MEMORANDUM TO: The Board of Directors

FROM: Mitchell L. Glassman
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DATE: February 26, 2010

SUBJECT: Final Rule Amending 12 C.F.R. § 360.6 Defining Transitional Safe Harbor Protection for Treatment By The FDIC As Conservator Or Receiver Of Financial Assets Transferred By An Insured Depository Institution In Connection With A Securitization

RECOMMENDATION

Staff recommends that the Board of Directors ("Board") adopt a Final Rule, effective immediately, to amend 12 C.F.R. § 360.6 to provide a transitional safe harbor for existing securitization and participation transactions potentially affected by changes to Generally Accepted Accounting Principles (GAAP). This transitional safe harbor will ensure that transactions that complied with Section 360.6 as currently in effect and any additional transactions in process through the transition date of September 30, 2010 will be permanently grandfathered under the pre-existing Section 360.6 and not lose the "legal isolation" protections under Section 360.6 due to the changes in accounting treatment. Section 360.6 currently provides a "safe harbor" that the FDIC as receiver will not, in the exercise of its statutory authority to repudiate contracts, reclaim or recover assets transferred by an insured depository institution for the purpose of securitization provided that the transfer would be accounted for as a sale under accounting rules that were in effect when Section 360.6 was first adopted.

The Final Rule is needed in the near term to forestall substantial downgrades in the ratings provided on existing securitizations and to enable planned securitizations for multiple asset classes that will be brought to market after the expiration of the March 31, 2010 safe harbor adopted by the Board on November 12, 2009.

EXECUTIVE SUMMARY

In 2000, the FDIC adopted a regulation, which was codified at 12 C.F.R. § 360.6 (the "Securitization Rule"). The Securitization Rule provided comfort that the FDIC, as conservator or receiver, would not try to 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 even in a conservatorship or receivership.

In June 2009, the Financial Accounting Standards Board ("FASB") announced changes to GAAP that would prevent most securitizations from being treated as off-balance sheet sales for accounting purposes. As a result, most securitizations will not meet the conditions for sale accounting treatment under GAAP and will be consolidated onto IDIs' balance sheets. Those changes became effective for reporting periods commencing after November 15, 2009, and will normally apply to new securitizations as well as those created before that date. Consequently, since the Securitization Rule depends on sale accounting treatment, the "safe harbor" it provided will no longer apply to the transfer into a securitization. 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.

As a result of the changes by FASB, most securitizations will not be treated as sales for accounting purposes. Given this likely accounting treatment, securitizations alternatively could be considered to be a form of secured borrowing. 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 given sale accounting treatment under the changes to GAAP, but is treated as a secured borrowing, Section 11(e)(13)(C) could prevent the security holders from recovering monies due to them by up to 90 days. We have 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.

Because the modifications to GAAP will require that financial assets transferred in connection with previously issued securitizations be consolidated on the books of the sponsor IDI and will apply to determine all sale transactions for annual reporting periods commencing on or after November 15, 2009, securitization practitioners 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. In response to industry concerns, the FDIC issued an Interim Final Rule in November 2009 that addressed securitizations (and participations) issued before March 31, 2010. After receiving public comments on the Interim Final Rule, which are summarized below, staff recommends

that the Board adopt a Final Rule to be effective immediately, which will extend the transitional safe harbor for securitizations and participations that previously met the conditions of 12 C.F.R. 360.6 until September 30, 2010. The extension of the safe harbor until September 30, 2010 via a final rule is appropriate under the "logical outgrowth" test as devised by the courts to determine whether a final rule is a logical development of the proposal and comments.[1]

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 will 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 or in the form of a participation, provided that such transfer meets 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

[1] *See NRDC v. Thomas*, 838 F.2d 1224, 1242 (D.C. Cir. 1988); *Nat'l Mining Ass'n v. MSHA*, 116 F.3d 520, 531 (D.C. Cir. 1997).

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 asset 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 ("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* ("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 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 will not apply to the transfers.

Staff believes that the concerns raised by 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 by providing a transitional safe harbor for securitizations and participations issued prior to September 30, 2010. Such securitizations and participations will receive protection under the safe harbor if they would have qualified for safe harbor treatment under Section 360.6, but for the changes to the GAAP Modifications preventing the transfers from receiving legal isolation treatment.

II. The Interim Final Rule

The Interim Rule amended the Securitization Rule by renumbering existing paragraph (b) as clause (b)(1) of paragraph (b). The Interim Rule inserted a new clause (b)(2) of the Securitization Rule that addresses any securitization (i) for which transfers of financial assets were made or (ii), for revolving trusts, for which beneficial interests were issued on or before March 31, 2010. The interim rule provided that, for these securitizations, the FDIC as conservator or receiver shall not, in the exercise of its statutory authority to disaffirm or repudiate contracts, reclaim, recover, or recharacterize as property of the institution or the receivership any such transferred financial assets notwithstanding that such transfer does not satisfy all conditions for sale accounting treatment under generally accepted accounting principles as effective for reporting

periods after November 15, 2009, if such transfer satisfied the conditions for sale accounting treatment set forth by generally accepted accounting principles in effect for reporting periods before November 15, 2009, except for the "legal isolation" condition that is addressed by the rule.

III. Summary of Comments Received

The FDIC requested comments on all aspects of the Interim Final Rule. The FDIC specifically requested that commenters respond to the following:

1. Do the changes to the accounting rules affect the application of the Securitization Rule to participations? If so, are there changes to the Interim Rule that are needed to protect different types of participations issued by IDIs more broadly?
2. Does the Interim Rule adequately encompass all transactions that should be included within its transitional safe harbor?
3. Is the transition period to March 31, 2010 sufficient to implement changes required by the Proposed Rule and to structure transactions to comply with the new generally accepted accounting principles?

In response to the request, the FDIC received two (2) comments from industry associations. A summary of the comments received follows.

The American Bankers Association (ABA) and the American Bankers Association Securities Association (ABASA) provided a joint comment letter to the FDIC and one other comment letter was received from the American Securitization Forum (ASF). Both comment letters stressed that loan securitization and participations

are important mechanisms that facilitate financial intermediation and the provision of credit and therefore, market participants need to have certainty regarding the treatment of these transactions in a conservatorship or receivership of the issuer.

In specific reference to the first question posed in the interim rule, the ABA/ABASA commented that FAS 166 would prospectively affect the application of the Securitization Rule to participations. Therefore, it is important that the FDIC include participations in the protections afforded by the Interim rule. In addition, the ABA/ABASA suggested that the accounting treatment of a participation should not control its treatment by the FDIC in a receivership or conservatorship of the originating lender.

In response to question #2, the ABA/ABASA responded that it is possible that the changes to GAAP might impact other types of variable interest entities and other entities, such as pooled funds and joint ventures. Participations or securities held by these entities may be consolidated and recorded on bank balance sheets under certain circumstances and therefore, such entities should also be protected under the final rule.

In response to question #3, both the ABA/ABASA and ASF commented that the permanent grandfathering of securitization and participation issuances in process through March 31, 2010 does not provide an adequate period of time for issuers to adapt to new regulatory requirements relating to the securitization process, particularly if changes to the terms of the transactions are necessary. The ASF suggested that the grandfathering period be extended for another 12-18 months after March 31, 2010.

In light of the comments received, staff recommends extending the safe harbor until September 30, 2010, so long as those securitizations and participations issued would have complied with the preexisting section 360.6 under generally accepted accounting principles in effect prior to November 15, 2009.

III. The Final Rule – Amendment to Section 360.6

The Final Rule amends the current Section 360.6 by inserting a new clause (b)(2) that addresses any securitization (i) for which transfers of financial assets were made or (ii), for revolving trusts, for which securitization notes were issued on or before September 30, 2010. The Rule will continue the safe harbor provision of Section 360.6(b) for financial assets transferred in connection with a securitization or participation issued on or before September 30, 2010, if such securitization or participation complied with the conditions for sale accounting treatment at the time of issuance. In addition the Rule will continue the safe harbor provision of securitization if such securitizations would have complied with Section 360.6 under GAAP in effect prior to November 15, 2009, notwithstanding the fact that the transfer of financial assets may not satisfy all conditions for sale accounting treatment under GAAP as effective for reporting periods after November 15, 2009.

Staff recommends that this transition period is appropriate to permit the market to continue operations until further regulatory and legislative measures are implemented for transactions entered into after September 30, 2010. Based upon feedback from market participants, the failure to provide a transition safe harbor will result in ratings downgrades of most, if not all, current securitizations and will preclude favorable ratings

for currently in process securitizations, including those under the Federal Reserve's Term Asset-Backed Securities Loan Facility.

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