

Introduction

Conference on Receivership Powers February 3, 2005

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When the Senate Banking Committee attempted last year to strengthen the oversight of Fannie Mae and Freddie Mac, no issue was more contentious than whether the GSEs' new regulator should have receivership powers. Although the Shelby bill contained provisions that would have allowed the regulator to adjust the GSEs' capital and restrict their non-mission activities to some degree—matters that could have a direct effect on their earnings—both companies chose to fight most tenaciously on the receivership issue. Ultimately, they were successful in limiting the receivership powers of the regulator, and it was on this basis that the administration finally opposed a bill that it had worked hard to pass.

There is no Senate committee bill yet this year, but three members of the Banking Committee—Senators Hagel, Sununu and Dole—have co-sponsored a new bill for tighter regulation of Fannie and Freddie, as well as the Federal Home Loan Banks, and that bill empowers the new regulator to act as a receiver. Senator Shelby, and Congressmen Oxley and Baker, have all indicated that they believe receivership powers are an essential element of any legislation that would tighten the regulation the GSEs. Accordingly, we can expect another major fight over the issue this year.

What is receivership and why is it so feared by Fannie and Freddie? In today's conference, we'll review the basic elements of receivership powers and how they differ from conservatorship—the authority that OFHEO already possesses. We'll also discuss the principal issues that have to be addressed in framing receivership powers and managing a receivership.

These matters are relatively straightforward, but why are Fannie and Freddie so alarmed about receivership powers?

Most observers in Washington think they know the answer. A receiver, as distinguished from a conservator, has the authority to marshal a company's assets, pay off its creditors and close it down. In other words, if Fannie or Freddie should encounter financial difficulties at some point in the future, their regulator would have the authority to terminate their activities—just as a bank regulator can now close down a failing bank.

Without such a mechanism, the thinking goes, they would have to be resolved by Congress itself, and that would assure that their creditors are bailed out. This may certainly be true, but there is another way of looking at this.

Both the Shelby bill and the Hagel-Sununu-Dole bill would allow the receiver to take them over and liquidate them *before* they become insolvent—much as a bank regulator can take control of and resolve a failing but not insolvent bank.

Why would the GSE regulator need this power? The obvious answer is similar to the reason bank regulators have receivership powers—that continuing to allow the failing GSE to operate would ultimately impose costs on the taxpayers, just as allowing a failing bank to continue in operation might impose costs on the deposit insurance fund.

But there's an obvious conceptual problem with this. If, as the Treasury keeps reminding us—and as the GSEs' charters state—the government does not stand behind the debt of Fannie and Freddie, why should the receiver worry about protecting the taxpayers?

The answer, unfortunately, is that no one really believes that Congress won't bail out Fannie and Freddie if they get into financial trouble.

But if this is true, why are Fannie and Freddie opposed to receivership? If, as seems to be signaled by the existence of receivership powers, Congress is likely to bail them out, they should *favor* receivership. This kind of receivership should give their creditors *more* confidence, rather than less, that they will be fully paid.

If the government is going to bail them out anyway, all well and good, but if there's not going to be a bailout it is surely better to have a regulator involved who will stop the losses before the companies' assets are worth less than their liabilities.

It appears that the administration and Congress want to give the new regulator receivership powers because they believe that will signal to the market that the government does *not* stand behind Fannie and Freddie—that holders of GSE debt actually have some risk of loss if the receiver acts after Fannie or Freddie is actually insolvent—even though logically there is no government interest in invoking a receivership unless there is a *likelihood* that it will act to bail them out. Nevertheless, Fannie and Freddie are acting as if they also believe that the markets will be spooked by receivership powers.

But is this correct—would the existence of receivership powers change the market's perception? That certainly isn't obvious from past experience. The Farm Credit Administration Board currently has authority to appoint a receiver for the Farm Credit Bank, all of which are GSEs for which the government is explicitly by statute relieved of liability. Yet, the debt of the Farm Credit Banks trades at a rate that is comparable to Fannie and Freddie's debt. In other words, the market is looking through the legalities and formalisms to something else.

In addition, and probably even more to the point, the regulator of the Farm Credit System had receivership powers in the 1980s, the system was still bailed out by Congress in the 1980s, to the tune of \$4 billion.

Accordingly, if it is in the minds of some that simply adopting receivership provisions will make a decisive difference in how the capital markets view Fannie and

Freddie, they should think again. While Fannie and Freddie may have chosen to fight on this ground, that does not mean that they have correctly assessed what effect a receivership provision might ultimately have. It is all guesswork at this point.

My concern is that there will be a huge fight in Congress over the receivership question, and in the end receivership will pass. At that point, many people will congratulate themselves, thinking that they have achieved a separation between the government and the GSEs. But the real effect will be at best minimal and at worst counterproductive. It may only signal to the capital markets that Fannie and Freddie are more likely than ever to be bailed out.

If there is real concern about the risks that Fannie Mae and Freddie Mac are creating for taxpayers, the only sensible course is to move toward privatization, or to create an environment in which it makes more sense for Fannie and Freddie to give up their corporate charters than to remain as GSEs. Receivership powers may not be the key to achieving this objective.