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Notice of Proposed Rulemaking to Amend Securitization Safe Harbor Rule

July 16, 2019

The FDIC Board today is considering a Notice of Proposed Rulemaking (NPR) to amend the FDIC's Securitization Safe Harbor Rule.¹ Since I intend to vote against this NPR, I would like to take this opportunity to explain the reasons for my vote.

The NPR would modify the Securitization Safe Harbor Rule to eliminate a disclosure requirement of the Rule that applies to private placements by insured depository institutions (IDIs) of residential mortgage backed securities (RMBS). The failure of the NPR to provide sufficient justification for this change is the reason I am opposed to the proposal. This proposal is of particular significance because it goes to a key measure taken by the FDIC to address a central cause of the financial crisis – the transmission of risk from badly underwritten mortgage loans through RMBS. Since the issue appears technical and is difficult to understand, I believe it is important to try to lay it out in as clear terms as possible and consider its implications carefully.

The FDIC Board originally adopted the so-called Securitization Safe Harbor Rule in 2000. The rule provided that the FDIC as conservator or receiver of a failed bank would not use its authority to repudiate bank contracts to reclaim, recover or recharacterize as property of the bank or the receivership any financial assets transferred by the bank in connection with a securitization, provided that the transfer met all conditions for sale accounting treatment under generally accepted accounting principles (GAAP).

In 2009, the Financial Accounting Standards Board (FASB) modified GAAP as it applied to securitization transactions. Market participants became concerned that some banks would be required to consolidate securitized assets on their balance sheets for financial accounting purposes, thus creating uncertainty as to the application of the FDIC's safe harbor. This action by FASB triggered the reopening of the Safe Harbor Rule by the FDIC. It is one of the changes to the Safe Harbor Rule finalized by the FDIC in September 2010 that is the object of the NPR before the FDIC Board today.

The requirements of the Safe Harbor Rule that were added in 2010 included several disclosure requirements, particularly related to residential mortgage backed securities. The preamble to the final rule made clear the purpose of the disclosure requirements:

The conditions are designed to provide greater clarity and transparency

¹ 12 CFR 360.6.

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.²

Paragraph (b)(2) in the FDIC's Safe Harbor Rule imposes extensive disclosure requirements relating to securitizations. A number of these requirements are FDIC-specific requirements that apply to both publicly and privately placed securitizations. Several of those FDIC requirements are specific to residential mortgage backed securitizations.

In addition, paragraph (b)(2) requires that a securitization at a minimum "comply with the requirements of Securities and Exchange Commission Regulation AB ... (to the extent then in effect) 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."

Here is where things get particularly tricky to follow. The SEC's Regulation AB governs the offering process, disclosure requirements and ongoing reporting requirements for securitizations. In April 2010, the SEC proposed significant changes to Regulation AB, including extensive new disclosure requirements. The new disclosure requirements as proposed would have applied to publicly placed securitizations; they also would have applied to private placements if requested by the investor. However, the final rule ultimately adopted by the SEC in 2014 dropped the provision requiring disclosure for privately placed securitizations.³

As a result, the Safe Harbor Rule adopted by the FDIC in 2010 requires that Regulation AB disclosures apply to private placements while the final Regulation AB disclosures adopted by the SEC in 2014 do not.

As to why this issue is being raised now, the preamble to the NPR before the FDIC Board today states:

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 securitization documents require compliance with Regulation AB in private transactions, private offerings of residential mortgage backed 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

² 75 Fed. Reg. 60287, 60291 (Sept. 30, 2010).

³ 79 Fed. Reg. 57183, 57190 (Sept. 24, 2014).

guarantee from, government-sponsored housing enterprises.⁴

The concerns expressed about the Regulation AB disclosure requirements appear to apply to residential mortgage backed securities whether they are publicly or privately placed. Since the FDIC has applied the Regulation AB disclosure requirements to private placements of RMBS and the SEC has not, private placements are the focus of the concerns expressed to the FDIC.

While the NPR states that FDIC staff has been told that potential IDI sponsors of residential mortgage securitizations have found it difficult to provide certain information required by Regulation AB, that information is not identified in the NPR nor is it explained why it is difficult to provide. Given the significant policy concerns that led to the adoption of these disclosure requirements, the basis for making changes or eliminating the requirements should be made clear and subject to careful analysis. The NPR fails to do that.

As a basis for dropping the application of the disclosure requirements of the SEC's Regulation AB to private placements of RMBS through the FDIC's Safe Harbor Rule, the NPR makes three arguments.

First, the NPR cites a paragraph from the preamble to the 2010 final Safe Harbor Rule which underscores that "the Rule and the SEC's proposed regulations are fully consistent." The NPR before the Board today argues that because the SEC finalized Regulation AB to apply only to public issuances, "[t]he FDIC is now proposing to modify the Rule such that its disclosure requirements are consistent with Regulation AB, and applicable only when disclosure is required by Regulation AB."⁵ The implication seems to be that the FDIC intended to conform the final Safe Harbor Rule to the final rule for Regulation AB.

However, the record does not really support that assertion. The FDIC Board was well aware when it adopted the final Safe Harbor Rule in September 2010 that the SEC's proposed New Regulation AB was subject to change. Nevertheless, the FDIC specifically wrote the final Safe Harbor Rule to apply new Regulation AB's proposed disclosure requirements to private as well as public placements. The preamble to the Notice of Proposed Rulemaking for the Safe Harbor Rule adopted by the FDIC in May 2010 specifically addressed the policy concern behind this decision:

The FDIC believes that regardless of whether the securitization transaction is in the form of a private rather than public securities issuance, full disclosure to investors in such transaction is necessary.... In particular, the FDIC is concerned that robust disclosure be provided in CDO [collateralized debt obligation] transactions and that ongoing monthly reports are provided to investors in a securitization, whether or not

⁴ Preamble at 6-7.

⁵ Preamble at 6-7.

there is an ongoing obligation for filing with respect to such securitization under the Securities Exchange Act of 1934.⁶

The preamble to the final Safe Harbor Rule specifically addressed the issue of possible differences with the SEC:

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 IDIs, 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. For the FDIC's safe harbor rule, the FDIC is setting the conditions that define how it 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.⁷

It seems clear that the FDIC Board intended to apply the proposed New Regulation AB disclosure requirements to private as well as public placements of RMBS, even if the proposed New Regulation AB disclosure requirements were subsequently changed.

The NPR before the FDIC Board today makes two other arguments to support the proposed change to the Safe Harbor Rule.

First, the NPR's preamble states the following:

The FDIC believes that if, in the midst of the financial crisis, it was appropriate, in crafting an FDIC rule governing when securitization investors are eligible for safe harbor protection, to make applicable to certain transactions SEC disclosure requirements that do not otherwise apply to those transactions, such a requirement is no longer necessary in view of regulatory developments relating to residential mortgages since 2010.⁸

However, the NPR does not indicate what those regulatory developments are or why they make the application of the SEC disclosure requirements no longer necessary.

Finally, the preamble to the NPR cites the other disclosure requirements in paragraph (b)(2) of the Safe Harbor Rule beyond those of Regulation AB and asserts they address the goals set out in the

⁶ 75 Fed. Reg. 27471, 27478.

⁷ 75 Fed. Reg. at 60291.

⁸ Preamble at 9.

preamble. However, it is difficult to evaluate that assertion without knowing specifically what is problematic about the Regulation AB disclosure requirements themselves.

In conclusion, the application of the FDIC's Safe Harbor Rule to publicly and privately issued securitizations, particularly residential mortgage backed securitizations, was a response to one of the central causes of the financial crisis. If the FDIC proposes to eliminate the Regulation AB disclosure requirements of the Safe Harbor Rule that apply to private placements in the RMBS market, it has an obligation to identify clearly what in the disclosure requirements is an impediment to the market and why its elimination would not undermine the purposes of the FDIC's Rule.

The NPR before the FDIC Board today fails to do that. For that reason I intend to vote against this NPR.