February 22, 2010

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

Re: Advanced Notice of Proposed Rulemaking Regarding the 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 (RIN #3064-AD55)

Dear Mr. Feldman:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates this opportunity to comment on the above-referenced proposed rulemaking published by the Federal Deposit Insurance Corporation ("FDIC").[2] The proposed rule (the "Proposed Safe Harbor") would amend the current safe harbor treatment set forth in 12 CFR §360.6 (the "2000 Safe Harbor") relating to the FDIC's repudiation powers (described below) in connection with participations and securitizations issued after March 31, 2010 and would, for certain transactions, provide relief from the requirement that the FDIC as conservator or receiver consent to any action taken by a secured creditor against collateral pledged by an insured depository institution ("IDI") within a 45- or 90-day period of the FDIC's appointment as conservator or receiver, respectively (the "FDIA Stay").[3]

[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit www.sifma.org.

[2] Advanced 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, 75 Fed. Reg. 4, 934 (Jan. 7, 2010) ("ANPR").

[3] 12 U.S.C. §1821(e)(13)(C).

As is evident in the ANPR, the FDIC is employing the Proposed Safe Harbor as a mechanism to regulate securitization terms and practices it views as having contributed to the credit crisis that has recently affected many IDIs and the markets generally. SIFMA supports efforts to improve the safety and soundness of the securitization process, and agrees that changes to previous practices and business models will be a necessary component of the restoration of healthy, economically beneficial securitization markets. We believe that the restoration of securitization will play a central role in an economic recovery by facilitating the return of credit availability to consumers and businesses. However, SIFMA does not believe the Proposed Safe Harbor is the appropriate means to regulate the securitization market for two reasons:

- **Regulation of the securitization market must be undertaken on a coordinated basis in consideration of on-going legislative reform efforts in Congress and in consultation with other relevant regulators.** The unilateral imposition of broad-based conditions on IDIs by the FDIC is premature. It poses an undue burden on IDIs and would front-run the large-scale, coordinated financial regulatory reform initiative currently being undertaken by Congress and other relevant regulators.

- **An insolvency safe harbor should be based on insolvency principles and should not impose requirements unrelated to insolvency.** Well-developed legal principles govern the treatment of securitized assets in insolvency. The ANPR eclipses those principles, first, by using the Proposed Safe Harbor to introduce market regulation unrelated to insolvency, and second, by suggesting that the treatment of assets under GAAP determines the treatment of assets in insolvency.

SIFMA respectfully requests that the FDIC extend the interim period for the effectiveness of the 2000 Safe Harbor (without regard to GAAP) for at least six months beyond March 31, 2010 or an appropriately longer period in order to utilize such extended interim period to work together with industry participants to outline safe harbor criteria that are based on the legal principles of isolation of assets in insolvency. If the FDIC nonetheless decides to pursue the course set out in the ANPR, SIFMA respectfully requests that the FDIC clarify the legal basis of the Proposed Safe Harbor as outlined in Section II below.

SIFMA is aware that a number of trade associations to which its members belong have submitted detailed comments on the specific requirements set forth in the ANPR and the FDIC's series of questions. This letter does not attempt to duplicate those comments. Rather, the comments that follow focus on policy implications and the legal underpinnings of the Proposed Safe Harbor as set out above. SIFMA would welcome the opportunity to discuss its concerns with the FDIC and to engage in ongoing dialogue regarding the most effective and efficient means to ensure an appropriate level of commercial certainty for market participants and a sound and robust securitization market.

I. The Proposed Safe Harbor is Not the Right Approach for Regulating Securitization

The ANPR has been published in the midst of attempts to effect broad-based reform of the financial regulatory system. While SIFMA is supportive of the FDIC's role in this effort, SIFMA believes that reform of the securitization market and the treatment of assets in insolvency are separate issues: the former requires measured and coordinated action in consultation with Congress and other relevant regulators and should be driven by broad-based market considerations, while the latter requires careful consideration of the legal principles governing the treatment of assets in insolvency and should be driven by those principles.

The ANPR takes the opposite approach. It uses the Proposed Safe Harbor to unilaterally regulate the bank securitization market, and, indirectly, the securitization industry as a whole. The FDIC's actions in this regard are of particular concern in light of recent proposals to extend the FDIC's resolution authority to permit it to exercise its receivership powers over many systemically significant financial companies. If such proposals go forward, the FDIC's legal analysis will become relevant to transactions involving a wide array of entities, thus heightening the need for coordinated regulation with input from Congress and all relevant regulators.

Additionally, the ANPR represents a unilateral policy action that would appear to front-run, and possibly conflict with, a number of deliberative legislative and regulatory undertakings that are already in motion. For example, the Securities and Exchange Commission ("SEC") is currently examining revisions to the requirements of Regulation AB and other securities laws that affect securitization, as part of a comprehensive process to review the "regulation of the asset-backed securities market — from disclosures to offering process to the reporting of asset-backed issuers."[4] Additionally, there are a number of proposals active in Congress that would affect securitization; importantly, many of them address the same issues as the ANPR but vary in their application and specific terms, thus potentially conflicting with the ANPR and creating uncertainty in securitization markets.

We also note that regulation of securitization is a safety and soundness issue of concern to all banking regulators, and therefore believe that a consultative process with those regulators is essential. Importantly, the Office of the Comptroller of the Currency has recently expressed doubts as to the efficacy of mandatory risk retention or "skin-in-the-game" requirements, which are at the core of the ANPR, advocating instead for directly establishing minimum underwriting standards.[5]

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[4] SEC Chairman Mary Schapiro's remarks to the 37th Annual Securities Regulation Institute, available online: http://sec.gov/news/speech/2010/spch012010mls.htm.

[5] "Securitization, 'Skin-in-the-Game' Proposals and Minimum Mortgage Underwriting Standards", remarks by John C. Dugan before the American Securitization Forum (February 2, 2010) ("Dugan Remarks"). Available online: http://www.occ.gov/ftp/release/2010-13a.pdf. Economists at the International Monetary Fund have also

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Unilateral action by the FDIC in the nature of the Proposed Safe Harbor, particularly at this time, would create a serious risk of inconsistency and uncertainty for all market participants. In contrast, the SEC and Congress would act in a manner that affects the entirety of the securitization market, not just a subset of the market embodied by the IDIs. Coordinated action by all banking regulators would similarly maximize the impact of regulatory reform. In particular, the ANPR would subject IDIs to disproportionate compliance and capital costs and regulatory burdens not borne by originators outside the FDIC's authority. While reform of securitization practices is warranted, the costs associated with the ANPR's requirements are not justified for all areas of securitization activity by IDIs. For example, for over 20 years the SEC has recognized that the extensive disclosure requirements of registered sales may be unnecessary in the institutional markets, and that the less restrictive practice of the 144A market can encourage issuers who "may have foregone raising capital in the United States due to the compliance costs and liability exposure associated with registered public offerings."[6] Yet the ANPR imposes extensive reporting and disclosure requirements uniformly on every securitization, whether originated by the smallest local bank or the largest international lender, and whether privately sold to a single sophisticated institution or publicly marketed to thousands. In addition to disadvantaging IDIs relative to non-bank institutions, the ANPR would also create an international competitive disadvantage for U.S. based IDIs, as foreign institutions would not be subject to its impact.

The costs and burdens of the ANPR's proposed terms would have the dual effect of placing IDIs (particularly smaller IDIs) at a potentially significant competitive disadvantage as compared to other originators as well as placing disparate requirements on securitizations as compared to other non-public securities offerings. As a result, rather than help to revitalize IDI securitizations – one of the most important tools in the provision of credit to consumers and businesses – such costs and burdens risk stifling IDI securitizations in the midst of an already tentative economic recovery. Such an approach is all the more premature in light of significant recent changes to regulatory capital treatment, the effects of which remains largely undetermined.

It is furthermore important to recognize an inherent deficiency in the use of the Proposed Safe Harbor as an indirect regulation. Although the responsibility for compliance with the conditions of the rule weighs on the IDI, the only consequence that would appear to flow from an IDI's failing to comply would be removal of the safe harbor for the relevant securitization. This could have significant consequences for the ratings assigned to an outstanding security, as well as for other investment characteristics that are important to its

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expressed doubts that a simple, across the board requirement would be effective. See Chapter 2 of the 2009 *Global Financial Stability Report*, available online: http://www.imf.org/external/pubs/ft/gfsr/2009/02/pdf/chap2.pdf

[6] Securities Act Release No. 6806 (October 25, 1988) (proposing adoption of Rule 144A under the Securities Act of 1933).

market value. Moreover, the costs and uncertainty of litigating any repudiation challenge by the FDIC, as well the consequences of losing true sale treatment, will likewise ultimately be borne by investors. The perverse effect of regulating securitizations by way of an insolvency safe harbor is that it is investors in the securitization markets, and not the IDI, who will ultimately be penalized for the IDI's failure or inability to comply with the rule. A direct regulation of securitization activity, implemented in coordination with actions by Congress and other relevant agencies, is the proper way to achieve the FDIC's aims without such adverse consequences for investors.

II. The Proposed Safe Harbor Does Not Promote the Goal of Legal Certainty for Securitization and for IDI Insolvency Rules Generally

SIFMA fully supports revising the 2000 Safe Harbor to provide certainty to market participants and investors as to how the FDIC would view a particular transaction in the event of an IDI insolvency. However, as noted above, SIFMA believes an insolvency safe harbor should be driven by the legal principles governing the treatment of assets in insolvency. The Proposed Safe Harbor not only imposes requirements we believe are unrelated to insolvency, but by dividing securitizations into two categories – those that qualify for sales accounting treatment and those that do not – and attaching vastly different consequences to each, it creates the impression that the treatment of assets under GAAP is dispositive of the treatment of assets in insolvency. As will be discussed in more detail below, such an approach is inconsistent with the history of the 2000 Safe Harbor and belies well-developed principles of insolvency law. In particular, SIFMA urges the FDIC to make clear in any final safe harbor that:

- the FDIC's power to repudiate a contract is not a general power to avoid asset transfers;
- whether a transaction is a sale under GAAP does not determine whether a transaction is a "true sale" at law;
- whether an entity is consolidated under GAAP does not determine whether an entity should be substantively consolidated in insolvency; and
- any safe harbor created by the FDIC is not exclusive. Under well-accepted legal principles, the failure to comply with one or more safe harbor conditions should not necessarily place the transferred assets within the reach of the FDIC as conservator or receiver.

A. Securitization Relies on Basic Principles of Legal Isolation

For the past several decades, securitizations have played an increasingly vital role in the U.S. economy. Securitization links the capital markets and credit formation activity, increasing the availability of credit to consumers and businesses at lower costs. According to

data from the Federal Reserve's Flow of Funds Statistics, securitization increased from four percent of credit provision in 1970 to about 30 percent by the end of 2008.[7]

Securitization depends fundamentally on the use of corporate structures that isolate financial assets from the general assets of the IDI effecting a securitization. Historically, IDI securitizations used a "one-step" corporate structure whereby the originator of financial assets (the "Originator") would sell assets to a special purpose entity ("SPE"), often a trust, which was specifically set up to purchase the Originator's assets and segregate payment flows on such assets from the other assets of the Originator (the "Issuer"). The Issuer would issue securities to investors and cash flows on the securitized assets would be paid through to investors according to the terms of the specific securities.

While "one-step" securitizations may still be used in certain circumstances, the majority of securitizations today take place according to a "two-step" structure whereby the Originator transfers assets to an SPE that may be a wholly-owned subsidiary of the Originator and, among other conditions, is only permitted to engage in the business of acquiring, owning and selling the Originator's assets. The SPE then sells the assets to the Issuer, which issues the securities to investors.

In each case, a securitization typically depends on a "true sale" in relation to the securitized assets, meaning that the assets are legally transferred to and owned by the securitization SPE. Originators and investors favor the two-step structure because the transfer of assets to the intermediate SPE is generally viewed to be a "true sale" of the Originator's assets to an entity that is "bankruptcy remote" from the Originator, meaning the entity should not be substantively consolidated with the Originator in an insolvency. Even if the transfer from the intermediate SPE to the Issuer may not be a "true sale", because the intermediate SPE is bankruptcy remote from the Originator, the transaction as a whole places the assets beyond the reach of the FDIC as conservator or receiver. Placing the assets beyond the reach of the FDIC as conservator or receiver is critical to the fundamental goal of securitizations, which is to isolate the assets supporting payments on the securities from the Originator. Such isolation allows rating agencies to evaluate the securities based on the credit quality of the securitized assets rather than the creditworthiness of the Originator and protects investors in the event of the Originator's insolvency from a court's determination that the cash flows backing the securities or the assets themselves are part of the Originator's estate. Placing the assets beyond the reach of the FDIC as conservator or receiver also protects investors from reinvestment risk that would arise from the FDIC's right to prepay financing obtained from the securitization.

A securitization that purports to place assets beyond the reach of the FDIC as conservator or receiver can be subject to two principal types of challenges. First, a court may examine the particular facts and circumstances of the securitization and determine that the

[7] Dugan Remarks, *supra* note 5.

transaction is properly characterized as a secured borrowing rather than a true sale.[8] Second, the court may examine the particular facts and circumstances of the SPE or intermediate SPE and determine that the entity and its assets should be substantively consolidated with the Originator.[9] In either case, the end result is that the financing obtained in the securitization can be repudiated as secured debt of the IDI.

B. *The FDIC's Receivership Powers Have Historically Been Construed to Respect Securitization Principles*

While the principles of true sale and substantive consolidation may apply in the case of an IDI insolvency as they would in the insolvency of any other originator, the particular powers of the FDIC as receiver raise specific issues for investors. One of the most significant of the FDIC's powers as conservator or receiver of a failed IDI is the power to disaffirm or repudiate any contract or lease (i) to which the IDI is a party; (ii) the performance of which the conservator or receiver determines to be burdensome; and (iii) the disaffirmance or repudiation of which the conservator or receiver determines, in the conservator's or receiver's discretion, will promote the orderly administration of the IDI's affairs.[10]

The FDIC's power to disaffirm or repudiate a contract simply permits the conservator or receiver to terminate the contract, thereby ending any future obligations imposed by the contract. It is not a general power to avoid consummated sales of assets. Thus, where a court determines a securitization to be a true sale, the repudiation power does not give the FDIC the power to reclaim or recover transferred assets. The FDIC explained this clearly in the release announcing the adoption of the 2000 Safe Harbor:

> [A] transaction that purports to be a sale of all of a financial asset … which would be characterized as a sale under the general legal view, should not need to be encompassed by the rule; the FDIC would not be able to recover transferred assets as a result of

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[8] Courts in the United States have looked to a number of factors in determining whether a transaction is properly characterized as a "true sale". Such factors may include objective indicia of intent such as the written agreement, (See e.g., In re Sackman Mortgage Corporation, 158 B.R. 926 (Bankr. S.D.N.Y. 1993)) the parties' practices, objectives, business activities and relationships (See, e.g., In re Joseph Kanner Hat Co., Inc., 482 F.2d 937 (2d Cir. 1973); Kelter v. American Bankers' Fin. Co., 160 A. 127 (Pa. 1932)), treatment by parties for tax and accounting purposes (See e.g., In re Bevill, Bresler & Schulman Asset Mgmt. Corp., 67 B.R. 557 (D.N.J. 1986)) and the economic substance of the transaction including the allocation of burdens and benefits (see e.g., Sackman, 158 B.R. at 933)) and recourse arrangements (See e.g., Major Furniture Mart, Inc. v. Castle Credit Corp., 602 F.2d 538 (3d. Cir. 1979)). There is no uniform test nor is one particular factor determinative. As discussed below, we look forward to discussing with the FDIC a safe harbor that sets forth a minimum, non-exclusive test, based on this case law.

[9] Likewise, in determining whether an affiliate should be substantively consolidated with the insolvent entity, courts apply a number of factors on a case-by-case basis. See Letter to Neil D. Baron, Esquire from John C. Murphy, Jr., FDIC General Counsel (April 9, 1986) (the "Murphy Letter"), attached as Annex A.

[10] 12 U.S.C. §1821(e)(1).

> repudiation. In the case of a completed sale, the FDIC would have nothing to repudiate if no further performance is required. Even in the case of a sale transaction that imposes some continuing obligation, a repudiation by the FDIC would relieve the FDIC from future performance, but generally should not result in the recovery of any property that was transferred by the institution before the appointment of the conservator or receiver.[11]

The ANPR reiterates this position, stating:

> The [2000 Safe Harbor] 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 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.[12]

In other words, where a transaction would be characterized as a sale according to applicable legal principles, no safe harbor from the repudiation power is needed. Where, because of the particular facts and circumstances of the transaction, a securitization would <u>not</u> be characterized as a true sale and would instead be characterized as a secured borrowing, or where, according to corporate separateness principles, the SPE or intermediate SPE to which the assets were transferred would be substantively consolidated with the IDI, the repudiation power has more significance. In such cases, the repudiation power would permit the FDIC to accelerate and repay principal and interest on the indebtedness attributed to the IDI, possibly through the date of receivership rather than through the date of repayment, and recover any collateral to the extent the value of the collateral exceeds the claim for repudiation damages. Moreover, since 2006, the FDIA Stay has given the FDIC the additional power to stay any action taken by a secured creditor against collateral pledged by an IDI within a 45 or 90 day period of the FDIC's appointment as conservator or receiver, respectively. Each of these powers creates risk to investors should a court fail to view a securitization as placing the assets beyond the reach of the FDIC as conservator or receiver.

IDIs therefore seek to structure, and investors seek to purchase, securitization interests that are not only disassociated from the credit risk of the IDI, but also from the risks associated with the FDIC's repudiation power. In this vein, in 1986, at the request of rating agencies that would otherwise have declined to rate mortgage pay-through bonds issued by an IDI subsidiary, the FDIC's General Counsel issued his opinion that a court would not substantively consolidate an issuing SPE subsidiary of an IDI provided certain conditions, based on generally recognized principles from reported judicial decisions, were met.[13]

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[11] 65 Fed. Reg. 156, 49189, 49192 (Aug. 11, 2000).

[12] ANPR, *supra* note 2 at 934.

[13] Murphy Letter, *supra* note 9.

C. *The 2000 Safe Harbor Was a Non-Exclusive Clarification of Accepted Limits on the Repudiation Power*

The 2000 Safe Harbor was issued in the wake of the adoption of Financial Accounting Standard No. 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, which later became Financial Accounting Standard No. 140 ("FAS 140"). Under FAS 140, one of the stated conditions for sales accounting is that the transferred asset must be beyond the reach of the transferor in a bankruptcy or receivership, otherwise known as "legal isolation". While securitizations had been accomplished by IDIs under the legal standards above prior to 2000, market participants seeking to apply the FAS 140 standard sought express comfort from the FDIC as to whether and how its statutory repudiation powers as receiver would apply in the context of a securitization: i.e. whether transferred assets could be reclaimed by the FDIC as having merely been pledged. The FDIC undertook that it would not seek to exercise its repudiation power (presumably whether arising from a "true sale" or substantive consolidation rationale), in relation to asset transfers made in connection with securitizations, where the transfers would otherwise meet the requirements for sales accounting under GAAP.[14]

As noted above, the FDIC recognized in 2000 that where a securitization would otherwise be treated as a sale under applicable legal principles, no safe harbor from the FDIC's repudiation power was truly necessary. Under the securitization structures contemplated by FAS 140, however, such treatment was uncertain in the absence of assurances from the FDIC. At the time, IDI securitizations were generally structured as one-step transactions, and there were significant concerns that retained recourse and other factors could lead the one-step transaction to be recharacterized as a non-recourse secured borrowing. In addition, to the extent that IDI securitizations were structured as two-step transactions, FAS 140 called for sales accounting for securitizations to be based on the device of a "qualified special purpose entity" ("QSPE"), which could take a variety of legal forms but would have contractually restricted purposes and powers. The equity or residual interest in the assets held by the QSPE could be owned principally, or even entirely, by the Originator, and the transfer to the QSPE would still be treated as a sale for accounting purposes. The requirements for qualifying as a QSPE were different and arguably more permissive than the principles of corporate separateness set out in the Murphy Letter, thus creating uncertainty as to whether the FDIC would view securitizations structured in accordance with FAS 140 as sales.[15]

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[14] In addition, the 2000 Safe Harbor requires that the IDI receive adequate consideration for the transfer of financial assets at the time of the transfer and that the documentation effecting the transfer reflect the intent of the parties to treat the transaction as a sale, and not as a secured borrowing, for accounting purposes. 12 CFR §360.6(c).

[15] After the 2000 Safe Harbor was issued, the AICPA issued guidance that required lawyers to render true sale opinions beyond the FDIC comfort given in the 2000 Safe Harbor, which in turn led to the migration of one-step securitization structures to two-step securitizations, as well as changes in many state laws relating to securitizations and the originator's "right of redemption". Even though the impetus for the 2000 Safe Harbor was the GAAP treatment of IDI securitizations, these later developments made the 2000 Safe Harbor less relevant to such

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The 2000 Safe Harbor facilitated accounting rules that allowed an IDI to achieve off-balance sheet accounting for sales that were in economic substance very much like non-recourse secured financings. Off-balance sheet securitizations allowed IDIs to lessen regulatory capital requirements associated with their exposures to financial assets and free up capital for other purposes. With this context in mind, it is clear that the FDIC did not intend to suggest that achieving GAAP sales accounting was *necessary* in order for a securitization to be considered a legal sale, but simply that the FDIC would consider sales accounting as *sufficient* in order for a securitization to be considered a legal sale, provided the other 2000 Safe Harbor conditions were met. As noted in the release to the 2000 Safe Harbor, "the rule is not intended to describe the exclusive circumstances in which legal isolation may occur."[16]

D. The FDIC Should Not Permit Accounting Changes to Create Legal Uncertainty

In June 2009, the FASB published Financial Accounting Statements No. 166, *Accounting for Transfers of Financial Assets* ("FAS 166") and No. 167, *Amendments to FASB Interpretation No. 46(R)* ("FAS 167") which change the way entities account for securitizations and SPEs. Under the new standards, the majority of securitizations will not be accounted for as sales but rather as secured borrowings. The vast majority of circumstances in which a securitization will be off-balance sheet will involve transfers to entities so clearly separate from the transferor as to make a challenge to such transfer based on true sale or substantive consolidation quite remote. As a result, the rationale for the 2000 Safe Harbor, which was predicated on facilitating sales accounting treatment under GAAP, no longer applies and the 2000 Safe Harbor is effectively obsolete.

Instead, the principal relevance of the loss of the 2000 Safe Harbor is to rating agencies and investors that no longer have the high degree of certainty it created as to when the FDIC would view a given securitization as a true sale or as a secured loan, thus exposing investors not only to the risk of repudiation and prepayment, but also to the FDIA Stay. However, in SIFMA's opinion, while uncertainty is an expected consequence of the loss of a bright-line safe harbor, much of the apprehension surrounding the impact of the change in accounting standards stems from a fundamental misunderstanding regarding the relationship between accounting treatment and insolvency treatment. As discussed, the 2000 Safe Harbor was never expressed to be exclusive. Judicial principles relating to true sale and substantive consolidation apply as they always have. Put another way, the loss of sales accounting treatment

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treatment. The 2000 Safe Harbor was still important, however, to the rating agencies and investors as an expression of the FDIC's intent regarding the treatment of both one-step and two-step structures in the event of a conservatorship or receivership of the IDI.

[16] *Supra* note 11 at 49191.

for securitizations under GAAP does not, either in theory or in practice, necessarily entail the loss of true sale treatment for receivership purposes.

Unfortunately, the ANPR sows confusion and uncertainty in this respect. The Proposed Safe Harbor divides the securitization world into essentially two categories: those that meet sales accounting requirements and are not subject to the repudiation power and those that do not meet sales accounting requirements and are only protected from the FDIA Stay in certain circumstances. In so doing, the ANPR seems to suggest that the position taken by the FASB by way of GAAP is dispositive of how a given transaction would be regarded by the FDIC in receivership. Such an approach sets aside well- accepted judicial principles of insolvency law. And it turns the FDIC's prior approach to sales accounting – as a *sufficient*, but not *necessary*, element of legal sale treatment – upside down.

Linking GAAP accounting standards – which change over time – and the FDIC's powers as conservator or receiver departs from past FDIC practice and is contrary to the goal of legal certainty in the securitization market. In particular, as noted, the FDIC takes this step at a time when an accounting sale has become far more difficult to achieve. Accounting standards have shifted enormously relative to the circumstances at the time of the 2000 Safe Harbor. Whereas the prior rules facilitated deconsolidation based on formal compliance with concepts such as the QSPE, the new standards under FAS 167 promote consolidation through the notion of a "controlling financial interest." A "controlling financial interest" requiring consolidation need not comprise all or even a majority of the residual economic interest in transferred assets. For example, if an IDI is in day-to-day control of the servicing activity of an entity, the IDI must consolidate that entity not merely if the IDI retains a majority of the risks and rewards of the entity, but in some cases if the IDI has any "obligation to absorb losses of the entity that could potentially be significant to the variable interest entity or the right to receive benefits from the entity that could potentially be significant to the variable interest entity."[17] This is in marked contrast to the now abandoned notion of a QSPE, which permitted an IDI to have very substantial economic exposure to the assets of an entity and yet not account for that entity's obligations as secured debt of the IDI.

The circumstances leading to the adoption of the 2000 Safe Harbor are essentially now reversed: many obligations of SPEs will be accounted for as debt of an IDI in circumstances that would be well outside those which would have suggested possible substantive consolidation between the SPV and the IDI as a matter of general law or of the FDIC's interests as conservator or receiver.[18] By no means should it require special assurance from the FDIC to reach the

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[17] FAS 167 Paragraph 14A.

[18] To take another example, if an IDI acts as servicer of a mortgage securitization and holds a one-third equity interest in it, the IDI would likely consolidate the entity for accounting purposes even though another investor holds a majority of the equity. (See FAS 167, Appendix C, Example 2). That level of involvement is very different from the sort of close correspondence between a securitization SPV and the IDI itself that prompted prior concerns about the effect of the repudiation power on the sale and accounting standards.

conclusion that, in a receivership, debt of an entity to which an IDI merely has some "potentially significant" exposure will not be treated as secured debt of the IDI itself in a receivership.

Accounting standards are driven by a myriad of considerations, not all of which necessarily correlate to the policy considerations underpinning insolvency and other relevant areas of law. For this reason, it is no surprise that accounting treatment and treatment in insolvency differ in many circumstances outside of securitizations. For example, in the context of repurchase transactions, depending on the particular facts and circumstances of the transaction, courts have in some cases treated such transactions as secured loans and in other cases as purchases and sales, despite the fact that such transactions are generally accounted for as secured loans.[19] The accounting treatment has been considered as a relevant factor, but has by no means been dispositive.[20] Moreover, as a general matter, affiliated corporate entities are consolidated for accounting purposes, yet they are treated as separate for insolvency and corporate law principles. Absent factors justifying "substantive consolidation", it would be a revolutionary idea to treat such entities as consolidated for insolvency law purposes simply because they are consolidated for accounting purposes.

E. A New FDIC Safe Harbor Should Reaffirm Accepted True Sale and Nonconsolidation Principles

To be clear, as noted above, SIFMA welcomes the amendment of the 2000 Safe Harbor to provide certainty not only to IDIs and rating agencies, but also to investors, as to how their investments will be affected in the event of an IDI's insolvency. However, in order to properly realign the relationship between accounting treatment and treatment in insolvency, the FDIC should make explicit, as it did in 2000, that the Proposed Safe Harbor is not exclusive. The FDIC should expressly confirm that "general legal principles" for determining whether a transfer is considered a sale referenced in the release to the 2000 Safe Harbor, as well as the commonly recognized judicial principles for determining corporate separateness referenced in the Murphy Letter, still apply to securitizations that fall outside the Proposed Safe Harbor or fail to satisfy one of its conditions.[21]

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[19] For cases where a repurchase transaction was considered to be a secured loan, see e.g., RTC v. Aetna Cas. & Sur. Co. of Ill., 25 F.3d 570 (7th Cir. 1994); Lombard-Wall Inc. v. Columbus Bank & Trust Co., No. 82 B 11 55 6 (Bankr. S.D.N.Y., bench decision, September 16, 1982). For cases where a repurchase transaction was considered to be a purchase and sale, see e.g., County of Orange v. Fuji Securities, Inc., 31 F. Supp. 2d 768 (C.D. Cal. 1998); Granite Partners. L.P. v. Bear, Stearns & Co., Inc., 17 F.Supp. 2d 275 (S.D.N.Y. 1998); Bevill, Bresler, *supra* note 8.

[20] See e.g., Bevill, Bresler, *supra* note 8 at 591-592.

[21] The FDIC's recognition of these principles has not been confined to the Murphy Letter or the 2000 Safe Harbor. As recently as 2008, in its Covered Bond Policy Statement, the FDIC confirmed that "[t]he FDIC applies well-defined standards to determine whether to treat such entities as ''separate'' from the IDI. If a subsidiary or SPV, in fact, has fulfilled all requirements for treatment as a ''separate'' entity under applicable law, the FDIC as conservator or receiver has not applied its statutory powers to the subsidiary's or SPV's contracts with third parties." 73 Fed Reg. 145, 43754, 43755 (July 28, 2008).

Moreover, as was implicit in the FDIC's comments in the release to the 2000 Safe Harbor, the FDIC should confirm that where a transaction would be characterized as a sale according to applicable legal principles, no safe harbor from the repudiation power is needed. In this regard, the application of the Proposed Safe Harbor requirements to transfers by an IDI which would otherwise be accounted for as a sale, to entities that would not be consolidated with the IDI under FAS 167, is neither warranted nor appropriate. A transaction between an IDI and a special purpose entity may of course raise true sale or repudiation concerns based on specific facts and circumstances. But to consider the general application of the repudiation power for sales to entities in which a party other than the IDI has the "controlling financial interest" introduces more legal and commercial uncertainty than it resolves.

More generally, the FDIC should provide a clear definition of "securitization" so as to dispel the impression that transactions that are not ordinarily considered as securitizations could be subject to the Proposed Safe Harbor criteria, and remove any potential negative implication as to the FDIC's repudiation power as a result of the failure of such transactions to comply with the Proposed Safe Harbor requirements. For example, to follow on one of the specific questions raised in the ANPR, unfunded or synthetic securitizations should be clearly excluded. Not only do such transactions not involve an asset transfer, they involve "Qualified Financial Contracts" that are governed by separate rules and the application of the Proposed Safe Harbor requirements to such transactions would be wholly inappropriate. Likewise, transactions that fit within the Covered Bond Policy Statement should also be clearly outside the Proposed Safe Harbor.

III. Conclusions

In closing, SIFMA wishes to reiterate its support for coordinated, comprehensive and measured regulation to improve the safety and soundness of the securitization market and for an insolvency safe harbor to provide certainty to market participants and investors. In SIFMA's view, however, the Proposed Safe Harbor accomplishes neither goal. SIFMA therefore urges the FDIC not to act unilaterally to regulate securitizations and to coordinate and participate with other relevant regulators in the larger conversation currently taking place regarding regulation of the securitization market. Finally, as noted above, SIFMA asks the FDIC to extend the interim period for the effectiveness of the 2000 Safe Harbor (without regard to GAAP) for at least six months beyond March 31, 2010 or an appropriately longer period in order to utilize such extended interim period to work together with industry participants to outline safe harbor criteria that are based on the legal principles of isolation of assets in insolvency.

* * * * *

SIFMA thanks the FDIC for affording it the opportunity to comment on the Proposed Safe Harbor. If you have any questions concerning these comments or would like to

discuss our comments further, please feel free to contact Christopher Killian, Vice President, Securitization Group at (212) 313-1126 or via email at ckillian@sifma.org or our outside counsel on this matter, Seth Grosshandler at (212) 225-2542 or via email at sgrosshandler@cgsh.com or Michael A. Mazzuchi at (202) 974-1572 or via email at mmazzuchi@cgsh.com, both of Cleary Gottlieb Steen & Hamilton LLP.

Sincerely,

Randolph C. Snook
Executive Vice President

ANNEX A

FDIC
Federal Deposit Insurance Corporation
Washington, DC 20429

General Counsel

April 9, 1986

Neil D. Baron, Esquire
Booth & Baron
122 East 42nd Street
New York, New York 10168

Dear Mr. Baron:

I am writing in response to your letter of March 7, 1986, on behalf of Standard & Poor's Corporation ("S&P"), regarding the position of the Federal Deposit Insurance Corporation ("FDIC") with respect to the separateness of a subsidiary established by an FDIC-insured institution in connection with the issuance by the subsidiary of mortgage pay-through bonds or preferred stock.

Your letter states that the insolvency of an FDIC-insured institution generally results in the acceleration of indebtedness secured by collateral pledged by such institution. As a result, a debtholder has a reinvestment risk associated with the insolvency of such institution. As a method of eliminating this reinvestment risk with respect to mortgage pay-through (or cash flow) bonds, it has been suggested that the insured institution create a wholly-owned subsidiary to which the insured institution would transfer, by capital contribution or otherwise, assets sufficient to satisfy S&P's rating criteria. The rated debt obligation would be issued by the subsidiary so that the insolvency or the appointment of a receiver with respect to the insured institution would not accelerate, and therefore not pose a reinvestment risk with respect to, such debt obligation. Indentures securing these financings would not provide for acceleration in the event of the insolvency of the insured institution. Your letter states further that inasmuch as S&P's rating is an assessment of compliance with the payment terms of the indenture, S&P will not rate these financings without our concurrence with your view that, as a legal matter, the separateness of the subsidiary would be maintained notwithstanding the insolvency of the insured institution.

Your letter states further that the issue of the separateness of such a subsidiary also arises in connection with a proposed issuance of preferred stock by such subsidiary. If the separateness of the subsidiary were disregarded upon the insolvency of the insured institution, the

preferred shareholders' rights to such assets would be subordinated to the rights of the general unsecured creditors of the insured institution.

Based on a letter from General Counsel to the Federal Home Loan Bank Board, dated March 23, 1984, S&P has rated preferred stock issued by subsidiaries of depository institutions insured by the Federal Savings and Loan Insurance Corporation. S&P has declined to rate similar financings issued by subsidiaries of FDIC-insured institutions due in part to its concern that the FDIC might attempt to disregard the separateness of the subsidiary. You have therefore requested our opinion regarding the separateness of such a subsidiary.

As you are aware, the FDIC does not issue binding advisory opinions as to positions it would adopt in hypothetical situations that arise in future receiverships of insured institutions. The FDIC's actions in its capacity as receiver of a failed insured institution are determined on a case-by-case basis, in accordance with applicable law and in light of the specific factual situation. I am willing, however, to provide my views as to what a court would hold in response to a challenge by the FDIC as receiver of a failed insured institution to the separateness of a subsidiary of the institution in connection with the subsidiary's issuance of mortgage pay-through bonds or preferred stock.

The requirements for maintaining the separate corporate identity of a wholly-owned subsidiary are discussed in detail in reported judicial decisions. Although there are variations that reflect differences in state law or the nature of a subsidiary's operations, there are certain organizational elements and operating procedures that are generally recognized as preserving the corporate separateness in the absence of other factors such as, for example, fraudulent purpose on the part of a parent. Your letter states that for purposes of this response regarding finance subsidiaries I should assume the existence of the following facts:

1. <u>Corporate Procedures</u>

   a) The subsidiary has established a separate office through which its business is conducted. In this connection, the insured institution might lease such office space on its premises to the subsidiary as may be necessary to the subsidiary's operations.

   b) At least one of the subsidiary's directors and one of its executive officers are not employees of the insured institution.

   c) The subsidiary maintains separate corporate records and books of accounts.

   d) The subsidiary's funds are not commingled with those of the insured institution.

e) The Board of Directors of the subsidiary will hold appropriate meetings to authorize all of the subsidiary's corporate actions.

f) The subsidiary is adequately capitalized in light of its contemplated business obligations.

2. Fairness of the Financing

The insured institution will receive an opinion from a reputable investment banking firm to the effect that:

a) The value of the subsidiary's common stock and the net proceeds from the sale of the subsidiary's obligations represent a fair and reasonably equivalent consideration for the assets transferred by the insured institution to the subsidiary.

b) The financing constitutes a practicable and reasonable course of action designed to improve the financial position of the insured institution without impairing the rights of its creditors (the "Reasonable Course Opinion"). A Reasonable Course Opinion would not, however, be provided in connection with pay-through bonds, with respect to which the collateral pledged to secure such bonds will generate a cash flow sufficient to provide full and timely payment of such bonds. You state that the need for a Reasonable Course Opinion is obviated by the fact that with respect to pay-through bonds the value of the collateral (other than overcollateralization provided merely as a substitute for pool insurance) will be approximately equal to the funds received by the insured institution from the sale of the bonds. In this connection, you enclose correspondence between the First Boston Corporation and the General Counsel of the Federal Home Loan Bank Board.

3. Business Purpose

The insured institution will adopt resolutions approving the financing as being in the best interest of the insured institution and its creditors. In such resolutions, the insured institution will determine that the financing represents a practicable and reasonable course of action to improve the financial position of the insured institution without impairing the rights of its creditors.

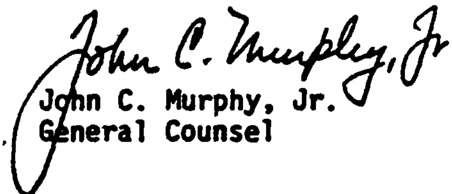
4. <u>Disclosure</u>

All material facts relating to the financing will be adequately disclosed in any offering circular or prospectus distributed in connection with the offering of the subsidiary's obligations, and following such offering the insured institution will disclose all material transactions associated with the financing in appropriate communications to depositors and in public announcements. Moreover, the annual financial statements of the insured institution will disclose the results of the financing under generally accepted accounting principles. In disclosing the use of proceeds, however, the offering circular might indicate that the proceeds will be used for general corporate purposes, without more specific disclosure.

It is my opinion that, based on the facts and conclusions you have assumed, a court would not uphold an attempt by the FDIC as receiver of the insured institution to disregard the separateness of the subsidiary.

I hope that the foregoing is responsive to your inquiry.

Sincerely,



John C. Murphy, Jr.
General Counsel