by this section, which FHFA determines is in the best interests of the regulated entity or FHFA,” *id.* 4617(b)(2)(J)(i). FHFA’s statutory mandate to preserve and conserve the assets of a regulated entity in conservatorship, combined with the

possibility of future receivership, requires it to take a prudent and deliberate approach to the disposition of claims by equity-holders that could both impede restoring a regulated entity in conservatorship to a sound and solvent condition and arbitrarily place some equity-holder claimants above others while that regulated entity is in conservatorship.

The Conservator has plenary authority under the Safety and Soundness Act to deal with pending claims against an Enterprise however it deems appropriate in the exercise of its duties. The duties of the Conservator include “preserv[ing] and conserve[ing] the assets and property of the regulated entity.” 12 U.S.C. 4617(b)(2)(D); see In re Fed. Nat’l Mtg. Ass’n Sec., Deriv. and “ERISA” Litig., --- F. Supp. ---, 2009 WL 1837757, *2 n.4 (D.D.C. June 25, 2009) (“Congress has determined that responsibility for deciding how to best preserve and conserve Fannie Mae’s assets lies solely with FHFA for the conservatorship period.”); Gibraltar Fin. Corp. v. Fed. Home Loan Bank Bd., No. CV 89 3489 WDK(GHKX), 1990 WL 394298, *5 (C.D. Cal. June 15, 1990) (“a conservator must be afforded great flexibility in the operation of a failing institution”) (involving Federal Savings and Loan Insurance Corporation as conservator of savings and loan).

With respect to Securities Litigation Claims in particular, the Conservator will be guided by the statutory receivership priority scheme in determining whether such claims may properly be paid in light of the central fact that conservatorship is temporary and receivership is a possibility. See 12 U.S.C. 4617(a)(4)(D) (conservatorship may be followed by receivership). The statutory receivership priority scheme, as implemented by § 1237.9, provides that claims derived from ownership of an equity security of an Enterprise are subordinated to all other claims. 12 U.S.C. 4617(c). If the Conservator

were to authorize payment of Securities Litigation Claims despite the statutory receivership priority system ranking such claims below all other claims, the purpose of the receivership priority system could be thwarted, leaving fewer corporate resources to pay higher-priority claims during a subsequent receivership. Indeed, paying such claims on a first-come, first-served basis during conservatorship could induce a “run on the conservatorship” with severe adverse repercussions for the ultimate success of the ongoing effort to rehabilitate a regulated entity in conservatorship. This section of the proposed regulation is intended to facilitate the Conservator’s discharge of its duty to avoid such consequences.

The approach taken in this section is also consistent with section 1117 of HERA and the Treasury Agreements thereunder, which allowed FHFA to avoid placing Fannie Mae and Freddie Mac in receivership by providing the Conservator with access to the billions of federal tax dollars necessary to attempt to restore the financial viability of the Enterprises through conservatorship. In short, without the continuing capital infusions made pursuant to the Treasury Agreements, both Enterprises would of necessity have been declared insolvent and placed in receivership many months ago. See 12 U.S.C. 4617(a)(4). While this might suggest that the Treasury funds would provide an effective source of funds for the Conservator to pay a Securities Litigation Claim, the purpose of the Treasury Agreements is not to compensate current or former equity-holders of the Enterprises for diminution in the value of their equity. See HERA section 1117(a), (b) (Treasury authority to purchase Enterprise securities to be used to “provide stability to the financial markets,” “prevent disruptions in the availability of mortgage finance,” and “protect the taxpayer”). Rather, the Treasury Agreements exclude from the amount that

can be drawn, liabilities that the Conservator determines shall be subordinated, including “a claim against Seller arising from rescission of a purchase or sale of a security issued by [an Enterprise] . . . or for damages arising from the purchase, sale or retention of such a security.” Treasury Agreements § 1, definition of “Deficiency Amount,” subparagraph (iii). Similarly, the Treasury Agreements do not allow any distribution with respect to the Enterprises’ equity interests without Treasury’s prior written consent. These provisions are in keeping with the intent of both the parties to the Treasury Agreements, and Congress in authorizing the Treasury Agreements, that the federal tax dollars infused through the Conservator be used to help restore the Enterprises to a sound and solvent condition, provide stability to the financial markets, prevent disruptions in the availability of mortgage financing, and protect the taxpayer, rather than to serve as a fund to make equity-holders whole. See Treasury Agreements at Background ¶¶ A, B; HERA section 1117.

In exercising its regulatory authority, FHFA is required “to ensure that the purposes of this chapter and the authorizing statutes are accomplished.” 12 U.S.C. 4526(a). As discussed above, the authorizing statutes for the Enterprises, as amended by section 1117 of HERA, include the mandate to “protect the taxpayers” as an integral part of any sale of stock by the Enterprises to Treasury. 12 U.S.C. 1719(g)(1) (Fannie Mae); 12 U.S.C. 1455(l)(1) (Freddie Mac). This section of the regulation is intended to enable the Conservator to operate a regulated entity in conservatorship in a manner consistent with the policies Congress sought to advance through the enactment of HERA by providing a default rule that Securities Litigation Claims will not be paid out of conservatorship assets, subject to the discretion vested in the Director to find that

payment might be appropriate in a particular instance because it would be in the interest of the conservatorship.

In exercising FHFA’s discretion to consider whether to make an exception to permit payment of certain Securities Litigation Claims on a case-by-case basis, the Director will be guided primarily by whether payment of the claim would be consistent with the Conservator’s mandate to put the regulated entity in a sound and solvent condition and to preserve and conserve the assets and property of the regulated entity. The Director may also consider the size and nature of the claim, the effect that paying the claim might have on the availability of funds to satisfy other claims against the regulated entity, the source of the funds from which the claim would be paid, whether any extraordinary funding arrangement (such as under section 1117 of HERA) is in place, and any other consideration the Director deems appropriate under the circumstances.¹⁰

This section also clarifies, in paragraph (b), that a LLRE established during receivership under section 1367(i) of the Safety and Soundness Act will not assume, acquire, or succeed to any Securities Litigation Claim against a regulated entity. Section 1367(b)(2)(G) of the Safety and Soundness Act provides that FHFA, as conservator or receiver, may “transfer or sell any asset or liability of the regulated entity in default, and may do so without any approval, assignment, or consent with respect to such transfer or sale.” 12 U.S.C. 4617(b)(2)(G). Further, section 1367(i)(2)(B)(ii) of the Safety and

¹⁰ By evaluating whether to pay a Securities Litigation Claim out of conservatorship assets as reflected in § 1237.13, the Conservator would not be adjudicating or determining the validity of any claim, and non-payment of a claim or judgment would not operate to extinguish the claim or judgment. If the Conservator decided under § 1237.13 not to pay a Securities Litigation Claim, including a judgment, during conservatorship, the claim or judgment would continue to exist. If the Enterprise entered receivership, the claim or judgment would be disposed of through the receivership claims process provided by statute. If the Enterprise exits conservatorship without undergoing receivership, the claim or judgment would survive the conservatorship and could be pursued or enforced against the Enterprise at that time.

Soundness Act provides that “a limited-life regulated entity shall not assume, acquire, or succeed to any obligation that a regulated entity for which a receiver has been appointed may have to any shareholder of the regulated entity that arises as a result of the status of that person as a shareholder of the regulated entity.” This language is similar to section 1367(c)(1)(D) of the Safety and Soundness Act, which assigns lowest priority in receivership to “[a]ny obligation to shareholders or members arising as a result of their status as shareholder or members.” For the same reasons discussed above why it is appropriate to treat the obligations described in section 1367(c)(1)(D) as including Securities Litigation Claims, it is equally appropriate to treat the language in section 1367(i)(2)(B)(ii) as encompassing those same claims. Congress intended for a LLRE to succeed to the charter of an Enterprise and to operate free of obligations to equity-holders, and it would frustrate that intent and create an incongruity if any obligations to equity-holders subordinated under section 1367(c)(1)(D) could nevertheless survive and be asserted against a LLRE.

Section 1237.14 Golden Parachute Payments.

The treatment of golden parachute payments under conservatorship and receivership will be addressed by another proposed rule.

VI. Regulatory Impacts

Paperwork Reduction Act

The proposed regulation does not contain any information collection requirement that requires the approval of the Office of Management and Budget under the Paperwork Reduction Act (44 U.S.C. 3501 et seq.).

Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) (5 U.S.C. 601 et seq.) requires that a regulation that has a significant economic impact on a substantial number of small entities, small businesses, or small organizations must include an initial regulatory flexibility analysis describing the regulation's impact on small entities. Such an analysis need not be undertaken if the agency has certified that the regulation will not have a significant economic impact on a substantial number of small entities. 5 U.S.C. 605(b). FHFA has considered the impact of the proposed regulation under the RFA. FHFA certifies that the proposed regulation, if adopted, is not likely to have a significant economic impact on a substantial number of small business entities because the regulation is applicable only to the regulated entities and the Office of Finance, which are not small entities for purposes of the RFA.

List of Subjects

12 CFR Part 1237

Capital, Conservator, Federal home loan banks, Government-sponsored enterprises, Receiver

12 CFR Part 1777

Administrative practice and procedure, Mortgages

Accordingly, for the reasons stated in the preamble, under the authority of 12 U.S.C. 4513b, 4526, and 4617 the Federal Housing Finance Agency proposes to amend chapters XII and XVII of Title 12, Code of Federal Regulations, as follows:

CHAPTER XII—FEDERAL HOUSING FINANCE AGENCY

Subchapter B—ENTITY REGULATIONS

1. Add part 1237 to subchapter B to read as follows:

PART 1237—CONSERVATORSHIP AND RECEIVERSHIP

Sec.

- 1237.1 Purpose and applicability.
- 1237.2 Definitions.

Subpart A—Powers

- 1237.3 Powers of the Agency as conservator or receiver.
- 1237.4 Receivership following conservatorship; administrative expenses.
- 1237.5 Contracts entered into before appointment of a conservator or receiver.
- 1237.6 Authority to enforce contracts.

Subpart B—Claims

- 1237.7 Period for determination of claims.
- 1237.8 Alternate procedures for determination of claims.
- 1237.9 Priority of expenses and unsecured claims.

Subpart C—Limited-Life Regulated Entities

- 1237.10 Limited-life regulated entities.
- 1237.11 Authority of limited-life regulated entities to obtain credit.

Subpart D—Other

- 1237.12 Capital distributions while in conservatorship.
- 1237.13 Payment of Securities Litigation Claims while in conservatorship.
- 1237.14 Golden parachute payments [Reserved].

Authority: 12 U.S.C. 4513b, 4526, 4617.

§ 1237.1 Purpose and applicability.

The provisions of this part shall apply to the appointment of the Federal Housing Finance Agency (“Agency”) as conservator or receiver of a regulated entity. These provisions implement and supplement the procedures and process set forth in Public Law 110-289 for conduct of a conservatorship or receivership of such entity.

§ 1237.2 Definitions.

For the purposes of this part the following definitions shall apply:

Agency means the Federal Housing Finance Agency (“FHFA”) established under 12 U.S.C. 4511, as amended by Public Law 110-289.

Authorizing statutes mean:

- (1) the Federal National Mortgage Association Charter Act,
- (2) the Federal Home Loan Mortgage Act, and
- (3) the Federal Home Loan Bank Act.

Capital distribution means, with respect to a regulated entity, the definition under 12 CFR 1777.3 or other applicable FHFA regulations.

Compensation means any payment of money or the provision of any other thing of current or potential value in connection with employment.

Conservator means the Agency as appointed by the Director as conservator for a regulated entity.

Default; In Danger of Default:

(1) Default means, with respect to a regulated entity, any official determination by the Director, pursuant to which a conservator or receiver is appointed for a regulated entity.

(2) In danger of default means, with respect to a regulated entity, the definition under section 1303(8)(B) of the Safety and Soundness Act or applicable FHFA regulations.

Director means the Director of the Federal Housing Finance Agency.

Enterprise means the Federal National Mortgage Association and any affiliate thereof or the Federal Home Loan Mortgage Corporation and any affiliate thereof.

Entity-affiliated party means any party meeting the definition of an entity-affiliated party under section 1303(11) of the Safety and Soundness Act or applicable FHFA regulations.

Equity security of any person shall mean any and all shares, interests, rights to purchase or otherwise acquire, warrants, options, participations or other equivalents of or interests in (however designated) in equity, ownership or profits of such person, including any preferred stock, any limited or general partnership interest and any limited liability company membership interest, and any securities or other rights or interests convertible into or exchangeable for any of the foregoing.

Executive officer means any person meeting the definition of executive officer under section 1303(12) of the Safety and Soundness Act or applicable FHFA regulations.

Golden parachute payment means, with respect to a regulated entity, the definition under 12 CFR part 1231 or other applicable FHFA regulations.

Limited-life regulated entity means an entity established by the Agency under section 1367(i) of the Safety and Soundness Act with respect to a Federal Home Loan Bank in default or in danger of default, or with respect to an enterprise in default or in danger of default.

Office of Finance means the Office of Finance of the Federal Home Loan Bank System.

Receiver means the agency as appointed by the Director to act as receiver for a regulated entity.

Regulated entity means:

- (1) The Federal National Mortgage Association and any affiliate thereof;

- (2) The Federal Home Loan Mortgage Corporation and any affiliate thereof; and
- (3) Any Federal Home Loan Bank.

Securities Litigation Claim means any claim, whether or not reduced to judgment, liquidated or unliquidated, fixed, contingent, matured or unmatured, disputed or undisputed, legal, equitable, secured or unsecured, arising from rescission of a purchase or sale of an equity security of a regulated entity or for damages arising from the purchase, sale, or retention of such a security.

State means States of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, Guam, the Virgin Islands, American Samoa, the Trust Territory of the Pacific Islands, and any other territory or possession of the United States.

Transfer means every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the equity of redemption of the regulated entity.

Subpart A—Powers

§ 1237.3 Powers of the Agency as conservator or receiver.

(a) Operation of the regulated entity. The Agency, as conservator or receiver, may:

- (1) Take over the assets of and operate the regulated entity with all the powers of the shareholders (including the authority to vote shares of any and all classes of voting stock), the directors, and the officers of the regulated entity and conduct all business of the regulated entity;

- (2) Continue the missions of the regulated entity;
- (3) Ensure that the operations and activities of each regulated entity foster liquid, efficient, competitive, and resilient national housing finance markets;
- (4) Ensure that each regulated entity operates in a safe and sound manner;
- (5) Collect all obligations and money due the regulated entity;
- (6) Perform all functions of the regulated entity in the name of the regulated entity that are consistent with the appointment as conservator or receiver;
- (7) Preserve and conserve the assets and property of the regulated entity (including the exclusive authority to investigate and prosecute claims of any type on behalf of the regulated entity, or to delegate to management of the regulated entity the authority to investigate and prosecute claims); and
- (8) Provide by contract for assistance in fulfilling any function, activity, action, or duty of the Agency as conservator or receiver.

(b) Powers as conservator or receiver. The Agency, as conservator or receiver, shall have all powers and authorities specifically provided by section 1367 of the Safety and Soundness Act and paragraph (a) above, including incidental powers, which include the authority to suspend capital classifications under section 1364(e)(1) of the Safety and Soundness Act during the duration of the conservatorship or receivership of that regulated entity.

(c) Transfer or sale of assets and liabilities. The Agency may, as conservator or receiver, transfer or sell any asset or liability of the regulated entity in default, and may do so without any approval, assignment, or consent with respect to such transfer or sale. Exercise of this authority by the Agency as conservator will nullify any restraints on sales

or transfers in any agreement not entered into by the Agency as conservator. Exercise of this authority by the Agency as receiver will nullify any restraints on sales or transfers in any agreement not entered into by the Agency as receiver.

§ 1237.4 Receivership following conservatorship; administrative expenses.

If a receiver immediately succeeds a conservator, administrative expenses of the conservatorship shall also be deemed to be administrative expenses of the subsequent receivership.

§ 1237.5 Contracts entered into before appointment of a conservator or receiver.

(a) The conservator or receiver for any regulated entity may disaffirm or repudiate any contract or lease to which such regulated entity is a party pursuant to section 1367(d) of the Safety and Soundness Act.

(b) For purposes of section 1367(d)(2) of the Safety and Soundness Act, a reasonable period shall be defined as a period of 18 months following the appointment of a conservator or receiver.

§ 1237.6 Authority to enforce contracts.

The conservator or receiver may enforce any contract entered into by the regulated entity pursuant to the provisions and subject to the restrictions of section 1367(d)(13) of the Safety and Soundness Act.

Subpart B—Claims

§ 1237.7 Period for determination of claims.

Before the end of the 180-day period beginning on the date on which any claim against a regulated entity is filed with the Agency as receiver, the Agency shall determine whether to allow or disallow the claim and shall notify the claimant of any determination

with respect to such claim. This period may be extended by a written agreement between the claimant and the Agency as receiver, which may include an agreement to toll any applicable statute of limitations.

§ 1237.8 Alternate procedures for determination of claims.

Claimants seeking a review of the determination of claims may seek alternative dispute resolution from the Agency as receiver in lieu of a judicial determination. The Director may by order, policy statement, or directive establish alternative dispute resolution procedures for this purpose.

§ 1237.9 Priority of expenses and unsecured claims.

(a) General. The receiver will grant priority to unsecured claims against a regulated entity or the receiver for that regulated entity that are proven to the satisfaction of the receiver in the following order:

(1) Administrative expenses of the receiver (or an immediately preceding conservator).

(2) Any other general or senior liability of the regulated entity (that is not a liability described under paragraph (a)(3) or (a)(4) of this section.

(3) Any obligation subordinated to general creditors (that is not an obligation described under paragraph (a)(4) of this section.

(4) Any obligation to current or former shareholders or members arising as a result of their current or former status as shareholders or members, including, without limitation, any Securities Litigation Claim.

(b) Similarly situated creditors. The receiver will provide similar treatment to all creditors under paragraph (a) of this section that are similarly situated, except that the

receiver may take any action (including making payments) that does not comply with this section, if—

(1) The Director determines that such action is necessary to maximize the value of the assets of the regulated entity, to maximize the present value return from the sale or other disposition of the assets of the regulated entity, or to minimize the amount of any loss realized upon the sale or other disposition of the assets of the regulated entity; and

(2) All creditors that are similarly situated under paragraph (a) of this section receive not less than the amount such creditors would have received if the receiver liquidated the assets and liabilities of the regulated entity in receivership and such action had not been taken.

(c) Priority determined at default. The receiver will determine priority based on a claim's status at the time of default, such default having occurred at the time of entry into the receivership, or if a conservatorship immediately preceded the receivership, at the time of entry into the conservatorship provided the claim then existed.

Subpart C—Limited-Life Regulated Entities

§ 1237.10 Limited-life regulated entities.

(a) Status. The United States Government shall be considered a person for purposes of section 1367(i)(6)(C)(i) of the Safety and Soundness Act.

(b) Investment authority. The requirements of section 1367(i)(4) shall apply only to the liquidity portfolio of a limited-life regulated entity.

(c) Policies and procedures. The Agency may draft such policies and procedures with respect to limited-life regulated entities as it determines to be necessary and

appropriate, including policies and procedures regarding the timing of the creation of limited-life regulated entities.

§ 1237.11 Authority of limited-life regulated entities to obtain credit.

(a) Ability to obtain credit. A limited-life regulated entity may obtain unsecured credit and issue unsecured debt.

(b) Inability to obtain credit. If a limited-life regulated entity is unable to obtain unsecured credit or issue unsecured debt, the Director may authorize the obtaining of credit or the issuance of debt by the limited-life regulated entity with priority over any and all of the obligations of the limited-life regulated entity, secured by a lien on property of the limited-life regulated entity that is not otherwise subject to a lien, or secured by a junior lien on property of the limited-life regulated entity that is subject to a lien.

(c) Limitations. The Director, after notice and a hearing, may authorize a limited-life regulated entity to obtain credit or issue debt that is secured by a senior or equal lien on property of the limited-life regulated entity that is already subject to a lien (other than mortgages that collateralize the mortgage-backed securities issued or guaranteed by an enterprise) only if the limited-life regulated entity is unable to obtain such credit or issue such debt otherwise on commercially reasonable terms and there is adequate protection of the interest of the holder of the earlier lien on the property with respect to which such senior or equal lien is proposed to be granted.

(d) Adequate protection. The adequate protection referred to in paragraph (c) of this section may be provided by:

(1) Requiring the limited-life regulated entity to make a cash payment or periodic cash payments to the holder of the earlier lien, to the extent that there is likely to be a decrease in the value of such holder's interest in the property subject to the lien;

(2) Providing to the holder of the earlier lien an additional or replacement lien to the extent that there is likely to be a decrease in the value of such holder's interest in the property subject to the lien; or

(3) Granting the holder of the earlier lien such other relief, other than entitling such holder to compensation allowable as an administrative expense under section 1367(c) of the Safety and Soundness Act, as will result in the realization by such holder of the equivalent of such holder's interest in such property.

Subpart D—Other

§ 1237.12 Capital distributions while in conservatorship.

(a) Except as provided in paragraph (b) of this section, a regulated entity shall make no capital distribution while in conservatorship.

(b) The Director may authorize, or may delegate the authority to authorize, a capital distribution that would otherwise be prohibited by paragraph (a) of this section if he or she determines that such capital distribution:

(1) Will enhance the ability of the regulated entity to meet the risk-based capital level and the minimum capital level for the regulated entity;

(2) Will contribute to the long-term financial safety and soundness of the regulated entity;

(3) Is otherwise in the interest of the regulated entity; or

(4) Is otherwise in the public interest.

(c) This section is intended to supplement and shall not replace or affect any other restriction on capital distributions imposed by statute or regulation.

§ 1237.13 Payment of Securities Litigation Claims while in conservatorship.

(a) Payment of Securities Litigation Claims while in conservatorship. The Agency, as conservator, will not pay a Securities Litigation Claim against a regulated entity, except to the extent the Director determines is in the interest of the conservatorship.

(b) Claims against limited-life regulated entities. A limited-life regulated entity shall not assume, acquire, or succeed to any obligation that a regulated entity for which a receiver has been appointed may have to any shareholder of the regulated entity that arises as a result of the status of that person as a shareholder of the regulated entity, including any Securities Litigation Claim. No shareholder or creditor of a regulated entity shall have any right or claim against the charter of the regulated entity once the Agency has been appointed receiver for the regulated entity and a limited-life regulated entity succeeds to the charter pursuant to this section.

§ 1237.14 Golden parachute payments [Reserved].

**CHAPTER XVII—OFFICE OF FEDERAL HOUSING ENTERPRISE
OVERSIGHT, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
PART 1777—PROMPT CORRECTIVE ACTION**

2. The authority citation for part 1777 is revised to read as follows:

Authority: 12 U.S.C. 1452(b)(2), 1456(c), 1718(c)(2), 1723a(k), 4513(a), 4513(b), 4514, 4517, 4611-4618, 4622, 4623, 4631, 4635.

3. Amend § 1777.3 by revising the definition of “Capital distribution” to read as follows:

§ 1777.3 Definitions.

* * * * *

Capital distribution means:

(1) Any dividend or other distribution in cash or in kind made with respect to any shares of, or other ownership interest in, an Enterprise, except a dividend consisting only of shares of the Enterprise;

(2) Any payment made by an Enterprise to repurchase, redeem, retire, or otherwise acquire any of its shares or other ownership interests, including any extension of credit made to finance an acquisition by the Enterprise of such shares or other ownership interests, except to the extent the Enterprise makes a payment to repurchase its shares for the purpose of fulfilling an obligation of the Enterprise under an employee stock ownership plan that is qualified under the Internal Revenue Code of 1986 (26 U.S.C. 401 et seq.) or any substantially equivalent plan as determined by the Director of FHFA in writing in advance; and

(3) Any payment of any claim, whether or not reduced to judgment, liquidated or unliquidated, fixed, contingent, matured or unmatured, disputed or undisputed, legal, equitable, secured or unsecured, arising from rescission of a purchase or sale of an equity security of an Enterprise or for damages arising from the purchase, sale, or retention of such a security.

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/S/

Edward J. DeMarco,
Acting Director, Federal Housing Finance Agency.

June 30, 2010

Date