

**FEDERAL DEPOSIT INSURANCE CORPORATION**  
**12 CFR Part 360**  
**RIN \_\_\_\_\_**

**Advance Notice of Proposed Rulemaking Regarding Treatment by the Federal Deposit Insurance Corporation as Conservator or Receiver of Financial Assets Transferred by an Insured Depository Institution in Connection With a Securitization or Participation After March 31, 2010**

**AGENCY:** Federal Deposit Insurance Corporation (FDIC)

**ACTION:** Advance Notice of Proposed Rulemaking

**SUMMARY:** The Federal Deposit Insurance Corporation (“FDIC”) is issuing this Advance Notice of Proposed Rulemaking to solicit public comment regarding proposed amendments to 12 C.F.R. §360.6 regarding the treatment by the FDIC, as receiver or conservator of an insured depository institution, of financial assets transferred by the institution in connection with a securitization or a participation after March 31, 2010 (the “ANPR”). In November 2009, the FDIC issued an Interim Final Rule amending its regulation codified at 12 C.F.R. section 360.6, Treatment by the Federal Deposit Insurance Corporation as Conservator or Receiver of Financial Assets Transferred by an Insured Depository Institution in Connection With a Securitization or Participation, to provide for safe harbor treatment for participations and securitizations until March 31, 2010 (the “Interim Rule”). The ANPR requests comments on the standards that should be adopted to provide safe harbor treatment in connection with participations and securitizations issued after March 31, 2010.

The ANPR seeks comment for forty-five (45) days on a range of issues that are implicated by proposed standards for a safe harbor for participations and securitizations issued after March 31, 2010. To provide a basis for consideration of the questions and

## Advance Notice of Proposed Rulemaking

the relationship of different conditions for such a safe harbor, the ANPR attaches as an addendum a draft of sample regulatory text that could be considered to set specific standards for such a safe harbor. This draft of regulatory text should be considered one example of regulatory text, and not a proposal. The Board's approval of the ANPR should not be considered as signifying adoption or recommendation of the sample regulatory text, but the text does provide context for response to the questions.

**DATES: Comments on this ANPR** must be received by **[INSERT DATE 45 DAYS AFTER FEDERAL REGISTER PUBLICATION]**.

**ADDRESSES:** You may submit comments on the ANPR, by any of the following methods:

- Agency Web Site: <http://www.FDIC.gov/regulations/laws/federal/notices.html>.  
Follow instructions for submitting comments on the Agency Web Site.
- E-mail: [Comments@FDIC.gov](mailto:Comments@FDIC.gov). Include **RIN #** \_\_\_\_\_ on the subject line of the message.
- Mail: Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance Corporation, 550 17th Street, N.W., Washington, DC 20429.
- Hand Delivery: Comments may be hand delivered to the guard station at the rear of the 550 17<sup>th</sup> Street Building (located on F Street) on business days between 7 a.m. and 5 p.m.

Instructions: All comments received will be posted generally without change to <http://www.fdic.gov/regulations/laws/federal/propose.html>, including any personal information provided.

**FOR FURTHER INFORMATION CONTACT:** Michael Krimminger, Office of the Chairman, 202-898-8950; George Alexander, Division of Resolutions and Receiverships, (202) 898-3718; Robert Storch, Division of Supervision and Consumer Protection, (202) 898-8906; or R. Penfield Starke, Legal Division, (703) 562-2422, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.

**SUPPLEMENTARY INFORMATION:**

**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 (“IDI”) with respect to transfers of financial assets by an IDI in connection with a securitization or participation when it adopted a regulation codified at 12 C.F.R. 360.6 (“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 in the form of a participation, provided that such transfer meets all conditions for sale accounting treatment under generally accepted accounting principles (“GAAP”). The rule was a clarification, rather than a limitation, of the repudiation power because 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 sold off balance sheet by the IDI.

## Advance Notice of Proposed Rulemaking

The Securitization Rule provided a “safe harbor” by confirming “legal isolation” if all other standards for sale accounting treatment, along with some additional conditions focusing on the enforceability of the transaction, were met by the transfer. Satisfaction of “legal isolation” was vital to securitization transactions because of the risk that the pool of financial assets transferred into the securitization trust could be recovered in bankruptcy or in a bank receivership. Generally, 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. The Securitization Rule provided the necessary confirmation of “legal isolation” and has served as a central component of securitization by providing 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. For most IDIs, the 2009 GAAP Modifications will be effective for reporting periods beginning after January 1, 2010. The 2009 GAAP Modifications made changes that affect whether a special

## Advance Notice of Proposed Rulemaking

purpose entity (“SPE”) must be consolidated for financial reporting purposes, thereby subjecting many SPEs to GAAP consolidation requirements. 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.<sup>1</sup> Given the likely accounting treatment, securitizations could be considered to be an alternative form of secured borrowing. As a result, the safe harbor provision of the Securitization Rule may not apply to the transfer.

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 financing. 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 financing, section 11(e)(13)(C) could prevent the security holders from recovering monies due to them by up to 90 days in a receivership. During that time, interest on the securitized debt theoretically could remain unpaid.

The FDIC 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

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<sup>1</sup> Of particular note, Paragraph 26A of FAS 166 introduces a new concept that was not in FAS 140, as follows: "...the transferor must first consider whether the transferee would be consolidated by the transferor. Therefore, if all other provisions of this Statement are met with respect to a particular transfer, and the transferee would be consolidated by the transferor, then the transferred financial assets would not be treated as having been sold in the financial statements being presented."

## Advance Notice of Proposed Rulemaking

credits, from being brought to market. The changes in GAAP may also affect the ratings of securitizations that qualify under the Federal Reserve's Term Asset-Backed Securities Loan Facility.

FAS 166 also affects the treatment of participations issued by an IDI, in that it defines participating interests as pari-passu pro-rata interests in a financial assets, and subjects the sale of a participation interest to the same conditions as the sale of financial assets. FAS 166 provides that transfers of participation interests that do not qualify for sale treatment will be viewed as secured borrowings. While the GAAP modifications have some effect on participations, most participations are likely to continue to meet the conditions for sale accounting treatment under GAAP.

The 2009 GAAP Modifications 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 financial 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. 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 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.

## Advance Notice of Proposed Rulemaking

The FDIC believes that several of the issues of concern for securitization participants regarding the impact of the 2009 GAAP Modifications can be addressed simply by clarifying the position of the conservator or receiver under established law. The ability of the FDIC as conservator or receiver to reach financial assets transferred by an IDI to an issuing entity in connection with a securitization is limited by the statutory provision prohibiting the conservator or receiver from avoiding a legally enforceable or perfected security interest, except where such an interest is taken in contemplation of insolvency or with the intent to hinder, delay, or defraud the institution or the creditors of such institution.<sup>2</sup> Accordingly, in the case of a securitization that satisfies the standards set forth in the ANPR, the conservator or receiver will not, in the exercise of its statutory repudiation power, attempt to reclaim or recover financial assets transferred by an IDI in connection with a securitization if the financial assets are subject to a legally enforceable and perfected security interest under applicable law.

Pursuant to 12 U.S.C. § 1821(e)(13)(C), 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. In order to address concerns that the statutory stay could delay repayment of investors in a securitization or delay a secured party from exercising its rights with respect to securitized financial assets, the FDIC may provide by regulation for the consent by the conservator or receiver, subject to certain conditions, to the continued

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<sup>2</sup> 12 U.S.C. § 1821(e)(11).

## Advance Notice of Proposed Rulemaking

payment of regularly scheduled payments under the securitization documents and continuing servicing of the assets, as well as the ability to exercise self-help remedies ten (10) days after a payment default by the FDIC or the repudiation of a transfer agreement during the stay period of 12 U.S.C. § 1821(e)(13)(C).

*Purposes of the ANPR.* The FDIC, as deposit insurer and receiver for failed insured depository institutions, has a unique responsibility and interest in ensuring that loans and other financial assets, as described in the ANPR, made by insured banks and thrifts 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. However, the FDIC's responsibilities to protect insured depositors and resolve failed insured banks and thrifts, and its fiduciary responsibility to the Deposit Insurance Fund, require it to ensure that, where it provides consent to special relief from the application of its receivership powers, it should do so in a manner that fulfills these responsibilities.

Securitization can be a valuable tool for liquidity for insured banks and thrifts and other financial institutions if it is supported by properly underwritten loans or other financial assets and structured to align incentives among all parties to the transactions for long-term sustainable lending. The FDIC supports sustainable securitization to provide balance sheet liquidity and, where appropriate, off balance sheet transactions that enhance prudent credit availability. Securitization, properly structured, can play an important role in recovery from the financial crisis.

However, 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



## Advance Notice of Proposed Rulemaking

misalignment of incentives in the securitization process for residential mortgages was 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.

Securitizations of other asset classes have not suffered the dramatic declines in issuance experienced by securitizations of newly originated mortgages. While mortgage securitizations have been extremely limited during 2009, and exclusively focused on seasoned mortgages, securitizations of credit card and other consumer loans have continued. However, securitizations of all asset classes are affected by the accounting changes and the changes in the application of the Securitization Rule consequent upon them.

Nonetheless, defects in the incentives provided by securitization through immediate gains on sale for transfers into securitizations 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 asset 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 insured depository institutions and to

## Advance Notice of Proposed Rulemaking

significant losses to the Deposit Insurance Fund. 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 certain conditions on securitizations designed to realign incentives. Additional considerations are present in connection with residential mortgage loan securitizations (“RMBS”) to avoid the devastating effects witnessed in the financial crisis.

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 clarification of the future application of its receivership powers in a way that reduces the risks to the Deposit Insurance Fund by better aligning the incentives in securitization to support sustainable lending and structured finance transactions.

## **II. Request for Comments**

The FDIC has included as Addendum A sample regulatory text to provide context for the responses to the questions posed in the ANPR. We believe that inclusion of the sample text will assist responders by offering a possible approach to integrating the potential conditions into a regulation and by providing context to how different conditions could be related to each other in a complete regulation. This does not imply that the Board has proposed or adopted the sample regulatory text.

An overall consideration is whether any future regulation should apply different conditions to different asset classes. There appears to be a need for greater transparency and clarity in all securitizations, but there is no question that greater difficulties have been demonstrated in residential mortgage-backed securities. With this background, it

## Advance Notice of Proposed Rulemaking

may be appropriate to make the conditions applicable to RMBS more detailed and explicit to address these issues. The sample regulatory text attached as Addendum A takes this approach and may be a useful contextual document for comparing how different standards could be applied.

### **General Questions:**

1. Do the changes to the accounting rules affect the application of the pre-existing Securitization Rule to participations? If so, are there changes to the Securitization Rule that are needed to protect different types of participations issued by IDIs?

2. Is the transition period to March 31, 2010 sufficient to implement the changes required by the conditions identified by Paragraph (b) and (c)? How does this transition period impact existing shelf registrations?

The following sections of this document identify different issues that could be addressed by a final rule, and follow the subdivisions within the sample regulatory text.

### **Capital Structure.**

For all securitizations, the FDIC believes that the benefits of a future safe harbor should only be available to securitizations that are readily understood by the market, increase liquidity of the financial assets and reduce consumer costs. A consideration is that lenders may have greater incentives to originate well underwritten loans and sponsors may have greater incentives to participate in securitizations of such loans if payments of principal and interest on the obligations are primarily dependent on the performance of the financial assets supporting the securitization. In this context, it is

## Advance Notice of Proposed Rulemaking

appropriate to consider whether external credit support, beyond loan-specific guarantees or other credit support, should be allowed.

The FDIC requests comment on the following issues:

3. Should certain capital structures be ineligible for the future safe harbor? For example, should securitizations that include leveraged tranches that introduce market risks (such as leveraged super senior tranches) be ineligible?.
4. For RMBS specifically, in order to limit both the complexity and the leverage of RMBS, and therefore the systemic risk introduced by them in the market, should the the capital structure of the securitization be limited to a specified number of tranches? If so, how many, and why? If no more than six tranches were permitted, what would be the potential consequence?
5. Should there be similar limits to the number of tranches that can be used for other asset classes? What are the benefits and costs of taking this approach?
6. Should re-securitizations (securitizations supported by other securitization obligations) be required to include adequate disclosure of the obligations including the structure and asset quality supporting each of the underlying securitization obligations and not just the obligations that are transferred in the re-securitization?
7. Should securitizations that are unfunded or synthetic securitizations that are not based on assets transferred to the issuing entity or owned by the sponsor be eligible for expedited consent?
8. Should all securitizations be required to have payments of principal and interest on the obligations primarily dependent on the performance of the financial assets supporting the securitization? Should external credit support be prohibited in order to

better realign incentives between underwriting and securitization performance.? Are there types of external credit support that should be allowed? Which and why?

**Disclosures.**

For all securitizations, disclosure serves as an effective tool for increasing the demand for high quality financial assets and thereby establishing incentives for robust financial asset underwriting and origination practices. 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 FDIC requests comment on the following issues:

9. What are the principal benefits of greater transparency for securitizations? What data is most useful to improve transparency? What data is most valuable to enable investors to analyze the credit quality for the specific assets securitized? Does this differ for different asset classes that are being securitized? If so, how?

10. Should disclosures required for private placements or issuances that are not otherwise required to be registered include the types of information and level of specificity required under Securities and Exchange Commission Regulation AB, 17 C.F.R. §§ 229.1100-1123, or any successor disclosure requirements?

11. Should qualifying disclosures also include disclosure of the structure of the securitization and the credit and payment performance of the obligations, including the relevant capital or tranche structure? How much detail should be provided regarding

## Advance Notice of Proposed Rulemaking

the priority of payments, any specific subordination features, as well as any waterfall triggers or priority of payment reversal features?

12. Should the disclosure at issuance also include the representations and warranties made with respect to the financial assets and the remedies for such breach of representations and warranties, including any relevant timeline for cure or repurchase of financial assets.

13. What type of periodic reports should be provided to investors? Should the reports include detailed information at the asset level? At the pool level? At the tranche level? What asset level is most relevant to investors?

14. Should reports include detailed information on the ongoing performance of each tranche, including losses that were allocated to such tranche and remaining balance of financial assets supporting such tranche as well as the percentage coverage for each tranche in relation to the securitization as a whole? How frequently should such reports be provided?

15. Should disclosures include the nature and amount of broker, originator, rating agency or third-party advisory, and sponsor compensation? Should disclosures include any risk of loss on the underlying financial assets is retained by any of them?

16. Should additional detailed disclosures be required for RMBS? For example should property level data or data relevant to any real or personal property securing the mortgage loans (such as rents, occupancy, etc.) be disclosed?

17. For RMBS, should disclosure of detailed information regarding underwriting standards be required? For example, should securitizers be required to confirm that the mortgages in the securitization pool are underwritten at the fully indexed

rate relying on documented income,<sup>3</sup> and comply with 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?

18. What are the primary benefits and costs of potential approaches to these issues?

**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 consistent with industry best practices and ongoing disclosure requirements. It must include appropriate measures to avoid conflicts of interest. The contractual rights and responsibilities of each party to the transactions must provide each party with sufficient authority and discretion for such party to fulfill its respective duties under the securitization contracts.

Additional requirements could be applied to RMBS to address a significant issue that has been demonstrated in the mortgage crisis by improving the authority of servicers to mitigate losses on mortgage loans consistent with maximizing the net present value of

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<sup>3</sup> Institutions should verify and document the borrower's income (both source and amount), assets and liabilities. For the majority of borrowers, institutions should be able to readily document income using recent W-2 statements, pay stubs, and/or tax returns. Stated income and reduced documentation loans should be accepted only if there are mitigating factors that clearly minimize the need for direct verification of repayment capacity. Reliance on such factors also should be documented. Mitigating factors might include situations where a borrower has substantial liquid reserves or assets that demonstrate repayment capacity and can be verified and documented by the lender. A higher interest rate is not considered an acceptable mitigating factor.

## Advance Notice of Proposed Rulemaking

the mortgages, as defined by a standardized net present value analysis. In addition, there has been considerable criticism of securitizations that give control of servicing discretion to a particular class of investors. Many have urged that future securitizations require that the servicer act for the benefit of all investors rather than maximizing the value of to any particular class of investors. There have also been concerns expressed that a prolonged period of servicer advances in a market downturn misaligns servicer incentives with those of the RMBS investors. Servicing advances also serve to aggravate liquidity concerns, exposing the market to greater systemic risk. These and other issues related to the contractual provisions, and allocations of responsibilities in securitizations, may create significant risks, and in some cases rewards, for different parties to securitizations.

The FDIC requests comment on the following issues:

19. With respect to RMBS, a significant issue that has been demonstrated in the mortgage crisis is the authority of servicers to mitigate losses on mortgage loans consistent with maximizing the net present value of the mortgages, as defined by a standardized net present value analysis. For RMBS, should contractual provisions in the servicing agreement provide for the authority to modify loans to address reasonably foreseeable defaults and to take such other action as necessary or required to maximize the value and minimize losses on the securitized financial assets?

20. Loss mitigation has been a significant cause of friction between servicers, investors and other parties to securitizations. Should particular contractual provisions be required? Should the documents allow allocation of control of servicing discretion to a particular class of investors? Should the documents require that the servicer act for the



## Advance Notice of Proposed Rulemaking

benefit of all investors rather than maximizing the value of to any particular class of investors?

21. In mitigating losses, should a servicer specifically be required to commence action to mitigate losses no later than a specified period, e.g., ninety (90) days after an asset first becomes delinquent unless all delinquencies on such asset have been cured?

22. To what extent does a prolonged period of servicer advances in a market downturn misalign servicer incentives with those of the RMBS investors? To what extent to servicing advances also serve to aggravate liquidity concerns, exposing the market to greater systemic risk? Should the servicing agreement for RMBS restrict the primary servicer advances to cover delinquent payments by borrowers to a specified period, e.g., three (3) payment periods, unless financing facilities to fund or reimburse the primary servicers are available? Should limits be placed on the extent to which, foreclosure recoveries can serve as a 'financing facility' for repayment of advances?

23. What are the primary benefits and costs of potential approaches to these issues?

### **Compensation.**

Due to the demonstrated issues in the compensation incentives in RMBS, the FDIC has concerns that compensation to all parties involved in the RMBS issuance should provide incentives for sustainable credit and the long-term performance of the financial assets and securitization. This has been of particular concern in the compensation provided to servicers for RMBS with some arguing that the compensation

## Advance Notice of Proposed Rulemaking

structure for servicers provides perverse incentives contrary to the interests of effective action to mitigate losses.

In this regard, please note that the sample regulatory text on compensation would apply only to RMBS. This does not mean that compensation issues may not be of concern in other asset classes.

The FDIC requests comment on the following issues:

24. Should requirements be imposed so that certain fees in RMBS may only be paid out over a period of years? For example, should any fees payable to the lender, sponsor, credit rating agencies and underwriters be payable in part over the five (5) year period after the initial issuance of the obligations based on the performance of those financial assets? Should a limit be set on the total estimated compensation due to any party at that may be paid at closing? What should that limit be?

25. Should requirements be imposed in RMBS to better align incentives for proper servicing of the mortgage loans? For example, should compensation to servicers be required to take into account the services provided and actual expenses incurred and include incentives for servicing and loss mitigation actions that maximize the value of the financial assets in the RMBS?

26. What are the primary benefits and costs of potential approaches to these issues?

27. Should similar or different provisions be applied to compensation for securitizations of other asset classes?

**Origination and Retention Requirements.**

The FDIC also is concerned that further incentives for quality origination practices may be appropriate conditions for any future safe harbor treatment. In particular, if a sponsor were required to retain an economic interest in the asset pool without hedging the risk of such portion, the sponsor would be less likely to originate low quality financial assets. Many proposals have required retention of some percentage, usually five or ten percent, of the credit risk of the financial assets. Limiting the ability to hedge this risk has also been proposed, but this raises issues as well.

Another issue raised in securitizations has been the high number of early payment defaults in some securitizations of RMBS during the crisis. One way to address this would be to require that mortgage loans be seasoned, i.e. originated more than twelve (12) months prior to the initial issuance of the RMBS. Of course, this raises issues for both originators and sponsors of securitizations.

An alternative to accomplish the goals of ensuring quality mortgages go into securitizations would be to require, at a minimum, representations and warranties on legal enforceability of the mortgage loan, verification of borrower income, occupancy status and compliance with the requirement of an underlying property appraisal. The securitization documents could then designate a contract party to verify these specific representations and warranties, as well as any additional representations and warranties so designated by the documentation, within a specified period after issuance of obligations under the securitization. The documentation could also require the sponsor to repurchase any financial assets that breach such representation and warranties within thirty (30) days of notice thereof from the Trustee and/or Custodian. To support this

## Advance Notice of Proposed Rulemaking

requirement, the possible approach would hold five (5) percent of the proceeds due to the sponsor back for twelve (12) months to fund any repurchases required after this review.

In addition, it may be appropriate to require originations of residential mortgage loans in an RMBS to comply with all statutory and regulatory standards in effect at the time of origination. This could also reduce potential future problems with repurchases of securitized loans.

The FDIC seeks comment on the following issues:

28. For all securitizations, should the sponsor retain at least an economic interest in a material portion of credit risk of the financial assets? If so, what is the appropriate risk retention percentage? Is five percent appropriate? Should the number be higher or lower? Should this vary by asset class or the size of securitization? If so how?

29. Should additional requirements to incentivize quality origination practices be applied to RMBS? Is the requirement that the mortgage loans included in the RMBS be originated more than 12 months prior to any transfer for the securitization an effective way to align incentives to promote sound lending? What are the costs and benefits of this approach? What alternatives might provide a more effective approach? What are the implications of such a requirement on credit availability and institutions' liquidity?

30. Would the alternative outlined above, which would require a review of specific representations and warranties after 180 days and the repurchase of any mortgages that violate those representations and warranties, better fulfill the goal of aligning the sponsor's interests toward sound underwriting? What would be the costs and benefits of this alternative?

## Advance Notice of Proposed Rulemaking

31. Should all residential mortgage loans in an RMBS be required to comply with all statutory and regulatory standards and guidance in effect at the time of origination? Where such standards and guidance involve subjective standards, how will compliance with the standards and guidance be determined? How should the FDIC treat a situation where a very small portion of the mortgages backing an RMBS do not meet the applicable standards and guidance?

32. What are appropriate alternatives? What are the primary benefits and costs of potential approaches to these issues?

### **Additional Questions:**

In looking at the sample regulatory text provided for context, the FDIC would like to pose the following additional questions:

33. Do you have any other comments on the conditions imposed by paragraphs (b) and (c) of the sample regulatory text?

34. Is the scope of the safe harbor provisions in paragraph (d) of the sample regulatory text adequate? If not, what changes would you suggest?

35. Do the provisions of paragraph (e) of the sample regulatory text provide adequate clarification of the receiver's agreement to pay monies due under the securitization until monetary default or repudiation? If not, why not and what alternatives would you suggest?

## Advance Notice of Proposed Rulemaking

All comments should refer to the name and number of the collection:

- <http://www.FDIC.gov/regulations/laws/federal/propose.html>.
- *E-mail:* [comments@fdic.gov](mailto:comments@fdic.gov). Include the name and number of the collection in the subject line of the message.
- *Mail:* Gary A. Kuiper (202.898.3877), Counsel, Federal Deposit Insurance Corporation, 550 17<sup>th</sup> Street, NW., Washington, DC 20429.
- *Hand Delivery:* Comments may be hand-delivered to the guard station at the rear of the 550 17th Street Building (located on F Street), on business days between 7:00 a.m. and 5:00 p.m.

**ADDENDUM A**

**Sample Regulatory Text  
For Comment Only**

**This Text Has Not Been Considered or Approved by the FDIC**

**§ 360.6 Treatment of financial assets transferred in connection with a securitization or participation.**

**(a) Definitions.**

(1) “Financial asset” means cash or a contract or instrument that conveys to one entity a contractual right to receive cash or another financial instrument from another entity.

(2) “Investor” means a person or entity that owns an obligation issued by an issuing entity.

(3) “Issuing entity” means an entity created at the direction of a sponsor that (i) owns a financial asset or financial assets or has a perfected security interest in a financial asset or financial assets and (ii) issues obligations supported by such asset or assets. Issuing entities may include, but are not limited to, corporations, partnerships, trusts, and limited liability companies and are commonly referred to as special purpose vehicles or special purpose entities. To the extent a securitization is structured as a two-tier transfer, the term issuing entity would include both the issuer of the obligations and any intermediate entities that may be a transferee.

(4) “Monetary default” means a default in the payment of principal or interest when due following the expiration of any cure period.

## Advance Notice of Proposed Rulemaking

(5) “Obligation” means a security that is primarily serviced by the cash flows of one or more financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period, plus any rights or other assets designed to assure the servicing or timely distributions of proceeds to the security holders issued by an issuing entity. The term does not include any instrument that evidences ownership of the issuing entity, such as LLC interests, common equity, or similar instruments.

(6) “Participation” means the transfer or assignment of an undivided interest in all or part of a financial asset, that has all of the characteristics of a “participating interest,” from a seller, known as the “lead,” to a buyer, known as the “participant,” without recourse to the lead, pursuant to an agreement between the lead and the participant. “Without recourse” means that the participation is not subject to any agreement that requires the lead to repurchase the participant’s interest or to otherwise compensate the participant upon the borrower’s default on the underlying obligation.

(7) “Securitization” means the issuance by an issuing entity of obligations collateralized by, or representing interests in, one or more specific financial assets where the payments on the obligations are generated by such financial assets and the investors are relying on the cash flow or market value characteristics and the credit quality of such financial assets (together with any identified external credit support) to repay the obligations. To qualify as a securitization the transaction must properly identify and segregate the financial assets that are being securitized with appropriate provisions to accommodate revolving structures for certain asset pools.



## Advance Notice of Proposed Rulemaking

(8) “Servicer” means any entity responsible for the management or collection of some or all of the financial assets on behalf of the issuing entity or making allocations or distributions to holders of the obligations, including reporting on the overall cash flow and credit characteristics of the financial assets supporting the securitization to enable the issuing entity to make payments to investors on the obligations.

(9) “Sponsor” means a person or entity that organizes and initiates a securitization by transferring financial assets, either directly or indirectly, including through an affiliate, to an issuing entity, whether or not such person owns an interest in the issuing entity or owns any of the obligations issued by the issuing entity.

(10) “Transfer” means (i) the conveyance of a financial asset or financial assets to an issuing entity or (ii) the creation of a security interest in such asset or assets for the benefit of the issuing entity.

**(b) Coverage.** This section shall apply to securitizations that meet the following criteria:

(1) Capital Structure and Financial Assets.

(A) The following requirements apply to all securitizations:

(i) The securitization shall not consist of re-securitizations of obligations unless the disclosures required in subparagraph (b)(2) below are available to investors for the underlying assets supporting the securitization at initiation and while obligations are outstanding. For re-securitizations which include financial assets that were not originated by the sponsor, disclosures provided by the originator of such financial

## Advance Notice of Proposed Rulemaking

assets that meet the standards in paragraph (b)(2) below will comply with this subparagraph; and

(ii) The payment of principal and interest on the securitization obligation must be primarily based on the performance of financial assets that are transferred to the issuing entity or owned by the sponsor and, except for interest rate risk or currency risk, shall not be contingent on market or credit events that are independent of such financial assets. The securitization may not be unfunded or synthetic.

(B) The following requirements apply only to securitizations in which the financial assets include residential mortgage loans:

(i) The capital structure of the securitization shall be limited to no more than six credit tranches and cannot include “sub-tranches,” grantor trusts or other structures designed to further increase the leverage in the capital structure. Notwithstanding the foregoing, the most senior credit tranche may include time-based sequential pay sub-tranches; and

(ii) The credit quality of the obligations cannot be enhanced at the issuing entity or pool level through external credit support or guarantees. However, the temporary payment of principal and interest may be supported by liquidity facilities. Individual financial assets transferred into a securitization may be guaranteed, insured or otherwise benefit from credit support at the loan level through mortgage and similar insurance or guarantees, including by private companies, agencies or other

## Advance Notice of Proposed Rulemaking

governmental entities, or government-sponsored enterprises, and/or through co-signers or other guarantees.

(2) Disclosures. The sponsor, issuing entity, and/or servicer, as appropriate, shall make available to investors, information describing the financial assets, obligations, capital structure, compensation of relevant parties, and relevant historical performance data as follows:

(A) The following requirements apply to all securitizations:

(i) Prior to issuance of obligations and monthly while obligations are outstanding, information about the obligations and the securitized financial assets shall be disclosed to all potential investors at the financial asset, pool, and security-level sufficient to permit evaluation and analysis of the credit risk and performance of the obligations and financial assets. Information shall be presented in such detail and in such format so as to facilitate investor evaluation and analysis of the obligations and financial assets securitized and, at a minimum, shall comply with the requirements of Securities and Exchange Commission Regulation AB, 17 C.F.R. §§ 229.1100-1123, or any successor disclosure requirements for public issuances, even if the obligations are issued in a private placement or are not otherwise required to be registered.

Information that is unknown or not available to the issuer without unreasonable effort or expense, may be omitted if the issuer includes a statement in the offering document verifying that the specific information is otherwise unavailable;

## Advance Notice of Proposed Rulemaking

(ii) Prior to issuance of obligations, the structure of the securitization and the credit and payment performance of the obligations shall be disclosed, including the capital or tranche structure, the priority of payments and specific subordination features; representations and warranties made with respect to the financial assets, the remedies for and the time permitted for cure of any breach of representations and warranties, including the repurchase of financial assets, if applicable; liquidity facilities and any credit enhancements, any waterfall triggers or priority of payment reversal features; and policies governing delinquencies, servicer advances, loss mitigation, and write-offs of financial assets;

(iii) While obligations are outstanding, information shall be made available on the performance of the obligations, including periodic and cumulative financial asset performance data, delinquency and modification data for the financial assets, substitutions and removal of financial assets, servicer advances, as well as losses that were allocated to such tranche and remaining balance of financial assets supporting such tranche, if applicable; and the percentage of each tranche in relation to the securitization as a whole; and

(iv) In connection with the issuance of obligations, and thereafter if the information changes, information shall be made available on the nature and amount of compensation paid to the originator, sponsor, rating agency or third-party advisory, and any mortgage or other broker, compensation and expenses of servicer(s), and the extent to which any risk of loss on the underlying assets is retained by any of them for such securitization.

## Advance Notice of Proposed Rulemaking

(B) The following requirements apply only to securitizations in which the financial assets include residential mortgage loans:

(i) Prior to issuance of obligations, sponsors shall disclose loan level information about the financial assets including, but not limited to, loan type, loan structure (for example, fixed or adjustable, resets, interest rate caps, balloon payments, etc.), maturity, interest rate and/or Annual Percentage Rate, and location of property; and

(ii) Prior to issuance of obligations, sponsors shall affirm compliance with all applicable statutory and regulatory standards for origination of mortgage loans and shall include loan level data to confirm that the mortgages in the securitization pool are underwritten at the fully indexed rate relying on documented income, and comply with 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. Sponsors shall also identify the percentage of financial assets in the pool that are underwritten using underwriter discretion or similar qualitative application of the underwriting criteria, and a third party due diligence report confirming compliance with such standards.

(3) Documentation and Recordkeeping. The documentation creating the securitization must clearly define the respective contractual rights and responsibilities of all parties as described below and use as appropriate any available standardized documentation for each different asset class.

## Advance Notice of Proposed Rulemaking

(A) The following requirements apply to all securitizations:

(i) The documentation must define all necessary rights and responsibilities of the parties, including but not limited to representations and warranties consistent with industry best practices, ongoing disclosure requirements, and appropriate measures to avoid conflicts of interest. The contractual rights and responsibilities of each party to the transaction, including but not limited to the originator, sponsor, issuing entity, servicer, and investors, must provide sufficient authority for the parties to fulfill their respective duties and exercise their rights under the contracts and clearly distinguish between any multiple roles performed by any party. The sponsor must maintain records of its securitizations separate from records of its other business operations. The sponsor shall make these records readily available for review by the FDIC promptly upon written request.

(B) The following requirements apply only to securitizations in which the financial assets include residential mortgage loans:

(i) Servicing and other agreements must provide servicers with full authority, subject to contractual oversight by any master servicer or oversight advisor, if any, to mitigate losses on financial assets consistent with maximizing the net present value of the financial asset, as defined by a net present value analysis. Servicers shall have the authority to modify assets to address reasonably foreseeable default, and to take such other action as necessary or required to maximize the value and minimize losses on the securitized financial assets applying industry best practices for asset management and servicing. The documents shall require the servicer to act for the benefit of all

## Advance Notice of Proposed Rulemaking

investors, and not for the benefit of any particular class of investors. The servicer must commence action to mitigate losses no later than ninety (90) days after an asset first becomes delinquent unless all delinquencies on such asset have been cured. A servicer must maintain sufficient records of its actions to permit appropriate review; and

(ii) The servicing agreement shall not require a primary servicer to advance delinquent payments of principal and interest for more than three payment periods, unless financing or reimbursement facilities are available, which may include, but are not limited to, the obligations of the master servicer or issuing entity to fund or reimburse the primary servicer, are available. Such “financing or reimbursement facilities” under this paragraph shall not depend on foreclosure proceeds.

(4) Compensation. The following requirements apply only to securitizations in which the financial assets include residential mortgage loans. Compensation to parties involved in the securitization of such financial assets must be structured to provide incentives for sustainable credit and the long-term performance of the financial assets and securitization as follows:

(i) Any fees or other compensation for services payable to the lender, sponsor, credit rating agencies, and underwriters shall be payable, in part, over the five (5) year period after the first issuance of the obligations based on the performance of those financial assets, with no more than eighty (80) percent of the total estimated compensation due to any party at closing; and

## Advance Notice of Proposed Rulemaking

(ii) Compensation to servicers shall provide incentives for servicing and loss mitigation actions that maximize the value of the financial assets as shown by a net present value analysis, and may be provide payment for any of services provided and reimbursement of actual expenses, an incentive fee structure, or any combination of the foregoing that provides such incentives.

### (5) Origination and Retention Requirements.

(A) The following requirements apply to all securitizations:

(i) The sponsor must retain at least an economic interest in a material portion, defined as not less than five (5) percent, of the credit risk of the financial assets. This retained interest may be either in the form of an interest in each of the credit tranches of the securitization or in a representative sample of the securitized financial assets equal to at least five (5) percent of the principal amount of the financial assets at transfer.

This retained interest may not be transferred or hedged during the term of the securitization.

(B) The following requirements apply only to securitizations in which the financial assets include residential mortgage loans:

(i) All residential mortgage loans transferred into the securitization must be seasoned loans that were originated not less than twelve (12) months prior to such transfer;

(ii) All assets shall have been originated in compliance with all statutory, regulatory, and originator underwriting standards in effect at the time of origination. Residential



## Advance Notice of Proposed Rulemaking

mortgages included in the securitization shall be underwritten at the fully indexed rate, based upon the borrowers' ability to repay the mortgage according to its terms, 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 to insured depository institutions at the time of loan origination. Residential mortgages originated prior to the issuance of such guidance shall meet all supervisory guidance governing the underwriting of residential mortgages then in effect at the time of loan origination.

### **(c) Other requirements.**

- (1) The transaction should be an arms length, bona fide securitization transaction, and the obligations shall not be sold predominately to an affiliate or insider;
- (2) The securitization agreements are 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;
- (3) The securitization was entered into in the ordinary course of business, not in contemplation of insolvency and with no intent to hinder, delay or defraud the bank or its creditors;
- (4) The transfer was made for adequate consideration;

## Advance Notice of Proposed Rulemaking

(5) The transfer and/or security interest was properly perfected under the UCC or applicable state law;

(6) The transfer and duties of the sponsor as transferor must be evidenced in a separate agreement from its duties, if any, as servicer, custodian, paying agent, credit support provider or in any capacity other than the transferor; and

(7) The bank properly segregates any financial assets and records that relate to the securitization from the general assets and records of the bank.

### **(d) Safe Harbor.**

(1) **Participations.** With respect to transfers of financial assets made in connection with participations, 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 provided that such transfer satisfies the conditions for sale accounting treatment set forth by generally accepted accounting principles, except for the “legal isolation” condition that is addressed by this paragraph.

(2) **Transition Period Safe Harbor.** With respect to any participation or securitization (i) for which transfers of financial assets were made or (ii), for revolving trusts, for which obligations were issued on or before March 31, 2010, 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

## Advance Notice of Proposed Rulemaking

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, provided that 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 this rule.

**(3) For Securitizations Meeting Sale Accounting Requirements.** With respect to any securitization (i) for which transfers of financial assets were made, or (ii) for revolving trusts for which obligations were issued, after March 31, 2010, and which complies with the requirements applicable to that securitization as set forth in Paragraphs (b) and (c), 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 such transferred financial assets, provided that such transfer satisfies the conditions for sale accounting treatment set forth by generally accepted accounting principles in effect for reporting periods after November 15, 2009, except for the “legal isolation” condition that is addressed by this rule.

**(4) For Securitization Not Meeting Sale Accounting Requirements.**

With respect to any securitization (i) for which transfers of financial assets made, or (ii) for revolving trusts for which obligations were issued, after March 31, 2010, and which complies with the requirements applicable to that securitization as set forth in Paragraphs (b) and (c), but where the transfer does not satisfy the conditions for sale accounting treatment set forth by generally accepted accounting principles in effect

## Advance Notice of Proposed Rulemaking

for reporting periods after November 15, 2009, the FDIC as conservator or receiver consents to the exercise of the rights and powers listed in 12 U.S.C. § 1821(e)(13)(C), and will not assert any rights to which it may be entitled pursuant to 12 U.S.C. § 1821(e)(13)(C), after the expiration of the specified time, and the occurrence of the following events:

(A) If at any time after appointment, the FDIC as conservator or receiver is in a monetary default under a securitization, as defined above, and remains in monetary default for ten (10) business days after actual delivery of a written request to the FDIC pursuant to paragraph (d) hereof to exercise contractual rights because of such monetary default, the FDIC hereby consents pursuant to 12 U.S.C. § 1821(e)(13)(C) to the exercise of any such contractual rights, including obtaining possession of the financial assets, exercising self-help remedies as a secured creditor under the transfer agreements, or liquidating properly pledged financial assets by commercially reasonable and expeditious methods taking into account existing market conditions, provided no involvement of the receiver or conservator is required.

(B) If the FDIC as conservator or receiver of an insured depository institution provides a written notice of repudiation of the securitization agreements, and the FDIC does not pay the damages due pursuant to 12 U.S.C. § 1821(e) by reason of such repudiation within ten (10) business days after the effective date of the notice, the FDIC hereby consents pursuant to 12 U.S.C. § 1821(e)(13)(C) for the exercise of any contractual rights, including obtaining possession of the financial assets, exercising self-help remedies as a secured creditor under the transfer

## Advance Notice of Proposed Rulemaking

agreements, or liquidating properly pledged financial assets by commercially reasonable and expeditious methods taking into account existing market conditions, provided no involvement of the receiver or conservator is required.

**(e) Consent to certain actions.** During the stay period imposed by 12 U.S.C. § 1821(e)(13)(C), the FDIC as conservator or receiver of the sponsor consents to the payment of regularly scheduled payments to the investors made in accordance with the securitization documents and to any servicing activity with respect to the financial assets included in securitizations that meet the requirements applicable to that securitization as set forth in paragraphs (b) and (c).

**(f) Notice for Consent.** Any party requesting the FDIC's consent as conservator or receiver under 12 U.S.C. § 1821(e)(13)(C) pursuant to Paragraph (d)(4)(i) of this rule shall provide notice to the Deputy Director, Division of Resolutions and Receiverships, Federal Deposit Insurance Corporation, 550 17th Street, NW, F-7076, Washington DC 20429-0002, and a statement of the basis upon which such request is made, and copies of all documentation supporting such request, including without limitation a copy of the applicable agreements and of any applicable notices under the contract.

**(g) Contemporaneous Requirement.** The FDIC will not seek to avoid an otherwise legally enforceable agreement that is executed by an insured depository institution in connection with a securitization or in the form of a 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).

## Advance Notice of Proposed Rulemaking

(h) **Limitations.** The consents set forth in this section do not act to waive or relinquish any rights granted to the FDIC in any capacity, pursuant to any other applicable law or any agreement or contract except the securitization transfer agreement or any relevant security agreements. Nothing contained in this section alters the claims priority of the securitized obligations.

(i) **No waiver.** This section 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, nor does it authorize nor shall it be construed as authorizing the attachment of any involuntary lien upon the property of the FDIC. Nor shall this section 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.

(j) **No assignment.** The right to consent under 12 U.S.C. § 1821(e)(13)(C) may not be assigned or transferred to any purchaser of property from the FDIC, other than to a conservator or bridge bank.

(k) **Repeal.** This section 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 this section before such repeal.