

July 11, 2019

**TO:** Board of Directors

**FROM:** Maureen E. Sweeney  
Director  
Division of Resolutions and Receiverships

Nicholas J. Podsiadly  
General Counsel  
Legal Division

**SUBJECT:** Proposed Rule to Revise Securitization Safe Harbor Rule

### **RECOMMENDATION**

Staff recommends that the Board approve a notice of proposed rulemaking (the “NPR”) to revise 12 C.F.R. Section 360.6, “Treatment of financial assets transferred in connection with a securitization or participation” (the “Rule”), in order to remove a requirement for safe harbor treatment that the documents governing a securitization issuance require compliance with Regulation AB of the Securities and Exchange Commission (“SEC”), 17 CFR 229.1100 *et. seq.*, as in effect from time to time (“Regulation AB”), in circumstances where Regulation AB is not, by its terms, applicable to that transaction. Under current law, Regulation AB imposes significant disclosure obligations in connection with an issuance of obligations in a securitization, but Regulation AB is not applicable to private placement transactions.

### **DISCUSSION**

#### **I. Background**

The Rule was originally adopted in 2000 and, as then adopted, provided that the FDIC as conservator or receiver would not use its authority to 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 in the form of a participation, provided that such transfer met all conditions for sale accounting treatment under generally accepted accounting principles (“GAAP”). In June 2009, the Financial Accounting Standards Board modified GAAP as it applied to securitization transactions. These changes caused market participants to be concerned that some IDIs would be required to consolidate securitized assets on their balance sheets for financial accounting purposes. In view of these changes, the FDIC amended and restated the safe harbor in its entirety by adopting the Rule in September 2010.

The Rule provides with respect to certain transfers of financial assets in connection with a securitization transaction 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 conditions and the requirements of the Rule are met. For other transactions that comply with its requirements, the Rule provides for the exercise of certain remedies on an expedited basis. For securitization transactions that are not grandfathered by the Rule, numerous conditions must be satisfied in order for a transaction to qualify for the benefits of the Rule. In adopting the Rule, the FDIC explained that “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. . . . To ensure that IDIs are sponsoring securitizations in a responsible and sustainable manner, the Rule imposes certain conditions on securitizations that are not grandfathered. . . .”<sup>1</sup>

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<sup>1</sup> 75 *Fed. Reg.* 60287 (September 30, 2010) at 60289-60290.

The requirements of the Rule that were added in 2010 include several disclosure requirements, one of which, in paragraph (b)(2)(i)(A), requires that the documents governing a securitization must require disclosure of information as to the securitized financial assets on a financial asset or pool level and on a security level that, at minimum, complies with Regulation AB, even if the obligations are issued in a private placement or are otherwise not required to be registered.

The SEC first adopted Regulation AB in 2004 as a new, principles-based set of disclosure items specifically tailored to asset-backed securities. The regulation was intended to form the basis of disclosure for both Securities Act registration statements and Exchange Act reports relating to asset-backed securities. In April 2010, the SEC proposed significant revisions to Regulation AB and other rules regarding the offering process, disclosure and reporting for asset-backed securities. Among such revisions were the adoption of specified asset-level disclosures for particular asset classes and the extension of the Regulation AB disclosure requirements to exempt offerings and exempt resale transactions for asset backed securities. As adopted in 2014, Regulation AB retained the majority of the proposed asset-specific disclosure requirements but declined to require issuers to provide the same disclosure for exempt offerings as is required for registered offerings. The disclosure requirements of Regulation AB vary, depending on the type of securitization issuance. The most extensive disclosure requirements relate to residential mortgage securitizations. These requirements became effective in November, 2016.

FDIC staff has been told that potential IDI sponsors of residential mortgage securitizations have found that it is difficult to provide certain information required by

Regulation AB, either because the information is not readily available to them or because there is uncertainty as to the information requested to be disclosed and, thus, uncertainty as to whether the disclosure would be deemed accurate. FDIC staff was also advised that due to the provision of paragraph (b)(2)(i)(A) that requires that securitization documents mandate compliance with Regulation AB in private transactions, private offerings of residential mortgage securitization obligations that are compliant with the Rule are similarly challenging for sponsors, and that the net effect has been to discourage IDIs from participating in the securitization of residential mortgages, apart from selling the mortgages to, or with a guarantee from, the government-sponsored housing enterprises.

## **II. Discussion**

When it adopted the Rule, the FDIC stated that the Rule was designed to provide greater clarity and transparency to allow for better ongoing evaluation of the quality of lending by banks and to reduce the risks to the DIF from opaque securitization structures and poorly underwritten loans that led to onset of the financial crisis. While the requirement of the Rule that the documents governing a private securitization require compliance with the disclosure requirements of Regulation AB differs from the requirements of Regulation AB as adopted by the SEC in 2014, the requirement was consistent with the SEC proposal to amend Regulation AB which was pending when the FDIC adopted the Rule. Under that proposal, investors in “structured finance products” (which term included private placements of securitization transactions) would have been entitled to request and receive the information that would be required by Regulation AB in a public transaction. Subsequently, the SEC finalized Regulation AB to apply only to public issuances.

FDIC staff is now proposing (the “proposed rule”) to modify the Rule such that the disclosure requirements in paragraph (b)(2)(i)(A) are consistent with Regulation AB and require disclosure only when required by Regulation AB, for several reasons. First, the need for the requirement that private transactions include Regulation AB disclosures has significantly diminished. The preamble to the Rule made clear that while the disclosure requirement applied to all securitizations, the FDIC was focused mostly on residential mortgage securitizations, and noted that “[t]he 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.”<sup>2</sup> FDIC staff believes that other regulatory developments since 2010 address the issues that underlay this concern in 2010 and, as a result, continuing to require Regulation AB disclosure in these transactions would no longer be a significant contributor to underwriting standards.

In addition, several other specific requirements in paragraph (b)(2) of the Rule address the expressed goals of providing clarity and transparency and reducing the risks from the type of opaque securitization structures that existed in 2010. Paragraph (b)(2)(i)(B) mandates that the documents governing the securitization require disclosure of numerous matters, including (among others), the capital or tranche structure of the securitization, priority of payments and subordination features, and representations and warranties made with respect to the financial assets. Paragraph (b)(2) also requires that the documents require that the issuer provide information as to the credit performance of the securities and the underlying financial assets, substitutions and removal of financial assets, servicer advances and losses allocated tranches. The documents must also disclose the nature and amount of compensation paid to originators,

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<sup>2</sup> *Id.* at 60289.

the sponsor, rating agencies, and certain other parties. In the case of securitizations backed by any residential mortgage, there are requirements for disclosure of certain loan level information, such as loan type, loan structure, maturity and interest rate, as well as disclosure of certain interests by servicers, and a requirement that the sponsors affirm compliance with applicable statutory and regulatory standards for the origination of mortgage loans. These additional requirements are not affected by the proposed rule and would remain in effect if the proposed rule is adopted.

Moreover, other sections of the Rule provide additional protections, including a section that requires that the securitization documents mandate that credit risk retention be effected in accordance with rules adopted by the FDIC and other agencies, and a section that limits the capital structure of residential mortgage securitizations to six credit tranches.

## **CONCLUSION**

It is recommended that the Board of Directors approve the revision to the Rule proposed by staff and authorize publication of the attached Federal Register notice.

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**ATTACHMENTS**

**A – Resolution**

**B – Federal Register Notice**