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February 22, 2010

By Electronic Mail

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

Re: RIN #3064–AD55
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
75 *Federal Register* 934, January 7, 2010

Dear Mr. Feldman:

The American Bankers Association (ABA)[1] and the ABA Securities Association (ABASA)[2] appreciate the opportunity to comment on the advance notice of proposed rulemaking (ANPR) of the Federal Deposit Insurance Corporation (FDIC) concerning the treatment by FDIC as conservator or receiver of financial assets transferred by an insured depository institution (IDI) in connection with a securitization or participation after March 31, 2010 (Securitization Rule). The ANPR seeks input on possible changes to FDIC's legal isolation safe harbor in its Securitization Rule in connection with changes to accounting rules adopted by the Financial Accounting Standards Board in Financial Accounting Statements No. 166 and 167 (FAS 166 and 167) with respect to consolidation of special purpose entities used in securitization transactions or participations.

The Securitization Rule clarified that FDIC as conservator or receiver would 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 the transfer met all conditions for sale accounting treatment under generally accepted accounting principles.

Since the adoption of the safe harbor in 2000, investors have known that in the event of a failure of a bank securitization sponsor, they could look to securitized financial assets for payments without interference by the FDIC. With implementation of FAS 166 and 167,

[1] The ABA brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthens America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $13.6 trillion in assets and employ over 2 million men and women.
[2] ABASA is a separately chartered affiliated of the ABA that represents those holding company members of the ABA that are actively engaged in capital markets, investment banking, and broker-dealer activities.

however, most such transactions will not be able to satisfy the requirement for sale accounting treatment and would not meet the current criteria for the FDIC safe harbor. To provide a transition period to address changes to the safe harbor, in November 2009 FDIC adopted an interim final rule[3] effectively grandfathering transactions consummated prior to March 31, 2010 so long as they complied with the accounting rules in effect prior to implementation of FAS 166 and 167.

Given the need to amend the Securitization Rule safe harbor to address the accounting changes, FDIC determined to seek input through this ANPR on possible substantive changes to the securitization process as a condition of eligibility for the safe harbor.

Summary of ABA-ABASA Position

We appreciate FDIC's willingness to accommodate the needs of investors in securitizations and participations by retaining a form of the safe harbor. We believe, however, that the changes contemplated in the ANPR and its sample regulatory text would, in effect, substantively transform the securitization process in the United States by imposing credit risk retention and other structural restrictions on securitization transactions which could fundamentally change the underlying economics of these transactions. We recognize and understand the concerns that have been raised about the role that securitization and, in particular, securitization of residential mortgages, played in the current economic downturn. Nonetheless, ABA and ABASA believe any action by FDIC to change substantively the securitization process is premature; nor is using amendments to the safe harbor an appropriate vehicle for effecting such significant changes.

Both the House and Senate are actively considering legislative changes that may impact significantly the securitization process, a legislative exercise that may itself be informed by the need for global harmonization of such requirements. Structural changes adopted by FDIC in advance of full legislative consideration may unnecessarily conflict with Congressional judgments. Moreover, current legislative proposals would require interagency rulemaking rather than the imposition of new standards by a single agency.

The changes contemplated to securitization in the ANPR are so different from existing practices that their implementation may well negatively impact the resurgence of a robust securitization market. Both FDIC and the Obama Administration have affirmed the need to "restart" the securitization market because of its importance to our economy as a funding mechanism. However, the types of restrictions addressed in the ANPR could fundamentally alter the underlying economics of securitizations in ways that cannot yet be ascertained with any certainty. Legislation passed by the House of Representatives in December 2009, H.R. 4173, would require the Federal Reserve Board to study the effect on the securitization market of both a credit risk retention requirement and the impact of the new accounting rules. We think this is a wise course prior to making fundamental changes to the rules governing securitizations.

Importantly, FDIC's regulations would apply only to bank sponsors of securitizations and thus would not reach transactions initiated by nonbank sponsors. As a result, bank sponsors will be at a competitive disadvantage with foreign and nonbank sponsors that would not have to comply with new restrictions on the manner in which they structure securitization transactions.

Separately, ABA and ABASA believe that the safe harbor should remain applicable to loan participations.

Finally, to permit sufficient time to fully consider these issues and reduce uncertainty for market participants, ABA and ABASA request that FDIC extend the grandfather provisions of the interim final rule for a minimum of six months.

In sum, and as discussed more fully below, ABA and ABASA oppose the changes contemplated in ANPR.

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[3] 74 *Federal Register* 59066.

Background

Since 2000, FDIC has provided a legal isolation safe harbor in its Securitization Rule to assure investors in securitizations and participations that in the event of the failure of an IDI, FDIC would not attempt to reclaim assets transferred in a securitization so long as certain conditions were met, one of which was that an accounting sale had occurred.[4] The implementation of FAS 166 and 167 now, however, makes it impossible for most asset transfers to qualify for an accounting sale, thus making them ineligible for the safe harbor.

Previously, FDIC had adopted an interim final rule providing that the safe harbor would remain in effect for all participations and securitizations for which financial assets were transferred or, for revolving securitization trusts, for which securities were issued prior to March 31, 2010, as long as those transactions complied with the accounting rules in effect prior to implementation of FAS 166 and 167. Thus, the Interim Final Rule effectively grandfathered asset transfers prior to March 31, 2010.

Thereafter, on December 15, 2009, FDIC issued the ANPR addressing possible new requirements for eligibility for the legal isolation safe harbor after March 31, 2010, and requesting comment on sample regulatory text incorporating the new requirements.

Discussion

FDIC Should Await the Culmination of Legislative Deliberations Before Acting.

Congress is currently considering legislation that significantly overlaps with the changes to the safe harbor requirements discussed in the ANPR. It is the position of ABA and ABASA that FDIC should await legislative action before moving forward on broad regulatory changes. We strongly believe that FDIC should not attempt unilaterally to reform the securitization process via amendments to the safe harbor.

The House of Representatives in December 2009 passed H.R. 4173, the "Wall Street Reform and Consumer Protection Act of 2009," which contains significant revisions to the securitization process as well as to loan underwriting standards. Under that legislation, a creditor that sells or transfers a loan must "retain an economic interest in a material portion of the credit risk of that loan. . ." The banking agencies and the Securities and Exchange Commission (SEC) would be authorized to determine the level of required risk retention based on the quality of the credit underwriting or due diligence or characteristics that would reduce credit risk. The agencies could also determine whether the retained risk should be held by a securitizer instead of or in addition to the originator.

Importantly, Title VII of H.R 4173 incorporates substantial portions of H.R. 1728, the "Mortgage Reform and Anti-Predatory Lending Act," which the House passed on May 7, 2009. Title VII would create a federal "duty of care" requiring licensing and registration of mortgage originators (under the provisions of the already passed SAFE Mortgage licensing act or applicable state statutes) and requiring originators to ensure that borrowers have a documented ability to repay the loan and are provided with a "net tangible benefit". This duty of care also would require that loans do not have "predatory characteristics" and that full disclosures are made to consumers.

H.R 4173 separately reserves to the SEC jurisdiction to require enhanced disclosures for each tranche of an asset-backed security to facilitate comparisons across securities backed by similar types of assets. Disclosures would be required at the asset level or loan level so that investors can independently perform due diligence.

Similar legislation in the Senate – the Dodd Committee Print – addresses securitizations and the appropriate level of credit risk to be retained for any asset that is transferred, sold, or conveyed through an asset-backed security. The federal banking regulators and the SEC would have joint rulemaking

[4] 12 C.F.R. 360-6.

authority to implement this requirement, but they would retain considerable exemption authority with respect to risk retention requirements for securitizers and originators that engage in high-quality underwriting of loans.

ABA and ABASA believe that given the current level of Congressional interest in reforming the securitization process, it is inappropriate for FDIC at this time to take action on these issues before Congress has had time to complete its deliberations. Moreover, both the House and Senate measures contemplate joint rulemaking with the federal bank regulators and the SEC, which we view as a clear reflection of the legislators' interest in uniform regulation.

It is critical to point out that the House legislation would address directly the perceived problems with the "originate to distribute" model of securitization—i.e., the disincentives for originators to engage in robust screening and underwriting practices where their financial interests in loans are extinguished upon sale or transfer. Trying to address lax underwriting practices through burdensome requirements at the securitization end of the lending process is both imprecise and ineffective. At worst, it may lead to additional regulatory burdens that unnecessarily increase securitization costs and ultimately constrict lending.

Finally, ABA and ABASA strongly believe that it is inappropriate for FDIC as a single agency to attempt to reform the securitization process through changes to its safe harbor rule. Such broad changes warrant the due consideration not only of Congress, but also of the other bank regulators and the SEC. A number of the contemplated requirements in the ANPR are unrelated to the need to address accounting changes. Accordingly, we urge FDIC to limit any changes to those necessary to have an effective safe harbor and leave substantive securitization reform to broader fora.

<u>New Regulatory Requirements Should Not Jeopardize Securitization as a Funding Source</u>.

That securitization has become a critical source of funding and liquidity for mortgage and consumer credit markets is widely accepted.[5] At present, participants in these markets face substantial uncertainty about the future of their businesses. A significant source of this uncertainty stems from current accounting changes, the likelihood of legislative changes, and the possibility of regulatory rulemakings, for example with respect to credit rating agencies and capital and liquidity requirements. Because of the potential convergence of these new requirements and the "moving target" nature of many of these changes, our members who are actively involved in securizations are unable currently to assess accurately the business and operational impacts of the changes contemplated in FDIC's ANPR.

As noted above, H.R. 4173 would require a study by the Federal Reserve Board on the impact of accounting changes and credit risk retention requirements on securitizations, which should provide the regulators with a roadmap to develop regulations without greatly diminishing securitization as a means of efficient and effective funding for our credit markets. ABA and ABASA strongly believe that such an impact assessment is a wise undertaking in the current environment in advance of any substantive rulemaking affecting securitization.

1. Eligibility for the Safe Harbor Must Be Readily Ascertainable.

From an investor perspective, it is critical to know at the time of inception whether a particular transaction qualifies for the safe harbor. Investors will want to know with certainty that the safe harbor will apply from issuance of securities through maturity. Alternatively, if the safe harbor clearly does not apply, the investor can use that information to assure that the price properly reflects the risks.

[5] American Bar Association, *Securitization in the Post-Crisis Economy: An ABA Business Law Section White Paper,* November 20, 2009, pg. 7, available at http://meetings.abanet.org/webupload/commupload/CL116000/newsletterpubs/BusinessLaw_AssetSecuritizationReforms.pdf.

If the safe harbor determination may be invalidated at some later point because of vague eligibility requirements or improper disclosure or recordkeeping its utility is illusory. If bank sponsors cannot assure investors that the safe harbor will continue for the life of the securitizations, the investors will divert funds into alternative investments or seek risk premiums in the pricing of securities, to the detriment of consumers seeking credit.

The Sample Regulatory Text in the ANPR contains a number of vague requirements that may give rise to second-guessing regarding the availability of the safe harbor. For example, is the safe harbor invalidated because disclosures are subsequently found to be improper or because the sponsor fails to give the required ongoing disclosures? Another example is the possible requirement that representations and warranties must be "consistent with industry best practices." At present, there are no industry-wide anointed "best practices" for representations and warranties. The reluctance of investors to rely on the safe harbor because of such uncertainties will lead to fewer investors for securitization products and increased transaction costs.

2. Disclosure Requirements Are Within the Purview of the SEC.

The Sample Regulatory Text would apply additional disclosure requirements to all bank-sponsored securitizations. While we understand the need for better disclosure to help restore investor confidence in securitizations, we believe it is inappropriate for FDIC to establish securities disclosure requirements, an area long within the purview of the SEC, without the benefit of SEC input.

Moreover, the ANPR would impose on *all* bank-sponsored securitizations the disclosure requirements of the SEC's Regulation AB which currently apply only to publicly issued securities. We believe there is no justification for imposing the Regulation AB disclosure scheme on privately placed securities whose investors are typically highly sophisticated and who conduct their own due diligence. The likely effect of this requirement would be to raise costs for bank sponsors but not for their nonbank competitors.

Importantly, SEC Chairman Mary Schapiro has instructed her staff to begin a broad review of Regulation AB including reporting and disclosure requirements.

3. Risk Retention Requirements Should Take Into Account the Retained Risk that is Already Built into Some Types of Asset Securitization.

Any regulations imposing on bank sponsors some form of credit risk retention must be sufficiently flexible to recognize the retained risk that is currently built into securitizations of different types of asset classes. One size will *not* fit all. For example, sponsors of credit card or automobile securitizations currently retain a first loss position in the form of excess spread, overcollateralization, and/or early amortization, among other features. A requirement to hold an additional five or more percent of the credit risk will increase capital requirements leading, in turn, to increased transaction costs. Again the likely effect of such a requirement would be to raise costs for bank sponsors but not for their nonbank competitors.

4. A "Seasoning" Requirement Could Negatively Impact Securitization.

The Sample Regulatory Text would condition eligibility for the safe harbor on a requirement that all mortgage loans in the transaction have been originated not less than 12 months prior to the transfer. We understand that many problems with mortgage loans become evident in the first twelve months, and the ultimate goal is to ensure that mortgage loans transferred into securitizations have been properly underwritten to avoid such problems. However, as discussed above, we believe that efforts targeted directly at underwriting standards will be far more effective in resolving these issues than indirect efforts aimed at securitizers. We believe that the seasoning requirement will raise significant questions for originators about how to fund the loans, whether through deposits or warehouse facilities, and the treatment of refinanced loans or new loans for existing customers for purposes of that requirement. We believe that the ultimate result will be an increase in securitization costs with concomitant decreases in the number of mortgages originated.

<u>Bank-Sponsored Securitizations Should Not Be Competitively Disadvantaged by FDIC's Regulations</u>.

FDIC's regulations would apply only to bank sponsors of securitizations and, thus, could have no impact on transactions initiated by nonbank sponsors. As a result, bank sponsors will be at a competitive disadvantage with domestic nonbank and foreign securitizes that would not have to comply with new restrictions on the manner in which they structure securitization transactions. Each of the specific requirements set forth in the Sample Regulatory Text come with costs in terms of dollars and personnel. As these costs mount for bank sponsors, banks are likely to pass the increased costs on to their customers or diminish their securitization activities or exit the business altogether. None of these possible outcomes would further the goal of restarting the securitization markets or serving bank customers' home and other consumer financing needs.

<u>The Securitization Rule Should Apply to Loan Participations.</u>

As a result of FAS 166, many common loan participation transactions will no longer qualify for sale accounting treatment and will, as a result, remain on the books of the originating bank. These transactions are legal sales and satisfy the criteria for sale accounting treatment (including legal isolation, the transferee's right to pledge or exchange the asset, and the transferor no longer maintaining effective control) but do not satisfy the criteria to qualify as a "participating interest". As a result, while these participations are listed as assets on the balance sheet of the originating bank, in substance, these are assets of the participant. Accordingly, we recommend that the Securitization Rule apply to participations that are legal sales and otherwise meet the criteria for sale accounting, but do not qualify as participating interests.

For example, LIFO (Last-In, First-Out) and FIFO (First-In, First-Out) loan participations[6] are performed specifically to address efficiently risk management concerns of small community banks. LIFO and FIFO participations allow small banks both to easily service the participations and to monitor their own legal lending limits, while permitting the originating bank to maintain an exclusive relationship with a large borrower. However, FAS 166 requires the participation to maintain proportionate cash flows in order to qualify as a participating interest (and attain sale accounting).

If LIFO and FIFO participations do not qualify as participating interests eligible for the safe harbor, these transactions, which are the life-blood of many community banks, will dry up and, thus, put these banks at a competitive disadvantage. Community banks will necessarily give up many large customers as their legal lending limits will require larger banks to service their customer's needs.

Another common example of a transaction that does not qualify for sale accounting is the transfer of that portion of a loan guaranteed by the Small Business Administration. These interests typically contain 90-day recourse features whereby any premiums paid by the buyer of the loan are refunded by the originating bank if the loan prepays. This transaction, also a legal sale, does not qualify for sale accounting because the portion sold does not qualify as a participating interest under FAS 166 until the end of the recourse period. Therefore, the selling bank must retain that portion of the loan on its books. If

[6] Within LIFO participations, the originating bank advances funds to its customer until the bank reaches its legal lending limit for that borrower; afterwards, the participating bank buys the amount of the loan that exceeds this limit. Per the participation agreement, the participating bank is repaid its principal prior to repaying the originating bank (thus, the participating bank is the last-in to lend and first-out with regard to being repaid – FIFO participations work in the reverse). However, in the event of default, the originating bank and the participating bank share any losses on a pro-rata basis.

these transactions do not qualify for the safe harbor, the price of such transactions will unnecessarily be discounted to account for the risk of repossession by the FDIC during the recourse period.

Conclusion

For all of the above reasons, ABA and ABASA oppose the changes contemplated in ANPR. FDIC's action is premature given Congressional consideration of substantive changes to securitizations. Moreover, requirements contemplated in the ANPR and the Sample Regulatory Text would, we believe, significantly impair the return of securitization as a robust funding and liquidity mechanism in U.S. markets and put insured institutions at a competitive disadvantage with nonbank and foreign securitizers. Finally, as noted above, ABA and ABASA request that FDIC extend the grandfather period in its interim final rule for a minimum of six months.

If you have any questions on the foregoing, please contact the undersigned.

Sincerely,

Cristeena G. Naser