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February 22, 2010

**Via E-Mail comments@fdic.gov**

Robert E. Feldman
Executive Secretary
Attention: Comments, Federal Deposit Insurance
Corporation
550 17th Street, N.W.
Washington, DC 20429

Re: RIN 3064 - AD55

Dear Mr. Feldman:

K&L Gates, LLP ("K&L Gates" or "we") appreciates this opportunity to comment on the Advanced Notice of Proposed Rulemaking with respect to *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* (the "ANPR") published in the Federal Register on January 7, 2010 by the Federal Deposit Insurance Corporation (the "FDIC").

K&L Gates is a global law firm, with over 1,800 lawyers in thirty-five offices. We have an active structured finance practice and regularly represent sponsors, investors and other market participants in securitization transactions, including those structured in reliance on the safe harbor set forth in 12 C.F.R. § 360.6 (the "Safe Harbor Rule"). The comments provided in this letter are our own, are not being provided at the request of any of our clients, and may not reflect the views of our clients.

Before providing our comments, we first provide a background of the Safe Harbor Rule and the context in which it was adopted and used. Rather than comment upon each enumerated request for comment, we provide a more general overview critique of the proposal, as we have some fundamental concerns with the draft rule appended to the ANPR (the "Draft Rule").

## BACKGROUND OF THE SAFE HARBOR RULE

Securitization is a process that isolates the risk inherent in an asset from the operating and credit risk of the transferor of that asset. The FDIC has long recognized the legitimacy of securitizations. The Federal Deposit Insurance Act (the "FDI Act"), for example, requires the FDIC to respect otherwise enforceable security interests granted in the context of legitimate securitization transactions, various FDIC policy statements and general counsel opinions have consistently recognized the statutory mandate favoring securitizations, or have recognized that assets transferred in securitizations were "sold" thereby terminating any rights that the FDIC as conservator or receiver would have to such assets.

Legal isolation analysis based upon the existence of a "true sale" has been a serious issue for the United States accounting profession. To qualify a securitized transaction as a sale under Financial Accounting Standard 140 ("FAS 140"), it must be shown that the transferred financial assets have been presumptively put beyond the reach of the powers of a receiver for the transferor or any consolidated affiliate of the transferor. The FDIC promulgated the Safe Harbor Rule in 2000 in order to address these concerns by confirming that in the event of a bank failure, the FDIC would not try to reclaim financial assets transferred into a securitization so long as an FAS 140 qualified sale had occurred.

Recent changes in accounting rules for securitizations have prompted a reconsideration of the role and purpose of the legal isolation safe harbor contained in the Safe Harbor Rule.[1] These amendments will require that many securitization transactions originally accounted for as sales be re-characterized for accounting purposes as secured borrowings, and will mandate that many such securitizations in the future be accounted as secured borrowings. In addition to raising questions about the treatment of existing transactions that are required to be brought on selling institutions' balance sheets, these accounting changes have also raised questions about whether, and under what circumstances, on-balance sheet securitizations should be covered by the Safe Harbor Rule. Many such transactions require legal isolation certainty, apart from accounting treatment, in order to obtain external ratings or to satisfy investors' due diligence concerns.[2] We understand that market participants and representative organizations have requested that the FDIC revise the Safe Harbor Rule to address these changes.

[1] The principal such change affecting term securitizations is the amendment of Financial Accounting Statement 140 to eliminate qualified special purpose entities. These amendments are effectuated by Financial Accounting Statements 166 and 167, which took effect for most depository institutions on January 1, 2010.

[2] It is important to note that the fact that a transaction is accounted for as a secured borrowing does not necessarily lead to the result that such transaction is not a true sale under common law. Given the modern trend to dispose of the distinction between sales and pledges of financial assets, prior to 2005 legislation affecting security interests granted by depository institutions, practitioners had generally followed the accounting treatment when opining on the rights of parties to a securitization in the event of conservatorship or receivership of a depository institution sponsor. Although FDIC interpretations of the statutory provision relating to security interests are still considered to be valid, many intervening changes, including the adoption in 2005 of an automatic stay in receiverships and conservatorships of insured depository institutions, have complicated the legal isolation analysis under those interpretations.

When the FDIC promulgated the Safe Harbor Rule, it indicated that a safe harbor was not required with respect to transfers of assets in on-balance sheet transactions if the transfer qualified as a common law sale. We believe that this is still the case. The ANPR acknowledges the issue created by 2005 legislation with respect to secured borrowings. That legislation provided the FDIC as conservator or receiver of an insolvent insured depository institution with a consent right to foreclosure by secured parties, which is essentially equivalent to an "automatic stay" in a bankruptcy case. For on-balance sheet securitizations, this created an issue as to whether the FDIC would treat a transfer of assets to a special purpose vehicle as a mere security interest (independent of the analysis as to whether a sale at taken place under common law), if such treatment was required by accounting rules.[3] In that case, there will be significant legal uncertainty as to whether the special purpose vehicle (or its trustee) would be stayed for forty-five or ninety days from the appointment of the FDIC as conservator or receiver, as the case may be, before it could foreclose on the collateral. Neither the ANPR nor the Draft Rule addresses this uncertainty.

## COMMENTS TO ANPR

We have four major concerns with the Draft Rule: (1) significant aspects of the Draft Rule appear inconsistent with to the FDIC's mission of ensuring the safety and soundness of the nation's *banking* system; (2) the Draft Rule fails as a safe harbor because the determination of compliance with the Draft Rule would be fraught with more uncertainty than the underlying legal isolation issue; (3) the Draft Rule does not adequately address serious market concerns pertaining to the treatment of assets by the FDIC as receiver of a transferor of assets in a securitization that is treated as a secured borrowing; and (4) the Draft Rule addresses issues that are properly in the jurisdiction of other regulatory agencies, principally the Securities and Exchange Commission.

### *Many Aspects of the Draft Rule Appear Contrary to the FDIC's Role as Deposit Insurer*

We are concerned that the ANPR will create conflict between the FDIC's traditional role as deposit insurer and its contemplated role in policing securitization markets. The Safe Harbor Rule has enhanced the safety and soundness of depository institutions by removing any legal uncertainty that may have otherwise impeded insured depository institution access to liquidity in the securitization markets. The ANPR goes well beyond this traditional purpose by seeking comment on various proposals to police securitization markets. We think it goes too far.

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[3] We submit that it cannot be the case that changes to accounting rules can have the effect of overruling judicial precedent.

Our primary concern is that these proposals would only apply to securitizations that insured depository institutions originate, not securitizations that end up on bank balance sheets. This creates the perverse situation where the FDIC is adopting a rule that *limits* an insured depository institution's ability to limit exposure to risky assets such institution originated, while not addressing high-risk asset backed securities that it might have purchased. As deposit insurer having responsibility for the safety and soundness of our nation's banking system, we believe it preferable that the FDIC encourage banks to remove risky assets and discourage banks from assuming risks that are not easily understood. We suggest that FDIC regulation of securitization markets be promulgated in a policy statement that governs the purchase of asset backed securities by insured depository institutions. This would decrease exposure of the deposit insurance fund to high-risk securitizations, while not creating special impediments to transfers of financial assets originated by insured depository institutions.

We also share FDIC concern about the origination of high-risk financial assets by insured depository institutions. The ANPR displays the FDIC's approach of limiting liquidity sources for high-risk assets to thereby limit such lending. Such an indirect approach may, however, have unintended consequences. There are already a plethora of statutes, regulations, rules, interpretations and policy statements governing lending activities of insured depository institutions that should already prevent unsound lending practices of the type that contributed to the most recent economic crisis.[4] Moreover, insured depository institutions are already subject to rigorous supervision and examination with respect to residential mortgage loan underwriting. We suggest that the FDIC could address concerns with loan underwriting by revisiting existing regulatory guidance on underwriting standards and risk management.

The ANPR and Draft Rule contemplate a requirement that insured depository institutions that sponsor securitizations retain a certain amount of the risk involved with the underlying asset pool. Given the FDIC's role as deposit insurer, it is difficult to fathom why it would *require* insured depository institutions to hold *more risk* in connection with securitizations. Prior to the recent crisis, one of the major issues faced by insured depository institutions that sponsored securitizations was the expectation of investors and other market participants that an insured depository institution would provide support to securitizations that it sponsored. Thus, there was an issue that in some cases it could be difficult to determine the level of risk undertaken by a financial institution solely by reference to explicit contractual obligations.

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[4] For example, long before the current economic crisis, the FDIC and other bank regulators implored insured depository institutions to exercise caution in originating nontraditional consumer mortgage loans. See, *e.g.*, FIL-89-2006, *Interagency Guidance on Nontraditional Mortgage Product Risks* (October 5, 2006).

We would have expected the FDIC to address this type of implicit recourse in the ANPR before proposing additional risk retention.

Risk retention raises a host of questions. These include the identity of the party required to retain risk; whether credit risk, prepayment risk, interest rate risk or other risk is the appropriate type of risk to retain, which can vary among asset classes; the level of subordination of the retained risk and the practical effect that risk retention has on reducing moral hazard, particularly considering that many of the institutions whose securitization activities caused systemic problems had significant retention through repurchase obligations tied to representations and warranties and through retentions of tranches; and the relation of risk retention concepts to the concept of sound underwriting practices. We understand that these issues are the subject of vigorous debate among economists and regulators. To the extent that special rules are adopted for insured depository institutions, such rules should take into account the exposure of deposit insurance funds to such retained risks and whether such rules are needed for insured depository institutions given the presence of extensive supervision and regulation.

***The Draft Rule Fails as a Safe Harbor***

Although the Draft Rule is intended to create a safe harbor, in many cases it would not be a better solution for the legal isolation issues the ANPR is intended to address. As lawyers called upon to render opinions in the transactional context, we are very aware of the adverse impact this regulatory uncertainty will have on capital formation efforts and the secondary market for bank-sponsored asset-backed securities. The ANPR contains many requirements, including ones that relate to compliance with undefined "best practices" and future performance. It would be difficult—if not impossible—to ascertain whether a depository institution has complied with such a rule at the time that assets are transferred because there is no assurance as to future performance and "best practices" cannot be ascertained with the degree of certainty ordinarily associated with a safe harbor rule. Additionally, a safe harbor is a poor choice for investor protection in securitizations as the consequences of noncompliance with a rule like the Draft Rule would actually harm the investors the rule is intended to protect.

Since the purpose of a safe harbor is to replace a difficult legal question with a more mechanical one, the incorporation of best practices into the Draft Rule makes the rule unworkable as a safe harbor. Although the securitization industry has for quite some time been addressing best practices for disclosure, reporting, underwriting and a host of other issues, it is unclear whether any practices are sufficiently authoritative to merit reliance in the safe harbor context. This would be particularly the case to the extent that the Draft Rule adds unenumerated disclosure obligations over those set forth in regulatory and other guidance such as Regulation AB.

The same uncertainty is also present with respect to periodic reporting requirements. This condition to a safe harbor in the securitization context is problematic. At the closing of the offering, investors, rating agencies and other parties involved in the securitization will require certainty around the issue of legal isolation and/or consent to action taken against collateral. When compliance with the safe harbor hinges upon future events, no certainty may be had. Under the Securities Act of 1933, a consequence of failure to comply with reporting obligations under the Securities Exchange Act of 1934 is that the depositor or sponsor becomes ineligible to register the offer and sale of asset-backed securities on Form S-3. The periodic reporting requirement of the Draft Rule would require investors to bear the consequence of such failure by causing a subordination of their interest in the securitized assets.

Many of the disclosure and reporting requirements contained in the Draft Rule appear intended to protect investors in securitizations originated by insured depository institutions. A safe harbor governing the FDIC's treatment of the transfer of assets is a strange choice of placement for an investor protection rule. If an institution intends to comply with such a safe harbor, but the transaction is found to not comply at the insolvency of the institution, the remedy seems to be that the FDIC would claim assets from, or delay enforcement of a security interest by, the same investors who the FDIC intended to protect. This remedy would only result in further losses to the investors and would do little to punish the offending institution. We would expect that if a rule substantially similar to the Draft Rule were adopted, many depository institutions would ignore the Draft Rule (as they legally may), and instead rely upon a common law analysis of "true sale" under state law to the extent consistent with rating agency criteria and, where appropriate, accounting considerations.

We believe that the focus of the Draft Rule should not be substantive regulation of securitizations. Rather, the Safe Harbor Rule should isolate those circumstances in which the FDIC can assure that, in its role as conservator or receiver of a failed institution, it would not seek to reclaim assets purportedly transferred to a securitization vehicle.

***The Draft Rule Does Not Adequately Address Changes in Law and Accounting Rules***

The Draft Rule fails to adequately resolve changes in the law and accounting rules that occurred since the adoption of the Safe Harbor Rule. In 2005, Congress passed legislation requiring a secured creditor to obtain the consent of the FDIC, as the conservator or receiver of a failed institution, before taking any action against collateral in the first 45 days following an FDIC conservatorship or the first 90 days following an FDIC receivership. This delay creates significant market risk and could result in substantial losses for investors in securitizations sponsored by depository institutions that later failed. Although the Draft Rule addresses this issue, it does not satisfactorily resolve it.

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For off-balance sheet securitizations that satisfy the requirements of the sample regulatory text of the Draft Rule, the safe harbor provisions in paragraph (d) of the sample regulatory text will be similar to what it is currently under the Safe Harbor Rule. The Draft Rule provides that 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 otherwise satisfies the conditions for sale accounting treatment set forth by generally accepted accounting principles. However, this safe harbor will be unimportant to the extent that the amendment to FAS 140 described above eliminates most off-balance sheet accounting for securitizations.

In the case of on-balance sheet transactions, paragraph (d) of the sample regulatory text of the Draft Rule would expose investors to risks arising from the limitation of the FDIC's waiver of its rights under the FDI Act to consent to the exercise of creditors' remedies. The safe harbor in the Draft Rule would still impose a ten day waiting period before self-help remedies could be taken against collateral, leaving investors in a securitization subject to the risk that the value of the securitized assets may deteriorate during that period. Because the FDIC would have the right to repudiate a securitization agreement contract at any time during the forty-five day period or ninety day period after the date of the appointment of the conservator or receiver, as applicable, investors would be subject to market risk for a period of up to fifty five days (in the case of a conservatorship) or one hundred days (in the case of a receivership) depending on the circumstances. Moreover, the Draft Rule seems to assume that the fact that a securitization is accounted for as an on-balance sheet transaction will lead to the inevitable result that such transaction is a pledge as a legal matter. This would have the effect of elevating FAS 166 and 167 to legal proclamations that overrule judicial decisions. As noted above, the same transaction may be accounted for as a secured borrowing and be treated as a true sale under common law.

The FDIC also solicited comment on whether a safe harbor is needed with respect to synthetic securitizations. Synthetic securitizations that are not based on assets transferred to the issuing entity or owned by the sponsor would not properly be covered by the rule because there is no transfer of, or grant of a security interest in, the financial assets on which credit protection is obtained, all of which remain on the sponsor's balance sheet. In a synthetic securitization, the sponsor enters into a credit derivative transaction with a special purpose entity that issues securities to investors or enters into offsetting derivatives. The credit derivative between the sponsor and the special purpose entity is designed to transfer credit risk with respect to assets the sponsor owns. In the case of synthetic securitizations by depository institutions the derivatives are normally structured to meet the criteria for qualified financial contracts under the FDI Act. Covering synthetic securitizations under the Draft Rule would duplicate the existing provisions of the FDI Act that expressly protect the right of counterparties to qualified financial contracts to terminate or liquidate such contracts following appointment of the FDIC as receiver or conservator.

***Any Rule Covering the Subject Matter of the Draft Rule Should Be Broadly Applicable and is Better Left in the Jurisdiction of Other Regulatory Agencies***

Because asset-backed securities issued by securitization trusts sponsored by banks are not bank securities exempt from registration with the Securities Exchange Commission pursuant to Section 3(a)(2) of the Securities Act of 1933, the substantive regulation of such asset-backed securities properly resides with the Securities Exchange Commission. In addition to the jurisdictional issue that the Draft Rule poses, its specific provisions could create duplication and confusion. For example, many of the disclosure and other investor protection provisions of the Draft Rule overlap with rules promulgated by the Securities and Exchange Commission under the Securities Act of 1933 and the Securities Exchange Act of 1934. They also may overlap with provisions of legislation currently being considered to reform asset-backed securities, which delegate rulemaking authority to the Securities and Exchange Commission or other regulatory bodies.

Moreover, the proposals set forth in the ANPR would deny insured depository institutions a level playing field with respect to the disposition of financial assets. Insured depository institutions should be subject to the same disclosure rules as their nondepository competitors. To that end, applicability of securities disclosure rules such as Regulation AB to unregistered offerings of asset-backed securities should be determined by the Securities and Exchange Commission. We believe that the goal of the Safe Harbor Rule—facilitating depository institutions' access to liquidity in the form of securitizations—should be maintained, but rules governing securitization markets should not be limited to depository institutions.

Many of the reforms the FDIC is proposing are important. They should be discussed in the larger context of market regulation, and not to safe harbor rules that insured depository institutions may choose to ignore. For example, increased authority for servicers may ultimately be desirable. But a safe harbor rule, applicable only to depository institution securitizers, appears to be a poor mechanism to advance such a reform. A rule of uniform application, compliance with which is mandatory for all securitizations of residential mortgage loans, or for all servicing arrangements including securitizations and loans held in portfolio, would be a better mechanism to adopt such a change. However, any bright line rules regarding loss mitigation, or loan servicing generally, will by definition curtail the flexibility in approach that may be needed as the mortgage lending and servicing market redevelops, and limit the discretion of servicers that may best serve the needs of investors and consumers.

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We agree that securitization markets are in need of reform. We appreciate the level of attention and concern invested by the FDIC in considering various policy alternatives to address this. However, we suggest that the adoption of any rule providing for substantive reform of securitization markets should follow congressional action so that any rules adopted have broad application. Alternatively, such rules could be adopted on an interagency basis. We see no reason for stringent requirements applicable only to insured depository institutions, which could put them at a competitive disadvantage. What is needed from the FDIC now is a traditional safe harbor rule that takes into account changes in the law and accounting since the adoption of the Safe Harbor Rule. It may be appropriate for the FDIC to use the occasion of amending the Safe Harbor Rule to renew consideration of regulatory steps it could take how to facilitate a vibrant covered bond market in the United States.

K&L Gates appreciates the opportunity to comment on the ANPR. If you should wish to discuss any of the comments set forth herein please contact Anthony R.G. Nolan at 212.536.4843 or Sean P. Mahoney at 617.261.3202.

Very truly yours,

/s/ K&L Gates LLP