MEMORANDUM TO: The Board of Directors

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

Richard J. Osterman, Jr.
Acting General Counsel

DATE: September 27, 2010

SUBJECT: Rule 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

RECOMMENDATION

Staff recommends that the Board of Directors ("Board") approve a final rule (the "Rule") to replace existing 12 C.F.R. § 360.6, as amended by the Interim Rule adopted on November 12, 2009 (the "Interim Rule"), and the Final Rule adopted on March 11, 2010 (as so amended, the "Transition Rule") for securitizations and participations issued after September 30, 2010.

For securitizations and participations issued on or before December 31, 2010, the Rule will continue the safe harbor provided by the Transition Rule. Assets transferred as part of a participation or securitization transaction on or before December 31, 2010 would not be reclaimed or recharacterized by the FDIC if they comply with the Transition Rule. The Rule also sets forth the conditions for applicability of safe harbor protection to securitizations or participations issued after December 31, 2010 as well as to securitization obligations arising under revolving trusts, master trusts and open commitments existing on the date of adoption of the Rule. Under this safe harbor, transfers of financial assets that are treated as sales under new accounting standards and

satisfy the safe harbor conditions would not be reclaimed or recharacterized by the FDIC in a conservatorship or receivership. A different, but equivalent safe harbor is provided for securitizations and participations that do not qualify for sale treatment. Under the Rule, transfers that do not qualify for sale treatment, but that comply with the conditions, are treated as secured transactions and investors will receive expedited access to the assets. The conditions for eligibility of the safe harbor relate to disclosure, transaction structures, documentation, risk retention and, for securitizations that include residential mortgage loans ("RMBS"), compensation, origination, servicing and sponsor reserves.

The Rule is needed to address the treatment by the FDIC of securitizations and participations 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.

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 insured depository institution (an "IDI") with respect to transfers of financial assets by an IDI in connection with a securitization or participation when it adopted 12 C.F.R. §360.6 (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 applied to an institution for which the FDIC may be appointed as conservator or receiver. If the transfer satisfied this condition, the Securitization Rule confirmed that the transferred assets were "legally isolated" from the IDI in an FDIC conservatorship or receivership. Since its adoption, the Securitization Rule has been relied on by securitization participants 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.

The implementation of new accounting rules has created uncertainty for securitization participants. On June 12, 2009, the Financial Accounting Standards Board ("FASB") 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,* and Statement of Financial Accounting Standards No. 167, *Amendments to FASB Interpretation No. 46(R)* (the "2009 GAAP Modifications"). The 2009 GAAP Modifications are effective for annual financial statement reporting periods beginning 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, 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 onto their balance sheets for financial reporting purposes. Similarly, the 2009 GAAP Modifications affect the way participations are treated on the issuing entity's balance sheet, 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 provisions of the existing Securitization Rule do not apply to these transfers.

Irrespective of whether a securitization qualifies for sale treatment, it is likely that it would qualify for treatment as a secured financing. However, Section 11(e)(13)(C) of the FDI Act, which was enacted by Congress in 2005, requires the consent of the conservator or receiver of an IDI for 45 or 90 days, respectively, before any action can be taken by a secured creditor against collateral pledged by the IDI. Thus, 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. During that time, interest and principal on the securitized debt could remain unpaid. Staff has been advised that this 90-day delay could impair the ratings or other credit evaluations provided on existing and future securitizations.

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. Credit rating agencies expressed concern that in the absence of clarification by the FDIC, an IDI securitization

might need to be linked to the IDI's credit rating. The Rule addresses theses issues in its provisions on the remedies and damages payable in the event of repudiation by a receiver or conservator.

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)(12) of the FDI Act,[1] 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, the Rule clarifies that if the FDIC repudiates the agreements, the FDIC will pay damages in an amount equal to the par value of the outstanding obligations plus unpaid, accrued interest through the date of repudiation to the extent actually received through payments on the financial assets received through the date of repudiation, and thereby discharge the lien on the securitization assets. Moreover, prior to any repudiation or, in the case of a monetary default, prior to the effectiveness of the FDIC's consent to the exercise of contractual remedies following the FDIC receiving notice of such monetary default, the FDIC as conservator or receiver would consent to the making of, or if serving as servicer, would continue to make, required payments of principal and collected interest and other amounts due on the securitized obligations during the statutory stay period. This clarification in paragraphs (d)(4) and (e) of the Rule addresses questions that have been raised about the scope of the stay codified in Section 11(e)(13)(C).

[1] 12 U.S.C. § 1821(e)(12).

To ensure that IDIs are sponsoring securitizations in a responsible and sustainable manner, the Rule imposes certain requirements on securitizations for which transfers of financial assets are made after December 31, 2010 (except in the case of securitizations from certain master or revolving trusts or open commitments), 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 the Rule 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 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.

At its December 15, 2009 meeting, the Board adopted an Advance Notice of Proposed Rulemaking (the "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. The FDIC considered the comments received in response to the ANPR and, at its May 11, 2010 meeting, the board adopted a Notice of Proposed Rulemaking (the "NPR") that sought public comment on proposed text (the "Proposed Rule") for such amendments and the requirements for application of the safe harbor.

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 the 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 Rule 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 as 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 Rule.

In order for loan participations to continue to satisfy the conditions imposed by GAAP for sale treatment, the Rule 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. The Rule also provides a safe harbor for transfers in connection with last-in first-out participations, regardless of whether the transfers meet such conditions.

Because the Rule applies only to securitizations and participations issued by IDIs, the Rule does not apply to certain government sponsored enterprises or any entity established or guaranteed by those GSEs. In addition, the Rule is not intended to apply to the Government National Mortgage Association (Ginnie Mae) or Ginnie Mae-guaranteed securitizations. When Ginnie Mae guarantees a security, the mortgages backing the security are assigned to Ginnie Mae, an entity owned entirely by the United States government. Ginnie Mae's statute contains broad authority to enforce its contract with the lender/issuer and its ownership rights in the mortgages backing Ginnie Mae-guaranteed securities.

II. Comments Received on the NPR

The FDIC received twenty-three comments from industry groups, issuers, investors and other interested parties. Twelve comments were received from trade associations. Three comments were received from banks. Three comments were received from rating agencies. An institutional investor, issuer and other interested parties provided the remaining five comments.

Several entities commented specifically on the need for greater disclosure, and the comments included support for the requirement of loan level data for residential mortgage loans. In addition, support was expressed for risk retention; however, there were differing views as to the level of required risk retention.

A number of commenters had objections to the Proposed Rule. Objections fell mainly into the following categories: (1) with the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the FDIC should only adopt conditions jointly with the other federal regulators; (2) certain criteria were deemed to be too qualitative in

nature; (3) certain conditions were viewed as potentially increasing costs to IDIs; and (4) the remedies available under the safe harbor and legal isolation were perceived as lacking clarity.

Joint action by the agencies. The FDIC undertook to revise its safe harbor in light of accounting changes that came into effect for reporting periods after November 15, 2009. At that point in time, the outcome of financial regulatory reform proposals was unclear. Staff did not recommend delay because the accounting and legal bases for the pre-existing safe harbor did not apply after November 2009. Given the changed facts, industry urged the FDIC to evaluate the safe harbor and provide guidance in light of the 2009 GAAP Modifications.

Beginning in the fall of 2009, FDIC staff discussed differing approaches to the safe harbor regulation with the staff of all relevant federal financial regulators and the Department of Treasury. Accordingly, earlier this year the Securities and Exchange Commission proposed new regulations to govern required disclosures for shelf registrations and private placements that were fully consistent with the additional transparency requirements contained in the FDIC's proposed rule. As a result, the FDIC's final rule and the SEC's proposed regulations are fully consistent.

Nothing in the proposed final rule is inconsistent with Dodd-Frank. The provisions of Dodd-Frank substantively address only the risk retention requirements and, pending further regulatory action, require five percent risk retention. This is fully consistent with the FDIC's final rule as well.

Section 941 of Dodd-Frank requires the federal banking agencies, including the FDIC, and the SEC to jointly prescribe regulations to require any securitizer to retain an

economic interest in a portion of the credit risk for any assets involved in a securitization. Dodd-Frank also requires regulations addressing retention of credit risk for residential mortgages, and requires the agencies to define "qualified residential mortgages" which are exempt from risk retention. Section 941 authorizes the rulemaking agencies to consider whether additional exemptions, exceptions, or adjustments are appropriate. The regulations covering securitizations involving residential mortgages must be jointly issued by the foregoing agencies along with the Secretary of the Department of Housing and Urban Development and the Federal Housing Finance Agency. These regulations must be adopted within 270 days of enactment of the Dodd-Frank legislation. In order to assure consistency between the Rule and these required interagency regulations, the Rule provides that upon the effective date of final regulations required by Section 941(b), such final regulations shall exclusively govern the requirement to retain an economic interest in a portion of the credit risk of the financial assets under the Rule.

An important consideration is that different regulatory agencies have different regulatory jurisdiction. The FDIC has regulatory jurisdiction over the rules applied in the resolution of failed insured depository institutions, as the SEC has jurisdiction over disclosure requirements under the securities laws. In exercising their different responsibilities, the agencies may have to adopt rules addressing the same issues within their regulatory mandate. In those cases, those rules should be harmonized except where differences are appropriate to accomplish their different regulatory missions. The FDIC's safe harbor rule sets the conditions that define how the FDIC will apply its receivership powers and, thereby, what types of transactions will be entitled to the safe harbor protecting them from application of certain of those powers. This was precisely what the

FDIC did in 2000 when it adopted the original version of Section 360.6. The interagency risk retention rule required by Dodd-Frank will not address all of the issues relevant to the application of those receivership rules or to the availability of the safe harbor. In exercising its regulatory jurisdiction, the FDIC's rule addresses risk retention as well as the other components of the safe harbor whereas the interagency rule will solely address risk retention. As noted above, the proposed Rule now provides that upon the effective date of final regulations required by Section 941(b), such final regulations shall exclusively govern the requirement to retain an economic interest in a portion of the credit risk of the financial assets under the Rule.

Certain criteria were too qualitative in nature. A number of commenters noted that reliance on qualitative criteria or requirements for continuing actions, such as ongoing disclosures, would make it more difficult to de-link the rating of a securitization from that of the sponsor. It is a debatable proposition that rating agencies cannot evaluate qualitative information when they must rely on changing, qualitative information in any ongoing surveillance of a rating. Nonetheless, the Rule reflects revisions from the text of the Proposed Rule and ties disclosures and many other requirements solely to the contractual terms of the securitization documents. This will permit a clearer assessment of whether a transaction meets the conditions in the Rule. Certain other conditions included in the Proposed Rule that were asserted to be vague were also modified to clarify terminology and respond to the concerns expressed in comments.

Conditions potentially increase costs for IDIs. Comments received 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 assertions that the conditions would impose additional costs on IDIs and competitively disadvantage IDIs in relation to non-regulated securitization sponsors.

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 lending by banks and reduce the risks to the DIF 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.

Remedies available under the safe harbor and legal isolation. A number of commenters were concerned that damages payable for repudiation of securitization transfer agreements would not include payment of interest to the date of repudiation. The Rule has been revised to specifically include in the calculation of repudiation damages accrued interest through the date of repudiation, to the extent received through payments on financial assets through the date of repudiation.

Some commenters also objected to the safe harbor's reliance on the accounting treatment of the transfers of financial assets being securitized and were critical of the Rule's treatment of financial assets that did not obtain off balance sheet accounting treatment as property of an insolvent IDI. 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.

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 Securitization Rule. Moreover, it is appropriate for the FDIC to rely on the books and records of a failed IDI in administering a conservatorship or receivership and consider how to apply a safe harbor for assets that are deemed part of the IDI's balance sheet under GAAP.

Objections to the 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 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 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 financial assets if they meet the conditions specified in the Rule.

III. The New Rule

The proposed new rule would replace the Securitization Rule as amended by the Transition Rule with the Rule. Paragraph (a) of the Rule sets forth definitions of terms used in the Rule. 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. Pursuant to these definitions, the safe harbor does not extend to securitizations issued by Fannie Mae or its affiliates, Freddie Mac or its affiliates, Ginnie Mae or any federal or state sponsored mortgage finance agency (each of the foregoing, a "Specified GSE") or by any entity established or guaranteed by a Specified GSE.

Paragraph (b) of the Rule 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 and by requiring retention of a share of the credit risk in the securitized loans. The requirements applicable to RMBS are more detailed and include additional capital structure, disclosure, documentation and compensation standards as well as a requirement for a one-year reserve fund.

These standards address the problems 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) in the Rule and the FDIC's consent to self-help remedies are conditioned on securitizations meeting the standards set forth in paragraphs (b) and (c) of the Rule.

Capital Structure and Financial Assets

Staff recommends that the benefits of the Rule 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, the documents governing the securitization will be required to provide that there be financial asset level disclosures as appropriate to the financial assets securitized for any re-securitizations (securitizations supported by other securitization obligations). Securitizations that are unfunded or synthetic securitizations (i.e. not based on originated financial assets) are not eligible for expedited consent under the Rule. To support sound lending, the documents creating a securitization must require that payments of principal and interest on the obligations be primarily dependent on the performance of the financial assets supporting the securitization and that such payments 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, the Rule limits the capital structure of the securitization to six tranches or less and, subject to limited exceptions, 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 be enhanced by credit support or guaranties provided by Specified GSEs and to use liquidity facilities to cover the temporary payment of principal and interest. 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 apply both at the initial issuance of obligations and with respect to periodic and, at a minimum, quarterly, 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, the securitization documents require that disclosure comply with the provisions of Regulation AB promulgated by the SEC or any successor disclosure regulation, whether or not a securitization is sold in a public issuance. The disclosures required under the Rule parallel New Regulation AB requirements but apply to all securitizations, including traditional private placements.

The Rule requires that the documents governing all securitizations require that the issuing entity, sponsor or servicer provide information about the obligations and securitized financial assets at the financial asset or pool level, as appropriate for the financial assets, and at the 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. It is contemplated that 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.

The Rule also requires that the securitization documents require that the structure of the securitization, including the relevant capital or tranche structure, be disclosed. 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.

The governing documents must also require that initial disclosures to investors include the nature and amount of compensation paid to the originator, sponsor, rating agency or third-party advisor, any mortgage or other broker and the servicer(s), 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 Rule also requires that for RMBS the securitization documents require servicers to disclose any ownership interest by the servicer or its affiliates in other whole loans secured by real property that secures a loan that is included in the asset pool. This disclosure does not apply to ownership of a securitization obligation, but only to whole loans in which the servicer or its affiliates have 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 requires

disclosure of all servicer interests and enhanced disclosures with respect to affiliated entities and originators of more than 10 per cent of the pool assets.

The Rule requires that the RMBS sponsors affirm compliance in all material respects with applicable statutory and regulatory standards for origination of mortgage loans, including underwriting at the fully indexed rate relying on documented income; and compliance with supervisory guidance governing the underwriting of residential mortgages. 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 are required to define the contractual rights and responsibilities of the parties, including but not limited to representations and warranties and any measures to avoid conflicts of interest. The documents are also required to provide authority for the parties to fulfill their 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 for RMBS must require the servicer to act for the benefit of all investors rather than any particular class of investors, and require that the servicer 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 not require a servicer to make advances to

cover delinquent payments by borrowers for more than three payment periods, unless financing or reimbursement facilities are available.

Compensation

An area of concern is the incentives created by the "originate to sell" model for residential mortgages 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 Rule seeks to realign compensation to credit rating agencies and similar third-party evaluation companies and servicers to provide incentives for sustainable credit and the long-term performance of the mortgage loans and securitizations.

The Rule requires that the securitization documents provide that 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 be 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, the securitization documents must provide that compensation to servicers in RMBS transactions must provide incentives for servicing, including payment for loan restructuring and loss mitigation actions, 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 Rule requires that the securitization documents require that the sponsor 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 sold, pledged or hedged during the life of the transaction, except for the hedging of interest rate or currency risk. The retention requirement is consistent with New Regulation AB requirement for eligibility for shelf registrations, but applies to all IDI issuers whether or not registered.

For RMBS, the documents must require the sponsor 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 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, the securitization documents shall include a representation that the assets in an RMBS shall have been originated in all material respects in compliance with statutory and regulatory standards in effect at the time of origination and that the mortgages were underwritten at the fully indexed rate and rely on documented income

and comply with all existing supervisory guidance governing the underwriting of residential mortgages.

Other Requirements

The Rule also includes in paragraph (c) general requirements for the transaction and the transfer of financial assets, including that the transaction should be an arms-length, bona fide securitization transaction as well as setting forth required provisions for the securitization documents, including that the documents require that the obligations issued in the securitization not be predominantly sold to an affiliate (other than a wholly-owned subsidiary consolidated for accounting and capital purposes with the sponsor) or insider of the sponsor; that the sponsor separately identify the financial assets in its financial asset data bases; and that, to the extent that the sponsor serves as servicer, custodian or paying agent for the securitization, amounts received with respect to the financial assets not be comingled with other assets, except for the time necessary to clear any payments, but not longer than two business days. In order to facilitate the timely fulfillment of the receiver's responsibilities upon appointment and 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, this Section also requires the documents to require that the sponsor keep copies of the securitization documents..

The Safe Harbor

Paragraph (d)(1) of the Rule 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, as well as for last-in first-out participations which do not qualify for such accounting treatment.

Paragraph (d)(2) of the Rule continues the safe harbor provision that was provided by the Transition Rule for:

(i) participations or securitizations for which transfers of financial assets were made on or before December 31, 2010;

(ii) obligations of revolving trusts or master trusts for which one or more obligations were issued on or before the date of adoption of the Rule; and

(iii) obligations issued under an open commitment, up to the maximum amount of the commitment as of the date of adoption of the Rule if one or more obligations were issued under such commitment on or before December 31, 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.

Paragraph (d)(3) provides a safe harbor confirming that the FDIC will not seek to reclaim the financial assets from the following securitizations, provided that they comply

with the requirements in paragraphs (b) and (c) of the Rule, and satisfy the new FASB requirements for sale accounting treatment under GAAP:

(i) securitizations for which transfers of financial assets were made after December 31, 2010;

(ii) securitizations from a master trust or revolving trust established after adoption of the Rule; and

(iii) securitizations from an open commitment that does not meet the requirements of paragraph (d)(2) of the Rule.

Paragraph (d)(4) provides a separate safe harbor for the following securitizations if they do not meet the new FASB requirements for sale accounting treatment under GAAP, but comply with the requirements in paragraphs (b) and (c) of the Rule:

(i) securitizations for which transfers of financial assets were made after December 31, 2010;

(ii) securitizations from a master trust or revolving trust established after adoption of the Rule; and

(iii) securitizations from an open commitment that does not meet the requirements of paragraph (d)(2) or (d)(3) of the Rule.

This 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 12 U.S.C. 1821(e)(13)(C). 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. Paragraph (d)(4)(i) provides that in the event the FDIC is in monetary default under a

securitization due to its failure to pay or apply collections from the financial assets received by it in accordance with 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 12 U.S.C 1821(e)(13)(C) and 12 U.S.C. 1825(b)(2) to the exercise of contractual rights under the documents on account of such monetary default, and such consent shall constitute satisfaction in full of obligations of the IDI and the FDIC as conservator or receiver to the holders of the securitization obligations for all amounts due.

Paragraph (d)(4)(ii) 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 securitization obligations on the date of the appointment of the FDIC as conservator or receiver, less any principal payments made through the date of repudiation, plus unpaid, accrued interest through the date of repudiation in accordance with the securitization documents to the extent actually received through payments on the financial assets received through 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 12 U.S.C. 1821(e)(13)(C) and 1825(b)(2) to the exercise of contractual rights under the documents.

In both of these situations, the 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, provided no involvement of the receiver or conservator is required other than

such consents, waivers or execution of transfer documents as may be reasonably requested in the ordinary course of business in order to facilitate the exercise of such contractual rights.

For securitizations that satisfy the requirements of paragraphs (b) and (c) of the Rule, paragraph (e) provides FDIC consent to servicing of the financial assets and payments to the investors in accordance with the securitization documents.

STAFF CONTACTS:
Michael H. Krimminger
Deputy to the Chairman for Policy
Office of the Chairman
202-898-8950

George Alexander, Manager
Capital Markets & Resolutions
202-898-3718

R. Penfield Starke
Senior Counsel
Receivership Policy Unit
703-562-2422