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***VIA E-MAIL:* comments@fdic.gov**

c/o Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
Attention: Comments

Re: Defining Safe Harbor Protection for 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)

Ladies and Gentlemen:

I appreciate the opportunity to submit this letter in response to the request of the Federal Deposit Insurance Corporation (the "FDIC") for comments regarding the Advanced Notice of Proposed Rulemaking (the "ANPR") referenced above. My response will include general comments on the proposed revisions to the current regulations, while also addressing some of the specific issues raised by the FDIC for comment, as appropriate.

Background

In 2000, the FDIC clarified the scope of its statutory authority as conservator or receiver to disaffirm or repudiate contracts of an insured depository institution with respect to transfers of financial assets by an insured depository institution in connection with a securitization or participation when it adopted a regulation codified at 12 CFR 360.6 (''the Securitization Rule''). Among other things, this Securitization Rule provided the necessary confirmation of ''legal isolation'' and has served as a central component of securitization by providing assurance that investors could look to securitized financial assets for payment without concern that the financial assets would be interfered with by the FDIC as conservator or receiver ("the Safe Harbor provision").

Recently, the implementation of new accounting rules has created uncertainty for securitization participants with respect to the Safe Harbor provision. On June 12, 2009, the Financial Accounting Standards Board (''FASB'') finalized modifications to GAAP through Statement of Financial Accounting Standards No. 166, *Accounting for Transfers of Financial Assets, an Amendment of FASB Statement No. 140* (''FAS 166'') and Statement of Financial Accounting Standards No. 167, *Amendments to FASB Interpretation No. 46(R)* (''FAS 167''). The standards are effective for annual financial statement reporting periods that begin after November 15, 2009, and affect whether a special purpose entity (‘‘SPE’’) must be consolidated for financial reporting purposes, thereby subjecting many SPEs to GAAP consolidation requirements.

These new standards will likely result in many more existing and future residential mortgage securitizations failing sale accounting treatment and instead being viewed an alternative form of on-balance sheet secured financing. As a result, the Safe Harbor provision of the FDIC’s Securitization Rule may not apply to these transfers in the manner in which it previously had. Unlike unregulated financial institutions that can issue securitizations that are remote from the issuer in the event of a bankruptcy, insured depository institutions that issue securitizations not subject to the Safe Harbor provision create a risk to investors that monies due are delayed or unpaid in the event of a bank seizure by the FDIC. This would, among other things, affect the way securitizations completed by insured depository institutions are viewed by the credit rating agencies and whether senior mortgage-backed securities can continue to achieve high ratings based solely on their credit quality, independent of the rating of the securitization sponsor. Linking these ratings to the issuing entity would likely mean that AAA ratings could not be attained for securities issued by insured depository institutions and could make residential mortgage securitization uneconomical for these issuers.

General Comments

In considering the accounting changes and the effects they will have on the application of the Securitization Rule, the FDIC must provide clarification of the application of its receivership powers as a precursor for any return to normalcy in the private residential mortgage securitization market. This should be done in a way that not only helps to better protect insured depositors and reduce risks to the Deposit Insurance Fund, but also acknowledges the important role that securitization plays in making credit both available and affordable for homebuyers. The FDIC is warranted in its view that the misalignment of incentives in the securitization process for residential mortgages was a significant contributor to the erosion of underwriting standards throughout the mortgage finance system and that those misalignments should be addressed in the final regulations.

The FDIC expressed in the ANPR that it is considering certain incentives for quality origination practices as conditions for any future safe harbor treatment. For example, one condition is to require a securitization sponsor to retain an economic interest in the asset pool without hedging the risk of that interest – similar to proposals currently being considered by other regulatory bodies. Another proposal mentioned in the ANPR is to require that mortgage loans be originated more than twelve (12) months prior to the initial issuance of the residential mortgage-backed securities (RMBS) in order to mitigate the risk of a high number of early payment defaults.

These conditions appear to be reactionary in nature and overly complex in their current forms to be used as the basis for long-term regulation. The application of the Safe Harbor provision to a particular financing needs to be more *straight-forward and clear* to ensure that any future safe harbor from the FDIC’s receivership powers is not granted in a manner that adds undue complexity to the process of securitization while still allowing the FDIC to fulfill its responsibilities.

As a Condition of the Safe Harbor provision, Strengthen Regulation over Loan Representation and Warranties

One of the most hotly debated topics pertaining to mortgage reform efforts is the notion of "skin in the game". Investors remain hesitant to purchase RMBS, and the Deposit Insurance Fund remains at risk of significant further losses, because too many loan sellers (including insured depository institutions) are not standing behind the loans that they sell. While the ANPR highlights a number of ways to incentivize the origination of high-quality loans, the best and most efficient way to ensure that the 'originate to distribute' model does not pose undue risks to the safety and soundness of insured depository institutions is to establish regulations that improve the enforceability of the basic representations and warranties made on residential mortgage loans sold into securitizations. This approach will help to ensure that mortgage loans are originated with the long-term sustainability of the banking and housing sectors in mind.

The initial goal of "skin in the game" should be to appropriately separate the "underwriting" risk associated with originating a mortgage loan from the "credit" risk associated with the ongoing performance of that loan. Investors are prepared to take credit risk, but only if that risk has been properly represented. That is, investment institutions need to be certain that their credit decisions are based upon accurate representations of the underlying residential loans - such as the absence of fraud, verification of borrower income, accuracy of property appraisals, compliance with applicable laws and regulations, and protection against early payment defaults. To the extent a breach in one of these representations occurs, a lender is supposed to promptly repurchase or replace the loan in question. If no breach is present, but a loss still occurs, then it is likely credit-related and it is more justified that the investor, rather than the originator, should bear the loss.

Loan representations and warranties are a straightforward check that should hold lenders accountable for the quality of their loans. But as recent history has shown, they have proven to be only as good as one's ability to enforce the repurchase provisions in place. A growing number of lawsuits have been filed against insured depository institutions and other lenders who originated residential loans during the housing bubble but have not stood behind their representations to investors after selling the loans into private securitizations. Many of these loans (e.g., subprime and option-ARM loans) might not have been made had investors been forced to hold sufficient cash to honor valid repurchase claims. In some cases, the lack of available capital to honor claims has contributed to bankruptcy filings or receivership for certain loan sellers, resulting in losses to the Deposit Insurance Fund. The lack of adequate reserves, combined with insufficient enforcement mechanisms, has effectively kept more defective loans in private residential loan securitization trusts and increased losses to investors, undermining investor confidence in securitization and increasing the cost of credit to homebuyers.

How to Enforce Loan Representation and Warranties

To safeguard loan representations and warranties, mortgage loan originators should comply with the following requirements in order to distribute their loans through securitization:

1) Originators should be required to maintain adequate cash-funded repurchase reserves.

For residential whole loans sold into securitizations, a new “repurchase reserve” tranche should be funded by the loan seller, in accordance with new FDIC guidelines. This will reduce initial securitization sale proceeds and effectively delay full gain on sale until demonstrated loan performance occurs.

The adequacy of the repurchase reserve should be regulated, as opposed to relying on accounting standards for loss contingencies to determine reserve adequacy. In the event of a claim, cash from the reserve should be made available only to the buyer of the mortgage security and not to third parties. This should include a safe harbor in the event of a bank seizure in accordance with the current statutory provision that prohibits the FDIC from avoiding a legally enforceable or perfected security interest, except where such an interest is taken in contemplation of insolvency or with the intent to hinder, delay, or defraud the institution or the creditors of such institution.

By funding repurchase reserves with cash and placing them beyond the reach of the loan seller, “skin in the game” can be safeguarded to ensure that lenders are originating high-quality loans that conform to the underwriting standards that capital markets participants rely upon to make informed investment decisions. As I will outline below, banks can realize their full “gain on sale” over time by recouping these repurchase reserves to the extent loans breaches do not occur over a specified period of time.

2) To ensure that loan representation and warranty reserves are adequate and properly incentivize lenders to originate high-quality loans, the FDIC (or another appropriate bank regulator) should set requirements for reserve sizing.

To ensure legal isolation of securitized assets and insignificant continuing involvement by securitization sponsors, loan sellers should be required to fund an upfront amount of capital for repurchase reserves that can be released back to them over time based upon pre-established criteria set forth in the governing securitization documents. This requirement should hold for all loans sold by a financial institution into a securitization, regardless of whether that institution originated the loans themselves or acquired them through wholesale or other channels. By keeping these contributors “on the hook”, they will be incentivized to only originate and/or purchase loans for securitization that are appropriately underwritten and that they will stand behind.

One approach that was proposed and outlined in the sample regulation would require a review of specific representations and warranties after 180 days and the repurchase of any mortgages that violate those representations and warranties. Subsequently, five (5) percent of the proceeds due to the sponsor would be held back for twelve (12) months to fund any repurchases required after this review. Additionally, the documentation could also require the sponsor to repurchase any financial assets that breach such representation and warranties within thirty (30) days of notice thereof from the Trustee and/or Custodian.

While this approach would succeed in ensuring that cash is available to honor repurchase claims, a less punitive approach could be adopted to adequately size the holdback that would better incentivize a securitization sponsor to engage in sound underwriting practices. The reserve should be based upon both a quantitative and qualitative assessment that factors in the direct risk inherent in the sold loans as well as the indirect risk of the lender/sponsor. For example, a new "representation and warranty reserve" tranche, with its own payment waterfall and priority, could be established through the governing securitization documents. The size of the tranche could be based on (i) a specified percentage of outstanding loan principal balances applicable for all industry participants based upon "prime" and "nonprime" collateral quality designations; and, (ii) an additional funding requirement based upon a Regulation AB review of the loan seller's underwriting infrastructure as well as their historical track record of producing high-quality and properly represented loans. Over time, "good" originators with proven performance histories can be allowed to set aside a smaller amount in reserves, while originators with "poor" track records can be required to set aside greater reserves for future securitizations, as determined by the FDIC (or another appropriate bank regulator or credit rating agency). This would effectively target poor lending practices and incentivize sound underwriting.

Note: The concept of a variable cost model is already used extensively by insured depository institutions in their dealings with Fannie Mae and Freddie Mac. Under master agreements with Fannie Mae and Freddie Mac, these institutions incur guarantee fees and other costs that are largely based upon loan underwriting standards and controls. These fees can vary over time based upon ongoing performance monitoring.

The repurchase reserve tranche should be funded with cash (and not simply "capital") directly from loan sale proceeds due to the loan originator/seller from the securitization trust. The reserve could be maintained by an independent securitization trustee for a period of two to three years, or the period when most repurchase claims are made. After this period ends, the reserve balance could be repaid to the loan seller on a percentage/pro-rata basis as loan principal is repaid by homeowners, with full repayment occurring by year five to the extent repurchase claims have not absorbed the reserve.

Finally, traditional GAAP standards can be followed to provision any excess repurchase loss contingencies necessary to ensure that the loan seller is adequately reserved for claims that exceed pre-funded reserve amounts. This additional loss contingency would be maintained on the loan seller's balance sheet in a similar manner as a traditional loan loss reserve. Any allocated capital for this excess reserve would not be beyond the reach of the FDIC as a conservator or receiver in the event of a seizure (as is the case today).

3) Binding arbitration with respect to loan representation and warranty claims should be mandated by the FDIC, with reserve payouts controlled by an independent securitization trustee or affiliate

Repurchase demands are often held up indefinitely by disputes between counterparties or by insufficient enforcement mechanisms within existing securitization documents. More recently, insufficient capital to honor repurchase claims has likely prompted many loan sellers to contest or even deny claims that may have been honored in the past. It is therefore imperative that the cash-funded repurchase reserve tranche of a securitization be controlled by independent parties that manage binding arbitration for all disputed claims. An independent party could logically be the securitization trustee (or contracted third-party affiliate) to the extent they are not a related party to the originators contributing loans to the securitization. This will ensure proper skin in the game and help rebuild investor confidence in the securitization process.

Note: This concept is similar to an alternative cited in the sample regulation that would require that a designated third party verify specific representations and warranties, as well as any additional representations and warranties so designated by the documentation, within a specified period after issuance of obligations under the securitization.

How this Proposal Enhances the Safety and Soundness of Insured Depository Intuitions

- Basic "skin in the game" is established by holding originators economically responsible for the stated attributes of their loans

- The risk that a loan seller will not have the cash (or "skin") on hand necessary to honor future obligations is mitigated, reducing the likelihood of unforeseen capital shortfalls at FDIC insured institutions

- A fair and timely resolution process for disputes over defective loans in a securitization will become standard and will not be influenced by a loan seller's ability to pay

- Regulated representation and warranty reserves will level the playing field for community banks that may not have attracted securitization financing in the past due to investor concerns over their underwriting infrastructure or their ability to meet repurchase claims

- By streamlining the process of bringing improperly underwritten loans back onto bank balance sheets, the FDIC can more effectively perform its responsibilities by recognizing underwriting risks more quickly in order to protect its Deposit Insurance Fund

Risk Retention Proposals

Some of the risk-retention alternatives included in both the ANPR and other regulatory reform proposals seem overly punitive and could potentially be "gamed" by lenders because of arbitrary retention requirements that do not clearly take into account the product-type or inherent risk of the loans they sell into a securitization. This could effectively delay a recovery in the private residential mortgage securitization market or at best hinder future credit availability as lenders gravitate towards loan products or structures where the retention/profit calculation is most attractive, rather than prioritizing borrower needs. Any new requirement for securitization sponsors to retain an investment in the loans that they sell (in addition to the regulation proposed herein regarding loan representation and warranty reserves) should be carefully vetted by regulators.

To the extent that a risk-retention requirement is pursued, it should be drafted in a manner that considers the funding structures of mortgage lending institutions and their ability to hold long-term investments. For example, most banks and thrifts are not structured to hold illiquid non-investment grade RMBS backed by loans that mature in 30 years due to the short-term nature of their deposit base and other funding sources. This is in contrast to non-depository issuers such as Fannie Mae and Freddie Mac or mortgage REITs that are structured to hold longer-term mortgage investments. This also differs from credit card lenders that issue securitizations where both the loans and liabilities are shorter-term and revolving in nature. Any risk-retention requirement pertaining to residential mortgages sold by insured depository institutions would therefore need to be structured accordingly and not "one size fits all". For example, a two year retention requirement could be evaluated that is sized in accordance with the inherent risk of the loans underlying a securitization.

Additional Thoughts on the Safe-Harbor Provision

As it relates to residential loan securitizations that do not qualify for sale accounting treatment under the new GAAP standards, it is both positive and necessary to make the criteria more stringent for attaining the Safe Harbor provision under the Securitization Rule. Some have argued that the lack of Safe Harbor may adversely affect the availability of mortgage credit due to the impact of rating agency downgrades of AAA-rated securitization collateral, the additional capital required by banks to hold securitizations on balance-sheet as secured borrowings, and potentially the additional insurance costs on the portion of secured loans funded by deposits.

I do not believe this to be true, as there are viable non-depository institutions that can acquire whole-loans from regulated financial institutions and complete securitizations that remove the need for the Safe Harbor provision altogether. If banks were to sell their whole-loan production to third-party securitization platforms rather than securitizing themselves, the originate-to-distribute model could function as intended without providing undue risk to the Deposit Insurance Fund. Banks currently have that option today – through Fannie Mae, Freddie Mac, and other well-capitalized private mortgage securitization sponsors – and can still originate and distribute loans profitably be selling them to these third parties.

In this regard, any rulemaking related to the Safe Harbor provision should be clear that sales of whole loans to third-party securitization platforms that are not sponsored by or affiliated with insured depository institutions are not transfers of assets that could be recovered by the FDIC in a bank failure – because there should not be a "legal isolation" issue when loans are sold to a third-party securitization platform.

I also support the requirements set forth in the sample regulation that call for the offering documents of a securitization (whether SEC-registered or exempt from registration or private placements) to comply with SEC disclosure requirements for public offerings. I also support the need for additional levels of disclosure for resecuritization transactions completed by FDIC insured depository institutions. While these additional requirements may be seen as excessive or burdensome to some industry participants, I feel that disclosure and transparency is an area that cannot be compromised given the large role that perceived “shadow banking” transactions played in setting off the global financial crisis.

I very much appreciate your consideration of my comments regarding changes to the Safe Harbor provision. If you would like to further discuss my any of my comments or recommendations, please do not hesitate to contact me at 415-389-7373 or at george.bull@redwoodtrust.com.

Sincerely,

George E. Bull, III

Biographical Note: George E. Bull, III, is the co-Founder, Chairman and CEO of Redwood Trust, Inc. (NYSE: RWT), a San Francisco Bay Area company established in 1994 that invests in and manages real estate mortgage related credit risk. Redwood has historically operated as a private market alternative to Fannie Mae and Freddie Mac with a focus on providing credit enhancement for the jumbo mortgage market. At the peak, Redwood provided credit enhancement for over $250 billion of mortgage loans in 2007 and its market share of the jumbo securitized market exceeded 30% from 2003 through 2007, enabling in excess of 600,000 homeowners to obtain low cost mortgage credit. Mr. Bull began his career at CalPERS in 1972.