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September 27, 2010

TO: CRE Finance Council

FROM: Scott A. Sinder
Rhonda M. Bolton

RE: The Federal Deposit Insurance Corporation's Final Rule on Safe Harbor for
Assets Transferred as Part of a Securitization

By a 4-1 vote today, the Federal Deposit Insurance Corporation ("FDIC") approved a final rule regarding treatment of assets transferred by an insured depository institution ("IDI") in connection with a securitization or participation when such institutions enter FDIC conservatorship or receivership, known as the "safe harbor" rule.¹ Generally, the FDIC has retained the basic elements of the safe harbor framework it proposed in May. The following requirements will be imposed on all securitizations or participations that are initiated starting January 1, 2011:

- a 5% minimum risk retention requirement for "sponsors," which term appears to be defined as the originating IDI. The retained risk can either be 5% of each credit tranche or 5% of a "representative sample" of the underlying financial assets. This risk retention requirement is subject to an "auto-conform" provision, which requires that it be replaced with whatever risk retention rules are developed in the joint rulemaking on risk retention required by Section 941(b) of the Dodd-Frank Act. The FDIC's final rule runs counter to the requests of the CRE Finance Council and many others that the FDIC not to unilaterally jump ahead of the joint rulemaking process Congress prescribed in Dodd-Frank. The FDIC justified its decision by citing its unique obligation as insurer and receiver of failed IDIs to ensure that mortgages and other assets originated by IDIs are originated for "long-

¹ The final rule is available at <http://www.fdic.gov/news/board/10Sept27no4.pdf>.

term sustainability.” The unfortunate consequence of the FDIC’s decision here – as the CRE Finance Council pointed out in its comments and echoed in the lone dissenting vote of Acting Comptroller of the Currency John Walsh – will be the creation of a two tiered securitization market, one for FDIC-insured institutions making loans, and another for other types of lenders;

- incorporation of asset-level and pool-level disclosure requirements into securitization agreements that, at a minimum, must comply with SEC Regulation AB, and will apply to all issuances including private placements. These disclosures must include information on representations and warranties made with respect to financial assets and information pertaining to remedies for breach of representations and warranties; the nature and amount of compensation paid to the originator, sponsor, rating agency or third-party advisor, any mortgage or other broker, and the servicer(s), and the extent to which any risk of loss on the underlying assets is retained by any of them for the securitization;
- limitations on capital structure that prohibit re-securitizations from being eligible for the safe harbor unless they meet the new disclosure obligations;
- limitations on payment structure, that require payment of principal and interest on the obligations to be primarily dependent on the performance of the assets supporting the securitization, thus limiting the use of external credit enhancement;
- documentation and recordkeeping requirements; and,
- a number of additional procedural requirements such as a requirement that securitization transactions be arms-length and for adequate consideration.

Several additional requirements apply to securitizations that involve residential loans, such as a limitation to six tranches, and specific modification authorities for servicers.

Securitizations that meet the foregoing requirements and that meet the sale accounting requirements in effect under Financial Accounting Standard (“FAS”) 166/167 (except for the “legal isolation” condition) will be protected by the safe harbor. For securitizations that meet the foregoing requirements but do not meet the new sale accounting requirements, the securitized assets will be viewed as subject to a perfected security interest, and would therefore be protected because the FDIC as conservator or receiver is generally prohibited from avoiding a legally enforceable or perfected security interest.

These new safe harbor requirements will go into effect for securitizations initiated on or after January 1, 2011. The final rule explicitly provides that securitizations or participations in process before December 31, 2010 are permanently grandfathered under the existing terms of the safe harbor rule in 12 C.F.R. § 360.6.