MEMORANDUM TO: The Board of Directors

FROM: Mitchell L. Glassman *Mitchell L. Glassman*
Director, Division of Resolutions and Receiverships

SUBJECT: Notice of Propose Rulemaking replacing 12 C.F.R. § 360.6 Treatment By The FDIC As Conservator Or Receiver Of Financial Assets Transferred By An Insured Depository Institution In Connection With A Securitization After September 30, 2010

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RECOMMENDATION

Staff recommends that the Board of Directors ("Board") approve a Notice of Proposed Rulemaking (the "NPR") to solicit comments on proposed changes to and the replacement of existing 12 C.F.R. Section 360.6 as amended by the Interim Rule adopted on November 12, 2009, and the Final Rule adopted by notational vote of the Board on March 11, 2010 (as so amended, the "Transition Rule"), for securitizations and participations issued after September 30, 2010. At its December 15, 2009 meeting, the Board adopted an Advance Notice of Proposed Rulemaking ("ANPR") that sought public comment on the scope of amendments to Section 360.6, as well as the requirements for the application of the safe harbor, which input has been helpful to the FDIC.

The new proposed regulations in the NPR (the "Proposed Rule") will continue the safe harbor provided by the Transition Rule for securitizations issued on or before September 30, 2010, and will clarify the conditions for a safe harbor for securitizations or participations issued after that date. Under the Proposed Rule, securitizations and participations that meet the new accounting standards for off balance sheet treatment and comply with conditions specified in the Proposed Rule would continue to be exempt from the FDIC's conservatorship and receivership powers applicable to assets of the failed

institution. The Proposed Rule also sets forth safe harbor protections for securitizations if the securitization does not comply with the new accounting standards for off balance sheet treatment by providing for expedited access to the financial assets that are securitized if they meet the conditions defined in the Proposed Rule. The conditions imposed under the Proposed Rule set standards for disclosure, transaction structures, documentation, and retention standards for all securitizations. The Proposed Rule imposes additional requirements for securitizations that include residential mortgage loans ("RMBS") addressing compensation, origination and servicing standards.

The conditions contained in the Proposed Rule will serve to protect the Deposit Insurance Fund ("DIF") and the FDIC's interests as deposit insurer and receiver by aligning the conditions for the safe harbor with better and more sustainable lending practices by insured depository institutions ("IDIs"). The losses incurred by the DIF, as well as the significant impact on IDIs, caused in part by the misalignment of incentives in preexisting securitization transactions, and in particular RMBS, demonstrate the need for strengthened requirements beyond those imposed when Section 360.6 was initially adopted by the Board in 2000. The notice and comment process will provide an opportunity for the FDIC to receive additional input and ensure that the requirements are appropriate to promote sustainable securitizations.

As discussed in more detail below, on April 7, 2010, the Securities and Exchange Commission ("SEC") proposed amendments to Regulation AB to require enhanced disclosures and risk retention for many securitizations ("New Regulation AB"). . If adopted as final regulations, New Regulation AB will significantly enhance transparency and support the realignment of incentives for securitization transactions in line with the

proposals contained in this Proposed Rule. Once finalized, the SEC changes will provide a strong foundation for market-wide transparency and avoid opportunities for arbitrage across different types of issuers.

The Proposed Rule is needed to address the treatment by the FDIC of all participations and securitizations after September 30, 2010, in light of changes to generally accepted accounting principles ("GAAP") while providing strong incentives for sustainable structured finance practices and mortgage loan origination practices. As noted below, most participations should continue to comply with Section 360.6. However, the Proposed Rule seeks additional comment on these effects and on any adjustments that may be appropriate to Section 360.6 as applied to participations.

EXECUTIVE SUMMARY

In 2000, the FDIC adopted a regulation, which was codified at 12 C.F.R. § 360.6 (the "Securitization Rule"), that provided comfort that the FDIC, as conservator or receiver, would not reclaim loans or other financial assets that had been transferred into a securitization trust or into a participation by an IDI. The condition for this commitment was that the transfer had to meet all conditions for sale accounting treatment under GAAP. If the transfer satisfied this condition, the Securitization Rule confirmed that the transferred financial assets were "legally isolated" from the IDI in an FDIC conservatorship or receivership.

In June 2009, the Financial Accounting Standards Board ("FASB") announced changes to GAAP that would prevent some securitizations from being treated as sales for accounting purposes. As a result, many securitizations would not meet the conditions for

sale accounting treatment under GAAP and would be consolidated onto IDIs' balance sheets. Those changes became effective for reporting periods after November 15, 2009 and apply to new securitizations as well as those created before that date. Because the Securitization Rule is based on sale accounting treatment, the "safe harbor" it provided would no longer apply to a transfer of assets into a securitization for which sale accounting treatment is not applicable. While there may be some effects on participations, most participations likely will continue to meet the conditions for sale accounting treatment under the Securitization Rule.

In 2005 Congress enacted 11(e) (13) (C) of the FDI Act. In relevant part, this provision requires the consent of the conservator or receiver for 45 or 90 days, respectively, before any action can be taken by a secured creditor against collateral pledged by the IDI. If a securitization is not eligible for sale treatment but is treated as a secured borrowing, Section 11(e) (13) (C) could prevent the security holders from recovering monies due to them for up to 90 days. Staff has been advised that this 90-day delay would cause substantial downgrades in the ratings provided on existing securitizations and could prevent planned securitizations for multiple asset classes, such as credit cards, automobile loans, and other credits, from being brought to market.

Due to the modifications to GAAP, the Board adopted the Interim Rule in November 2009 to provide a safe harbor for participations and securitizations initiated through March 31, 2010. This period was extended to September 30, 2010 on March 11, 2010. Under this extension, all existing securitizations as well as those for which transfers were made or, for revolving trusts, for which obligations were issued, on or

prior to September 30, 2010, were permanently "grandfathered" so long as they complied with the pre-existing section 360.6, irrespective of the GAAP Modifications.

On January 7, 2010, the FDIC published the ANPR requesting broad input on most factors that affect the securitization safe harbor in light the 2009 GAAP Modifications. The ANPR included sample text for a new safe harbor, to provide a context for responses to the questions posed in the ANPR. The FDIC received thirty-seven comments from industry groups, issuers, investors, consumer advocates and other interested parties. Staff has reviewed the comments received and revised certain portions of the sample text and formulated the Proposed Rule based on those comments.

The Proposed Rule will clarify the treatment of financial assets in participations and securitizations in four different contexts.

First, New Section 360.6 continues the safe harbor treatment for transfers of financial assets made in connection with participations that meet the new sale accounting requirements.

Second, New Section 360.6 continues safe harbor treatment for securitizations and participations for which transfers of financial assets were made or, for revolving trusts, for which obligations were issued, on or prior to September 30, 2010 under the Securitization Rule or the Transition Rule.

Third, for securitizations on or after September 30, 2010, New Section 360.6 will provide legal isolation if the securitization complies with specified conditions and the transfer meets the new sale accounting requirements.

Fourth, for those securitizations on or after September 30, 2010, where the transfer does not meet the new sale accounting requirements but complies with the

specified conditions, New Section 360.6 defines how the FDIC, as conservator or receiver, will make payment or provide expedited access to the financial assets under 12 U.S.C. § 1821(e)(13)(C). If the FDIC is in monetary default or repudiates the transaction, but fails to pay damages due within ten (10) business days, it will be deemed to have given consent to the exercise of any contractual rights under the transaction. In addition, until such damages are paid or such contractual rights are exercised, New Section 360.6 authorizes continued servicing operations and the payment of all contractual amounts, except for provisions that take effect upon the appointment of the conservator or receiver. Finally, New Section 360.6 defines the damages payable for repudiation.

In both of the latter cases, all securitizations must meet certain disclosure, asset, structuring and retention standards set forth in the rule, and RMBS must meet additional requirements regarding disclosure, compensation, origination, servicing and establishment of a reserve fund. This difference in treatment of residential mortgage-backed securitizations from other securitizations reflects the clear defects demonstrated in the crisis by such mortgage-backed securitizations.

If the securitization is not treated as a sale but meets the standards in New Section 360.6, consent to exercise self-help remedies against the financial assets supporting the securitization would be granted ten (10) business days after a monetary default by the FDIC as defined in New Section 360.6 and notice thereof has been given to the FDIC, or ten (10) business days after repudiation of a transfer agreement, unless the FDIC pays damages in an amount determined pursuant to New Section 360.6. New Section 360.6 also permits the making of required payments on the securitization during the stay period.

Moreover, New Section 360.6 imposes the requirements stated above as a prerequisite to obtaining the benefits of the safe harbor provided by New Section 360.6. These requirements are consistent with the SEC requirements and will serve as an incentive to originate good quality assets and will lead to sustainable securitization practices.

DISCUSSION

I. Background

In 2000, the FDIC clarified the scope of its statutory authority as conservator or receiver to disaffirm or repudiate contracts of an IDI with respect to transfers of financial assets by an IDI in connection with a securitization or participation when it adopted the Securitization Rule. This rule provided that the FDIC as conservator or receiver would not use its statutory authority to disaffirm or repudiate contracts to reclaim, recover, or recharacterize as property of the institution or the receivership any financial assets transferred by an IDI in connection with a securitization or participation, provided that such transfer met all conditions for sale accounting treatment under GAAP. The rule was a clarification, rather than a limitation, of the repudiation power. Such power authorizes the conservator or receiver to breach a contract or lease entered into by an IDI and be legally excused from further performance, but it is not an avoiding power enabling the conservator or receiver to recover assets that were previously transferred by the IDI in connection with the contract. The Securitization Rule provided a "safe harbor" to permit transfers of financial assets by an IDI to an issuing entity in connection with a securitization or in the form of a participation to satisfy the "legal isolation" condition of GAAP as it applies to an institution for which the FDIC may be appointed as conservator or receiver. To satisfy the legal isolation condition, the transferred financial assets must

have been presumptively placed beyond the reach of the transferor, its creditors, a bankruptcy trustee, or in the case of an IDI, the FDIC as conservator or receiver. Since its adoption, the Securitization Rule has been relied on by securitization participants, including rating agencies, as assurance that investors could look to securitized financial assets for payment without concern that the financial assets would be interfered with by the FDIC as conservator or receiver.

Recently, the implementation of new accounting rules has created uncertainty for securitization participants. On June 12, 2009, the Financial Accounting Standards Board finalized modifications to GAAP through Statement of Financial Accounting Standards No. 166, *Accounting for Transfers of Financial Assets, an Amendment of FASB Statement No. 140* ("FAS 166") and Statement of Financial Accounting Standards No. 167, *Amendments to FASB Interpretation No. 46(R)* ("FAS 167")(the "2009 GAAP Modifications"). The 2009 GAAP Modifications are effective for annual financial statement reporting periods that begin after November 15, 2009. The 2009 GAAP Modifications made changes that affect whether a special purpose entity ("SPE") must be consolidated for financial reporting purposes, even if legally isolated, thereby subjecting many SPEs to GAAP consolidation requirements because of the IDI's control over the financial assets. These accounting changes will require some IDIs to consolidate an issuing entity to which financial assets have been transferred for securitization on to their balance sheets for financial reporting purposes. Similarly, the 2009 GAAP Modifications affect the way participations are treated on the issuing entity's balance sheets, requiring that participations that do not meet the conditions for sale treatment be treated as secured borrowings of an IDI. As a result, in either case, the safe harbor provision of the

Securitization Rule does not address the transfers.

Irrespective of whether a securitization qualifies for sale treatment it, is likely that it would qualify for treatment as a secured financing, and Section 11(e) (13) (C)[1] of the FDIA creates some uncertainty for securitization participants. This Section provides that no person may exercise any right or power to terminate, accelerate, or declare a default under a contract to which the IDI is a party, or to obtain possession of or exercise control over any property of the IDI, or affect any contractual rights of the IDI, without the consent of the conservator or receiver, as appropriate, during the 45-day period beginning on the date of the appointment of the conservator or the 90-day period beginning on the date of the appointment of the receiver. Consequently, securitized assets that remain property of the IDI (but subject to a security interest) would be subject to the stay, raising concerns that any attempt by securitization noteholders to exercise remedies with respect to the IDI's assets would be delayed by up to 90 days. During that time, interest and principal on the securitized debt could remain unpaid.

The 2009 GAAP Modifications also affect the way securitizations are viewed by the rating agencies and whether they can achieve ratings that are based solely on the credit quality of the assets, independent from the rating of the IDI. Rating agencies are concerned with several issues, including the ability of a securitization transaction to pay timely principal and interest in the event the FDIC is appointed receiver or conservator of the IDI. Rating agencies are also concerned with the ability of the FDIC to repudiate the securitization obligations and pay damages that may be less than the principal amount of such obligations. Moody's, Standard & Poor's, and Fitch have expressed the view that because of the 2009 GAAP Modifications and the extent of the FDIC's rights and powers

[1] 12 U.S.C. § 1821(e)(13)(C).

as conservator or receiver, bank securitization transactions are unlikely to receive AAA ratings and would have to be linked to the rating of the IDI. Securitization practitioners have asked the FDIC to provide assurances regarding the position of the conservator or receiver as to the treatment of both existing and future securitization transactions to enable securitizations to be structured in a manner that enables them to achieve de-linked ratings.

Staff believes that several of the issues of concern for securitization participants regarding the impact of the 2009 GAAP Modifications on the eligibility of transfers of financial assets for safe harbor protection can be addressed simply by clarifying the position of the conservator or receiver under established law. Under Section 11(e) (11) of the FDI Act,[2] the conservator or receiver cannot use its statutory power to repudiate or disaffirm contracts to avoid a legally enforceable and perfected security interest in transferred financial assets. Of course, this provision applies whether or not the securitization meets the conditions for sale accounting. As a consequence, New Section 360.6 would clarify that if the FDIC repudiates the agreements, the FDIC will pay damages in an amount equal to the par value of the outstanding obligations and thereby discharge the lien on the securitization assets. Moreover, prior to any monetary default or repudiation, the FDIC as conservator or receiver would consent to the making of required payments of principal and interest and other amounts due on the securitized obligations during the statutory stay period. This clarification in paragraphs (d)(4) and (e) of New Section 360.6 addresses questions that have been raised about the scope of the stay codified in Section 11(e)(13)(C).

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[2] 12 U.S.C. § 1821(e)(11).

To ensure that IDIs are sponsoring securitizations in a responsible and sustainable manner, New Section 360.6 imposes certain requirements on all securitizations issued on or after September 30, 2010, including those that qualify as sales, as a prerequisite for the application of the FDIC safe harbor and the consent to the exercise of the rights and powers listed in Section 11(e)(13)(C) with respect to securitized financial assets. RMBS must comply with additional requirements set forth in New Section 360.6 in order to benefit from the FDIC safe harbor. These requirements are intended to support sustainable origination and underwriting practices, while securitization provides increased liquidity to the marketplace.

The FDIC, as deposit insurer and receiver for failed IDIs, has a unique responsibility and interest in ensuring that residential mortgage loans and other financial assets originated by IDIs are originated for long-term sustainability. The supervisory interest in origination of quality loans and other financial assets is shared with other bank and thrift supervisors. Nevertheless, the FDIC''s responsibilities to protect insured depositors and resolve failed insured banks and thrifts, and its responsibility to the DIF, require it to ensure that, where it provides a safe harbor consenting to special relief from the application of its receivership powers, it must do so in a manner that fulfills these responsibilities.

The evident defects in many subprime and other mortgages originated and sold into securitizations requires attention by the FDIC to fulfill its responsibilities as deposit insurer and receiver in addition to its role as a supervisor. The defects and misalignment of incentives in the securitization process for residential mortgages were a significant contributor to the erosion of underwriting standards throughout the mortgage finance

system. While many of the troubled mortgages were originated by non-bank lenders, insured banks and thrifts also made many troubled loans as underwriting standards declined under the competitive pressures created by the returns achieved by lenders and service providers through the "originate to distribute" model.

Defects in the incentives provided by securitization through immediate gains on sale for transfers into securitization vehicles and fee income directly led to material adverse consequences for insured banks and thrifts. Among these consequences were increased repurchase demands under representations and warranties contained in securitization agreements, losses on purchased mortgage and asset-backed securities, severe declines in financial asset values and in mortgage- and asset-backed security values due to spreading market uncertainty about the value of structured finance investments, and impairments in overall financial prospects due to the accelerated decline in housing values and overall economic activity. These consequences, and the overall economic conditions, directly led to the failures of many IDIs and to significant losses to the DIF. In this context, it would be imprudent for the FDIC to provide consent or other clarification of its application of its receivership powers without imposing requirements designed to realign the incentives in the securitization process to avoid these devastating effects.

The FDIC's adoption of 12 C.F.R. § 360.6 in 2000 provided clarification of "legal isolation" and facilitated legal and accounting analyses that supported securitization. In view of the accounting changes and the effects they have upon the application of the Securitization Rule, it is crucial that the FDIC provide a safe harbor and expedited consent in a way that reduces the risks to the DIF by better aligning the incentives in

securitization to support sustainable lending and structured finance transactions.

The proposed action by the FDIC is fully consistent with the Board's prior adoption of the Covered Bond Policy Statement on July 15, 2008. In that action, the FDIC Board of Directors acted to clarify how the FDIC would treat covered bonds in the case of a conservatorship or receivership with the express goal of thereby facilitating the development of the U.S. covered bond market. As noted in the Covered Bond Policy Statement, it served to "define the circumstances and the specific covered bond transactions for which the FDIC will grant consent to expedited access to pledged covered bond collateral." The Policy Statement further specifically referenced the FDIC's goal of promoting development of the covered bond market, while protecting the DIF and prudently applying its powers as conservator or receiver.

The proposed action is also consistent with the SEC's proposed New Regulation AB. The SEC's proposed rule represents a significant overhaul of Regulation AB and related rules governing the offering process, disclosure requirements and ongoing reporting requirements for securitizations. New Regulation AB would establish extensive new requirements for both SEC registered publicly-offered securitization and on private placements, including disclosure of standardized financial asset level information, enhanced investor cash flow modeling tools and on-going information reporting requirements. In addition New Regulation AB requires certain certifications to the quality of the financial asset pool, retention by the sponsor or an affiliate of a portion of the securitization securities and third party reports on compliance with the sponsor's obligation to repurchase assets for breach of representations and warranties as a precondition to an issuer's ability to use a shelf registration. The disclosure and retention

requirements of New Regulation AB are consistent with and support the approach of the Proposed Rule.

In order for loan participations to continue to satisfy the conditions imposed by GAAP for sale treatment, the proposed New Section 360.6 specifically continues the safe harbor provision for transfers of financial assets in the form of a loan participation that continue to meet the conditions for sale treatment under the 2009 GAAP Modifications.

II. Comments Received on the ANPR

The FDIC received thirty-seven comments from industry groups, issuers, investors, consumer advocates and other interested parties. Most of the comments presented objections to the proposed rule. Eleven comments were received from trade associations. Six comments were received from banks, including one law firm on behalf of a bank. Four comments were received from law firms that did not specify a relationship with any particular institution. Two rating agencies submitted comments. Three comments were received from consumer advocates. Institutional investors and other interested parties provided the remaining eleven comments.

The institutional investors and consumer advocates broadly supported the proposed changes as responsive to the issues demonstrated in the prior model of securitization. Several institutional investors commented specifically on the need for greater disclosures of loan level data particularly for residential mortgage loans and of delinquencies experienced in the transactions. Others emphasized the value of disclosures and strong representations and warranties as important in allowing investors to understand and limit the ongoing risks in a securitization. Both consumer advocates and investors expressed support for risk retention and greater clarity in compensation and

servicing responsibilities as means to better align incentives towards long-term sustainable lending.

A number of banks, law firm commenters, and industry trade organizations opposed, for a variety of reasons, to the new conditions set forth in paragraph (b) of the Proposed Rule. Their comments in opposition to the conditions included: disagreement that such requirements would serve to promote more long-term sustainability for loans and other financial assets originated by IDIs; and that the conditions would impose additional costs on IDIs and competitively disadvantage IDIs in relation to non-regulated securitization sponsors. Several commenters stated that the FDIC should not unilaterally adopt new conditions, and some urged the FDIC to act only on an interagency basis or following final Congressional action.

These comments reflect a misunderstanding of the purpose of the conditions. The conditions are designed to provide greater clarity and transparency to allow a better ongoing evaluation of the quality of the lending by banks and reduce the risks to the Deposit Insurance Fund from opaque securitization structures and the poorly underwritten loans that led to the onset of the financial crisis. In addition, these comments fail to recognize that securitization as a viable liquidity tool in mortgage finance will not return without greater transparency and clarity because investors have experienced the difficulties provided by the existing model of securitization. However, greater transparency is not solely for investors, but will serve to more closely tie the origination of loans to their long-term performance by requiring disclosures of that performance. Staff notes that the conditions are supported by New Regulation AB

recently proposed by the SEC and also reflected in the proposed financial services legislation.

Moody's and Fitch noted that reliance on qualitative criteria, such as ongoing disclosure, would make it more difficult to de-link the rating of a securitization from that of the sponsor. While, this is a debatable proposition in the context of rating agency actions that normally evaluate qualitative information, the Proposed Rule ties disclosures and other requirements to the contractual terms of the securitization to permit a clearer assessment of whether a transaction meets the conditions in the Proposed Rule.

A number of law firms and industry groups also objected to the safe harbor's reliance on the accounting treatment of the transfers of financial assets being securitized. Commenters suggested that the FDIC focus instead on a legal sale analysis in determining whether a transfer of assets was eligible for the safe harbor. Several commenters objected to the "secured transaction" approach as being untested, incomplete and difficult to implement.

Staff recommends rejection of this position because the Securitization Rule as adopted in 2000, as well as the FDIC's longstanding evaluation of the assets potentially subject to receivership powers, has been based on the treatment of those assets as on or off balance sheet. This was explicitly stated in the the Securitization Rule. Moreover, in providing a safe harbor, it is appropriate for the FDIC to consider those assets treated under GAAP as part of the IDI's balance sheet in determining how it may respond in a conservatorship or receivership.

Objections to the 'secured transaction' treatment of securitization transfers that do not meet the requirements for off balance sheet treatment under the new accounting rules

are misplaced. Prior to the Securitization Rule, securitization transactions were typically treated as secured transactions or sales. As a result, under the Proposed Rule, if the transfer does not meet the standards for off balance sheet treatment, the FDIC will consider the transaction as a secured transaction if it meets the requirements imposed on such transactions under the Proposed Rule and state law. In this way, investors in securitization transactions that do not qualify for off balance sheet treatment may still receive benefits of expedited access to the securitized loans if they meet the conditions specified in the Proposed Rule.

The Proposed Rule includes changes responsive to these comments and clarifications to address other comments.

A material change was made to the loan origination requirement in response to comments objecting to the requirement for RMBS that loans have been originated at least 12 months before inclusion as financial assets in a securitization. The Proposed Rule deletes this seasoning requirement and instead provides that securitizations that include residential mortgage loans will be required to establish a reserve fund equal to at least five (5) percent of the cash proceeds of the securitization payable to the sponsor to cover repurchase obligations for breaches of representations and warranties in the year following the date of issuance of obligations under the securitization.

III. The Proposed New Rule – New Section 360.6

The proposed new rule replaces the Securitization Rule as amended by the Transition Rule with a new Section 360.6. Paragraph (a) of New Section 360.6 sets forth definitions of terms used in the proposed New Section 360.6. It retains many of the definitions previously used in the Securitization Rule but modifies or adds definitions to the extent necessary to accurately reflect current industry practice in securitizations.

Paragraph (b) of New Section 360.6 makes a clear distinction between the conditions imposed on RMBS from those imposed on securitizations for other asset classes in order for the rule to apply to transfers of financial assets to an issuing entity in connection with a securitization or RMBS. In the context of a conservatorship or receivership, the requirements applicable to all securitizations will improve overall transparency and clarity through disclosure and documentation requirements along with ensuring effective incentives for prudent lending by requiring that the payment of principal and interest on the obligations be based primarily on the performance of the financial assets as well as a requirement for retention of a share of the credit risk in the securitized loans. The requirements applicable to RMBS are more detailed and explicit and include additional capital structure changes, disclosures, documentation, compensation, and origination and retention standards.

These standards reflect the experience of difficulties created by some securitization structures. Confidence can be restored in RMBS markets only through greater transparency, other structures that support sustainable mortgage origination practices and requiring increased disclosures. To that end, the safe harbor provided in paragraph (d) of the Proposed Rule and the FDIC's consent to self-help remedies of the Proposed Rule are conditioned on securitizations meeting certain disclosure, asset, structuring and documentation standards set forth in paragraphs (b) and (c) of the Rule. These standards are generally consistent with industry efforts[3] while taking into account New Reg AB and other proposed regulatory and legislative initiatives.

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[3] See, Testimony of George P. Miller, Executive Director, American Securitization Forum Before the Senate Banking, Housing and Urban Affairs Subcommittee on Securities, Insurance and Investments, "Securitization of Assets: Problems and Solutions", October 7, 2009.

Capital Structure and Financial Assets

Staff recommends that the benefits of New Section 360.6 should be available only to securitizations that are readily understandable by the market, increase liquidity of the financial assets and reduce consumer costs. Consistent with New Regulation AB, any re-securitizations (securitizations supported by other securitization obligations) would need to include financial asset level disclosures as appropriate to the financial assets securitized. Securitizations that are unfunded or synthetic securitizations (i.e. not based on originated financial assets) are not eligible for expedited consent under the Proposed Rule. To support sound lending, all securitizations are required to have payments of principal and interest on the obligations primarily dependent on the performance of the financial assets supporting the securitization. Payments of principal or interest to investors must not be contingent on market or credit events that are independent of the assets supporting the securitization, other than interest rate and currency mismatches between the financial assets and the securitization obligations.

For RMBS, New Section 360.6 limits the capital structure of the securitization to six tranches or less and, subject to a limited exception, may not include sub-tranches. In addition, RMBS cannot benefit from external credit support mechanisms at the issuing entity or pool level but would be able to use liquidity facilities to cover the temporary payment of principal and interest and facilities to cover interest shortfalls in the event the FDIC repudiates the securitization. These conditions are designed to limit both the complexity and the leverage in RMBS and therefore the systemic risks introduced by securitizations in the market.

Disclosures

Several conditions for all securitizations focus on disclosures that are relevant to the continued performance of the asset pool. These provisions would apply both at the initial issuance of obligations and with respect to monthly reporting to investors. By increasing transparency in securitizations, investors (which may include banks) can decide whether to invest in a securitization based on full information with respect to the quality of the asset pool and provide additional liquidity only for sustainable origination practices. The conditions require that, at a minimum, disclosure comply with the provisions of Regulation AB promulgated by the SEC to govern disclosures relating to asset-backed securities, or any successor regulation, with the same level of specificity applicable for public issuances, whether or not a securitization is sold in a public issuance. The disclosures required under the Proposed Rule parallel New Regulation AB requirements but would apply to all securitizations, including traditional private placements.

New Section 360.6 requires that the documents governing all securitizations require that the issuing entity, sponsor or servicer provide information about the securitized financial assets at the loan, pool, and security-level to enable evaluation and analysis of the credit risk and performance of the obligations and the financial assets during the term of the securitization. While financial asset level disclosures are required, pool level disclosures would be permitted for securitizations of certain financial assets, such as credit cards, for which loan level data is less relevant and which may involve millions of individual financial assets. To the extent information is not available after

reasonable investigation, the issuer must include a statement in the offering document specifying that such information is unavailable.

New Section 360.6 would also require that the securitization documents disclose the structure of the securitization, including the relevant capital or tranche structure. The governing documents must also require that the periodic reports provided to investors include losses that were allocated to each tranche and the remaining balance of financial assets supporting each tranche as well as the percentage of each tranche in relation to the securitization as a whole. These requirements are also consistent with New Regulation AB, but provide for broader application to all IDI issuances.

Initial disclosure to investors must also include the nature and amount of broker, originator, rating agency or third-party advisory, and sponsor compensation and the extent to which any risk of loss on the underlying financial assets is retained by any of such persons for such securitization. This disclosure should enable investors to assess potential conflicts of interests and how the compensation structure affects the quality of the mortgage loan assets securitized or the securitization as a whole. New Regulation AB also asks originators to identify broker relationships, but does not specifically require the disclosure of compensation amounts.

The new rule would also require servicers to disclose any ownership interest by the servicer or its affiliates in other loans secured by real property that secures a loan that is included in the asset pool. This disclosure would not apply to securities, but only to whole loans in which the servicer or its affiliates had an interest. This disclosure will give investors information to evaluate whether there are any potential servicer conflicts of interest that might impede the servicer's actions to maximize value for the benefit of

investors. These requirements are consistent with New Regulation AB that require disclosure of all servicer interests and enhance disclosures with respect to affiliated entities and originators of more than 10% of the pool assets.

New Section 360.6 requires that the RMBS sponsors affirm compliance with all statutory and regulatory standards for origination of mortgage loans, including: underwriting at the fully index rate; relying on documented income; and complying with existing supervisory guidance governing the underwriting of residential mortgages. This requirement is consistent with the chief executive officer certification requirement under New Regulation AB. Sponsors are also required to provide a third party due diligence report confirming compliance with such standards.

Documentation and Recordkeeping

For all securitizations, the operative agreements should define all necessary rights and responsibilities of the parties, including but not limited to representations and warranties and ongoing disclosure requirements. The agreements should also specify any measures required to avoid conflicts of interest. The contractual rights and responsibilities of each party to the transactions must provide each party with sufficient authority for such party to fulfill its respective duties under the securitization contracts.

For RMBS, staff is particularly interested in increasing the ability of servicers to mitigate losses on mortgage loans consistent with maximizing the net present value of the mortgage loan. Moreover, the documents must provide that the servicer act for the benefit of all investors rather than any particular class of investors and require the servicer to commence action to mitigate losses no later than 90 days after an asset first becomes delinquent.

Staff believes that in RMBS a prolonged period of servicer advances in a market downturn misaligns servicer incentives with those of the securitization investors, and therefore, the servicing agreement should restrict servicer advances to cover delinquent payments by borrowers to three payment periods, unless financing or reimbursement facilities are available. For example, advances could be made by the issuing entity from funds reserved for such purpose; however, such "financing or reimbursement facilities" may not depend on foreclosure proceeds.

Compensation

An area of concern is the incentives created by the "originate to sell" model that reduced the quality of financial assets originated and was a primary cause of the collapse of securitization markets in the current economic crisis. Therefore, the compensation requirements only apply to RMBS. Due to the demonstrated issues in the compensation incentives in RMBS, the Proposed Rule seeks to realign compensation to all parties involved in the origination of assets and in the RMBS issuance to provide incentives for sustainable credit and the long-term performance of the mortgage loans and securitizations.

Fees or other compensation for services payable to credit rating agencies and other third-party evaluation companies must be payable over the five (5) year period after the first issuance of the RMBS obligations and based on the performance of surveillance services and the financial assets, with no more than sixty (60) percent of the total estimated compensation due to any party at closing.

A second area of concern is aligning incentives for proper servicing of the financial assets. Therefore, compensation to servicers in RMBS transactions must provide

incentives for servicing and loss mitigation actions that maximize the net present value of the mortgage loans. The Proposed Rule specifically notes that compensation should be provided for loan restructuring and other loss mitigation services that maximize the net present value of the financial assets.

Origination and Retention Requirements

To provide incentives for quality origination practices in all securitizations the sponsor must retain an economic interest in a material portion of the credit risk of the financial assets, which is defined as an interest of not less than five (5) percent. This retained interest may be held either in the form of an interest of not less than five (5) percent in each of the credit tranches sold or transferred to the investors or in a representative sample of the securitized financial assets equal to not less than five (5) percent of the principal amount of the financial assets at transfer. This retained interest cannot be transferred or hedged during the life of the transaction. The retention requirement is consistent with New Reg AB requirement for eligibility for shelf registrations, but would apply to all IDI issuers whether or not registered.

For RMBS, the sponsor must also establish a reserve fund equal to at least five (5) percent of the cash proceeds of the securitization payable to the sponsor to cover repurchase obligations for the breach of representations and warranties during the first year of a securitization transaction. This reserve fund will ensure that the sponsor bears a significant risk for poorly underwritten loans during the first year of the securitization.

In addition, all residential mortgage loans in an RMBS must comply with all statutory and regulatory standards in effect at the time of origination. Residential mortgages must be underwritten at the fully indexed rate and rely on documented income

and comply with all existing supervisory guidance governing the underwriting of residential mortgages, including the Interagency Guidance on Non-Traditional Mortgage Products, October 5, 2006, and the Interagency Statement on Subprime Mortgage Lending, July 10, 2007, and such additional guidance applicable at the time of loan origination.

New Section 360.6 also includes in paragraph (c) general requirements for the transaction and the transfer of financial assets most of which were also contained in the Securitization Rule. The transaction should be an arms-length, bona fide securitization transaction. Obligations may not be sold to an affiliate or insider. The securitization agreements must be in writing, approved by the board of directors of the bank or its loan committee (as reflected in the minutes of a meeting of the board of directors or committee), and have been, continuously, from the time of execution, in the official record of the bank. The securitization must be entered into in the ordinary course of business, for adequate consideration, not in contemplation of insolvency and with no intent to hinder, delay or defraud the bank or its creditors. Reflecting the change to possible treatment as secured financing, the transfer and/or security interest needs to be properly perfected under the UCC or applicable state law.

In order to grant expedited consent, the conservator or receiver will require that the financial assets be separately identified in the sponsor's financial asset data bases, and that, to the extent that the sponsor serves as servicer, custodian or paying agent, amounts received with respect to the financial assets not be comingled with other assets, except to the extent necessary to clear any payments, but not longer than two days. The sponsor must also keep copies of the securitization documents, keep a current list of its

securitizations as well as the most recent Form 10-K or other periodic financial report for each securitization SPE. This requirement facilitates the timely fulfillment of the receiver's responsibilities upon appointment and will expedite the receiver's analysis of securitization assets and determination of which assets have been securitized and are therefore potentially eligible for expedited access by investors.

The Safe Harbor

Paragraph (d)(1) of New Section 360.6 continues the safe harbor provision that was provided by the Securitization Rule and the Transition Rule for participations that qualify for sale accounting treatment under GAAP.

Paragraph (d)(2) of New Section 360.6 continues the safe harbor provision that was provided by the Transition Rule for participations or securitizations for which transfers of financial assets were made or, for revolving trusts, for which obligations were issued, on or before September 30, 2010. It provides that for these participations or securitizations, the FDIC as conservator or receiver will not, in the exercise of its statutory authority to disaffirm or repudiate contracts, reclaim, recover, or recharacterize the transferred financial assets as property of the institution or the receivership. This safe harbor for participations or securitizations applies even if the transfer does not satisfy all conditions for sale accounting treatment under GAAP as effective for reporting periods after November 15, 2009, so long as it satisfied the conditions for sale accounting treatment in effect for reporting periods before November 15, 2009 and the transaction otherwise complied with prior Section 360.6.

For securitizations for which transfers of financial assets were made or, for revolving trusts, for which obligations were issued, after September 30, 2010 that comply

with the requirements in paragraphs (b) and (c) of New Section 360.6, and meet the new FASB requirements for sale accounting treatment under GAAP, Paragraph (d)(3) provides a safe harbor confirming that the FDIC will not seek to reclaim the financial assets from the securitization. This safe harbor allows the transaction to remain legally isolated from the conservatorship or receivership, in the same manner as under the prior Section 360.6.

For securitizations for which transfers of financial assets were made or, for revolving trusts, for which obligations were issued, after September 30, 2010 that comply with the requirements in paragraphs (b) and (c) of New Section 360.6 but do not meet the new FASB requirements for sale accounting treatment under GAAP, Paragraph (d)(4) provides a separate safe harbor. The safe harbor clarifies the FDIC's options with respect to such securitization and provides for consent by the conservator or receiver to certain actions during the stay period imposed by Section (11)(e)(13)(C) of the FDIA.

There are two situations in which the consent would be given (i) monetary default under a securitization by the FDIC as conservator or receiver or (ii) repudiation of the securitization agreements by the FDIC. New Section 360.6(d)(4)(A) provides that in the event the FDIC is in monetary default under the securitization documents, and the default continues for a period of ten (10) business days after written notice to the FDIC, the FDIC will be deemed to consent pursuant to Section (11)(e)(13)(C) to the exercise of contractual rights under the documents on account of such monetary default, and such consent shall discharge the lien on the financial assets included in the securitization and constitute satisfaction in full of obligations of the IDI and the FDIC as conservator or receiver to the holders of the securitization obligations.

New Section 360.6(d)(4)(B) provides that in the event the FDIC repudiates the securitization asset transfer agreement, the FDIC shall have the right to discharge the lien on the financial assets included in the securitization by paying damages in an amount equal to the par value of the obligations in the securitization on the date of the appointment of the FDIC as conservator or receiver, less any principal payments made to the date of repudiation. If such damages are not paid within ten (10) business days of repudiation, the FDIC will be deemed to consent pursuant to Section (11)(e)(13)(C) to the exercise of contractual rights under the documents.

In both of these situations, the Proposed Rule specifies that if the FDIC is deemed to consent to the exercise of contractual remedies, the actions that may be taken include obtaining possession of the financial assets, exercising self-help remedies as a secured creditor, or liquidating the financial assets by commercially reasonable and expeditious methods taking into account existing market conditions, provided no involvement of the receiver or conservator is required.

Paragraph (f) identifies what is required to seek the FDIC's consent in the case of a monetary default.

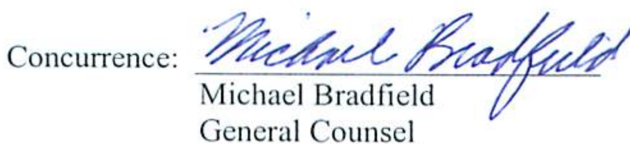
Paragraph (e) provides FDIC consent to normal servicing of the financial assets and payments to the investors in accordance with the securitization documents, except for provisions that take effect upon the appointment of the receiver or conservator and to servicing activity required in furtherance of the securitization for securitizations that meet the requirements of paragraphs (b) and (c) of New Section 360.6. This simply means that the securitization will continue as before the appointment of the conservator or receiver.

but that it cannot be terminated or otherwise accelerated based solely on that appointment.

Paragraph (g) provides that the conservator or receiver will not seek to avoid an otherwise legally enforceable agreement that is executed by an IDI in connection with a securitization or in the form of a loan participation solely because the agreement does not meet the ''contemporaneous'' requirement of 12 U.S.C. §§ 1821(d)(9), 1821(n)(4)(I), or 1823(e).

Paragraph (i) provides that New Section 360.6, like the Securitization Rule, does not authorize, and shall not be construed as authorizing, the waiver of the prohibitions in 12 U.S.C. § 1825(b)(2) against levy, attachment, garnishment, foreclosure, or sale of property of the FDIC; does not authorize nor shall it be construed as authorizing the attachment of any involuntary lien upon the property of the FDIC; shall not be construed as waiving, limiting or otherwise affecting the rights or powers of the FDIC to take any action or to exercise any power not specifically mentioned, including but not limited to any rights, powers or remedies of the FDIC regarding transfers taken in contemplation of the institution's insolvency or with the intent to hinder, delay or defraud the institution or the creditors of such institution, or that is a fraudulent transfer under applicable law.

Paragraph (k) provides that New Section 360.6 may be repealed by the FDIC upon 30 days notice provided in the Federal Register, but any repeal shall not apply to any issuance made in accordance with the rule before such repeal.

Concurrence: 
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