October 8, 2015

TO: Board of Directors

FROM: Bret D. Edwards
Director
Division of Resolutions and Receiverships

Charles Yi
General Counsel
Legal Division

SUBJECT: Final Rule to Revise 12 C.F.R. Section 360.6 "Treatment of financial assets transferred in connection with a securitization or participation" (the "Securitization Safe Harbor Rule") and Proposed Rule to Further Revise the Securitization Safe Harbor Rule

RECOMMENDATION

Staff recommends that the Board approve and authorize for publication in the *Federal Register* two notices to revise the Securitization Safe Harbor Rule: a notice of final rulemaking and a notice of proposed rulemaking. The reason that staff is proposing two separate rulemakings to amend the Securitization Safe Harbor Rule is that one recommended change to the Rule, clarifying the transition of the Rule's risk retention requirements to the recently promulgated credit risk retention rule under the Dodd-Frank Act, was previously proposed and is being finalized after notice and comment. A second change, designed to conform to Consumer Financial Protection Bureau ("CFPB") regulations dealing with the servicing of residential mortgages that became effective last year, was not included in the original proposal and, accordingly, staff recommends proposing this second change for notice and comment. More specifically, the two notices recommended for publication are:

(i) **Final rule (the "Final Rule") relating to credit risk retention requirements.** The Final Rule clarifies (a) the date on which compliance with the credit risk retention requirements adopted under Section 15G of the Securities Exchange Act ("Section 15G") will need to be specified in the documentation governing a securitization transaction in order for the transaction to qualify for special treatment; (b) that the Securitization Safe Harbor Rule requirement as to such regulations (the "Section 15G Regulations") relates to the securitization documentation but is not intended to require continuous compliance with the Section 15G Regulations; and (c) that the Securitization Safe Harbor Rule condition relating to the Section 15G Regulations does not require that there be changes to documents governing an asset-backed security issuance that closes before the date on which compliance with the Section 15G Regulations is required for such type of issuance. These provisions are the same as the comparable provisions set forth in the Notice of Proposed Rulemaking to Revise Section 360.6 Relating to the Treatment of Financial Assets Transferred in Connection with a Securitization or Participation published on in the Federal Register on January 30, 2015 ("NPR"). In response to the sole comment letter received to the NPR, the Final Rule also revises the Securitization Safe Harbor Rule to permit the sponsor of a securitization transaction that closes between the date the Final Rule is published in the *Federal Register* and the date on which compliance with the Section 15G Regulations is required the option to comply with Securitization Safe Harbor Rule by providing in the documents creating the securitization transaction that it will be bound by the Section 15G Regulations as though they were already in effect with respect to that securitization transaction.

(ii) **Notice of Proposed Rulemaking (the "Second NPR") relating to residential mortgage loan servicing requirements.** The Second NPR would clarify that the requirement

that a servicer take loss mitigation action within 90 days of delinquency does not require that the securitization documents require a servicer to act contrary to the CFPB's mortgage loan servicing requirements set forth in Regulation X (12 CFR 1024), which became effective on January 10, 2014.

DISCUSSION

I. Background

The Securitization Safe Harbor Rule provides special treatment for securitization transactions that satisfy the conditions set forth in the Rule. It provides with respect to certain transfers of financial assets in connection with securitization transactions that the FDIC, in its capacity as receiver or conservator of an insured depository institution, will not in the exercise of its authority to repudiate contracts, recover or reclaim such financial assets where the requirements of the Rule are met. For other transactions that comply with its requirements, the Securitization Safe Harbor Rule provides for the exercise of certain remedies on an expedited basis. The Securitization Safe Harbor Rule was amended and restated in 2010 to include additional conditions for safe harbor treatment for transactions that were not grandfathered by the Rule; these additional conditions included, among others, a credit risk retention requirement, as well as requirements relating to residential mortgage loan servicing, disclosure and credit rating agency compensation.

II. The Final Rule

The 2010 restatement provides that upon the effective date of the joint rulemaking establishing credit risk retention requirements under Section 15G, the credit risk retention requirements

adopted by that rulemaking replace the specific risk retention requirements included in the Securitization Safe Harbor Rule.

Paragraph (b)(5)(i) of the Securitization Safe Harbor Rule sets forth the conditions relating to credit risk retention that apply to transfers of financial assets in connection with securitization transactions (other than those grandfathered by the 2010 restatement). Under paragraph (b)(5)(i)(A), prior to the effective date of the Section 15G Regulations, the documents governing such securitization transactions must require that the sponsor retain an economic interest in not less than five (5) percent of the credit risk of the financial assets relating to the securitization. Paragraph (b)(5)(i)(B) provides that, upon the effective date of the Section 15G Regulations, such regulations shall exclusively govern the requirement to retain an economic interest in the credit risk of such financial assets.

Section 15G provides that regulations issued thereunder become effective with respect to residential mortgage securitizations one year after the date on which the regulations are published in the *Federal Register* and, with respect to all other securitizations, two years after such publication date. The Federal Register publication of the Section 15G Regulations, on December 24, 2014, specifies "compliance dates" that correspond to these effective dates. However, in accordance with Federal Register editorial conventions (which require that a Federal Register publication specify as the effective date the date on which a rule affects the current Code of Federal Regulations) the Federal Register publication also specifies February 23, 2015 as the "effective date" of the Section 15G Regulations.

The NPR was intended to eliminate any confusion that might be created by the use of "effective date" in this way by clarifying that paragraph (b)(5)(i)(B) requires that the documents governing

a securitization transaction are not required to require compliance with the Section 15G Regulations until the date on which compliance with the Section 15G Regulations is required with respect to that type of securitization transaction pursuant to Section 15G.

The NPR clarified two other points related to paragraph (b)(5)(i) of the Securitization Safe Harbor Rule. The first clarification makes clear that paragraph (b)(5)(i) is intended to require that, upon and following the effective date of the Section 15G Regulations, the Securitization Safe Harbor Rule requirements as to risk retention are satisfied if the governing documents of a securitization transaction require retention of an economic interest in financial assets relating to a securitization transaction in accordance with the Section 15G Regulations, and that if the documentation satisfies this condition (and assuming all other conditions of the Securitization Safe Harbor Rule are satisfied), the transaction will not lose the benefits of the safe harbor solely on the basis of any actual non-compliance with the Section 15G Regulations risk retention requirements by the sponsor or another applicable party.

The second clarification makes clear that paragraph (b)(5)(i)(B) of the Securitization Safe Harbor Rule does not require that any action be taken with respect to issuances of asset-backed securities that comply with paragraph (b)(5)(i)(A) and close prior to the effective date of the Section 15G Regulations.

Provisions making these clarifications are included in the Final Rule without change from the comparable provisions included in the NPR. The Final Rule also includes an additional, related change proposed in a comment letter from the Structured Finance Industry Group ("SFIG"), which was the only comment letter received in response to the NPR. SFIG endorsed the proposals included in the NPR and proposed that the Final Rule also include a provision that

would permit securitization sponsors to comply with the Securitization Safe Harbor Rule risk retention requirement by electing to comply with the risk retention requirements of the Section 15G Regulations before compliance is required by those Regulations. Such election would be evidenced by the inclusion of a provision in the documents creating the securitization transaction that requires compliance with the Section 15G Regulations, notwithstanding that the applicable compliance date thereunder has not yet occurred. Staff supports inclusion of this option because the Section 15G Regulations reflect FDIC policy and, since the Securitization Safe Harbor Rule has always required the transition to the Section 15G risk retention requirements, there is no compelling reason to require that securitization sponsors await the applicable compliance date in order to agree to comply with the Section 15G Regulations. By making the option available, the FDIC can avoid imposing unnecessary burdens on sponsors that issue multiple series under a single securitization structure and that otherwise might need to establish a securitization structure for the issuance of multiple series that complies with the Securitization Safe Harbor Rule risk retention requirements before the applicable compliance date under the Section 15G Regulations, only to be required to amend the structure after the applicable compliance date under the Section 15G Regulations occurs. In addition, permitting securitization sponsors to satisfy the Securitization Safe Harbor Rule by agreeing to comply early with the Section 15G Regulations will permit some sponsors to avail themselves of the applicable specially tailored risk retention option provided in those Regulations. While in some cases the early compliance option may also permit sponsors to benefit from exemptions available under the Section 15G Regulations earlier than otherwise would be the case, in adopting the Section 15G Regulations, the FDIC determined that the approach to risk retention set forth in those Regulations is appropriate and

permitting early compliance is consistent with the goal of easing administrative costs and burdens associated with regulatory compliance.

III. The Second NPR

Paragraph (b)(3)(ii) of the Securitization Safe Harbor Rule sets forth the conditions that are applicable to the servicing of residential mortgage loans. In January, 2013, the CFBP amended Regulation X by adopting certain mortgage loan servicing requirements.[1] These amendments became effective on January 10, 2014. Following up on a question asked at the January 21, 2015 Board of Directors meeting when the Board approved the NPR, FDIC staff undertook a review of these servicing requirements to identify any areas of overlap between such servicing requirements and the servicing requirements included in the Securitization Safe Harbor Rule and to determine whether any such overlaps might cause confusion or whether the two regulations might conflict. FDIC staff consulted with staff at the CFPB and the Office of Comptroller of the Currency as part of this review. Regulation X, as amended (at 12 CFR 1024.41), includes a provision that in general prohibits a servicer from making the first notice or filing required for a foreclosure unless a mortgage loan is more than 120 days delinquent. Paragraph (b)(3)(ii)(A) includes a condition that the securitization documents must require that the servicer commence action to mitigate losses no later than 90 days after a mortgage loan first becomes delinquent (unless all delinquencies are cured within the 90-day period). The Securitization Safe Harbor Rule does not define what constitutes loss mitigation actions, but the preamble to the notice of proposed rulemaking relating the Securitization Safe Harbor Rule stated that action to mitigate

[1] Regulation X was issued to implement the Real Estate Settlement Procedures Act of 1974, as amended, 12 U.S.C. 2610 *et. seq.*

losses may include contact with the borrower or other steps designed to return the asset to regular payments, and does not require initiation of foreclosure proceedings. Although the Securitization Safe Harbor Rule does not require that a servicer take foreclosure steps in order to discharge its loss mitigation obligation, it is possible that in certain circumstances such action may be the appropriate loss mitigation action. To avoid confusion between the requirements of these two rules, staff is proposing that the Securitization Safe Harbor Rule be amended to make clear that the Rule does not require that securitization documents require a servicer to violate this or any of the other mortgage servicing standards provided for in Regulation X.

CONCLUSION

The Division of Resolutions and Receiverships and the Legal Division recommend that the Board of Directors approve and adopt the Final Rule and the NPR and authorize their publication in the *Federal Register*.

Staff Contacts

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ATTACHMENTS

A-1 Resolution - Final Rule

A-2 Resolution - NPR

B-1 Federal Register Notice - Final Rule

B-2 Federal Register Notice - NPR