February 6, 2020

FDIC Securitization Safe Harbor Rule

Amendment to FDIC Securitization Safe Harbor Rule to Limit Requirement to Comply with SEC Regulation AB to Public Offerings

SUMMARY

The FDIC's Rule 360.6 (the "*Securitization Rule*"), originally adopted in 2000, establishes the criteria under which the FDIC, as conservator or receiver of an insured depository institution (an "*IDI*"), will not exercise its repudiation authority to recover or reclaim financial assets transferred by the IDI in a securitization transaction. Since it was amended on September 30, 2010, the Securitization Rule has provided a safe harbor for transfers of financial assets that satisfy the conditions for sale accounting treatment under generally accepted accounting principles ("*GAAP*"), except for the "legal isolation" condition,[1] subject in the case of transfers made after December 31, 2010 to compliance with additional conditions set forth in the amended rule,[2] and has also provided more limited protection for transfers made after December 31, 2010 that do not qualify for sale accounting treatment under GAAP.[3] At a meeting on January 30, 2020, the FDIC adopted by a vote of three-to-one (Director Gruenberg dissenting) an amendment to the Securitization Rule, proposed on July 16, 2019,[4] that eliminates the requirement that the information provided to potential investors at a minimum comply with the requirements of Regulation AB ("*Regulation AB*") of the Securities and Exchange Commission (the "*SEC*") whether the obligations issued in the securitization are publicly offered and subject to Regulation AB disclosure requirements or are privately placed and not subject to those disclosure requirements.[5]

BACKGROUND

The Securitization Rule establishes criteria under which the FDIC, as receiver or conservator for an IDI, will not use its repudiation power to recover or reclaim financial assets that the IDI has transferred in connection with securitizations.[6] Originally adopted in 2000, the Securitization Rule was amended on September 30, 2010 to impose new conditions to the availability of the safe harbors provided for transfer of financial assets

in certain securitization transactions.[7] These additional conditions included a requirement, applicable to all securitizations, that the documentation for the securitization must require that the information provided to potential investors, at a minimum, must comply with the requirements of Regulation AB or any successor requirements for public issuances, even if the obligations issued in the securitization are privately placed or are not otherwise required to be registered under the Securities Act of 1933, as amended (the "*Securities Act*").[8] The 2010 amendments followed an SEC proposal, among other things, to expand the disclosure required by Regulation AB significantly to include, among other things, detailed asset-level information, and to condition the availability of the safe harbor exemptions from registration provided by Rule 144A and Regulation D under the Securities Act upon investors being given, upon request, the same information that would be required if the offering were registered under the Securities Act.[9] Although the SEC adopted amendments to Regulation AB on August 24, 2014, these amendments did not include this modification to Rule 144A and Regulation D. Although the SEC noted at the time that this proposal remained outstanding, it has taken no further action on it.[10]

AMENDMENT

The FDIC has now revised the Securitization Rule to remove the requirement that the securitization documents require compliance with Regulation AB in circumstances where the regulation is not by its terms applicable to the transaction. The revisions will become effective either 30 or 60 days after publication in the Federal Register. The FDIC's Notice of Proposed Rulemaking (the "*NPR*") issued in 2019 noted that it had received feedback "that it is difficult for institutions to comply with Regulation AB as applied to certain types of securitization transactions, in particular residential mortgage securitizations."[11] The FDIC noted that its rationale for adopting this disclosure requirement in 2010 had been to lower "the likelihood of a buildup of structurally opaque and potentially risky mortgage securitizations or other securitizations that could pose risks to IDIs" but asserted that in the interim "other regulatory changes have been implemented that have also contributed to the same objective."[12] At the same time, according to the FDIC's adopting release, the net effect of the requirement "appears to have been a disincentive for IDIs to sponsor securitizations of residential mortgages that are compliant with the [Securitization] Rule."[13]

The adopting release notes "numerous regulatory developments that have the effect of limiting or precluding poorly underwritten, risky securitizations, particularly securitizations of residential mortgages."[14] It also emphasizes that the amendment does not affect the Securitization Rule's other disclosure requirements, which include requirements to disclose the capital structure of the securitization, priority of payments and subordination features, representations with respect to the securitized assets, remedies and cure periods for breaches of representations, ongoing information about the performance of the securities and the underlying assets, compensation paid to originators and other parties[15] and, in the case of residential mortgage loan securitizations, certain loan level information that is not as extensive as the information required by Regulation AB.[16]

The FDIC noted that a majority of the 10 comment letters it received supported the amendment, noting in particular that several commenters observed that aligning the scope of the Regulation AB disclosure requirement in the Securitization Rule with the scope of transactions subject to Regulation AB itself would "level the playing field" between IDIs and other securitization sponsors. Other commenters noted that the amendment would "help promote an increase in credit available to the mortgage market" and "increase liquidity for mortgage and other asset classes and lower costs and improve choices for consumers."[17] Other letters, from individuals, a financial reform advocacy group and a public interest group, were critical of the amendment, arguing, for example, that the FDIC should "demonstrate a dire shortage of residential mortgage credit sufficient to justify the need for the amendment" and that the NPR did not adequately explain how post-financial crisis regulatory changes would prevent the amendment "from leading to the conditions that led to the financial crisis."[18] The FDIC reiterated its position that other post-crisis regulatory changes, together with the Securitization Rule's remaining disclosure requirements, adequately address the concerns raised by the amendment's critics.

The FDIC expects that the amendment is most likely to affect private label residential mortgage-backed securities because Regulation AB's disclosure requirements for that asset class are its most extensive, although private label residential mortgage-backed securities remain a small portion of the overall residential mortgage-backed securities market and relatively few IDIs have issued them in recent years.

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ENDNOTES

1 *See* FDIC Rule 360.6(d)(1), (2) and (3).

2 *See* FDIC Rule 360.6(b) and (c).

3 See FDIC Rule 360.6(d)(4).

4 84 Federal Register 43732 (August 22, 2019).

5 *See* FDIC Rule 360.6(b)(2)(i)(A).

6 Although the Securitization Rule addresses participations in financial assets as well as securitizations, the amendment does not address participations.

7 *See* our memorandum to clients dated May 21, 2010 entitled *FDIC Securitization Rule: FDIC Proposes Revised Securitization Rule Including Safe Harbors for Securitization Transactions Not Entitled to Off Balance Sheet Treatment under New Accounting Standards* and our memorandum to clients dated October 13, 2010 entitled *FDIC Securitization Rule: FDIC Adopts Revised Securitization Rule Substantially as Proposed* for additional information on the 2010 amendments as proposed and adopted by the FDIC.

8 *See* FDIC Rule 360.6(b)(2)(i)(A).

9 *See* our memorandum to clients dated April 23, 2010 entitled *SEC Asset-Backed Securities Reform: SEC Proposes Significant Revisions to Rules on the Offering Process, Disclosure and Reporting for Asset-Backed Securities* for additional information on these proposals.

10 *See* our memorandum to clients dated September 16, 2014 entitled *Asset-Backed Securities Disclosure and Regulation: SEC Adopts Revisions to Regulation AB and Other Rules Governing the Offering Process, Disclosure and Reporting for Asset-Backed Securities* for more information on the revisions to Regulation AB and other rules relating to asset-backed securities.

11 84 Federal Register 43732, 43733 (August 22, 2019).

12 Ibid.

13 "Amendment to Securitization Safe Harbor Rule" issued by the FDIC on January 30, 2020 (the "*Adopting Release*") at p. 3.

14 Adopting Release at pp. 7-8.

15 *See* FDIC Rule 360.6(b)(2)(i)(B) through (D).

16 *See* FDIC Rule 360.6(b)(2)(ii)(A).

17 Adopting Release at pp. 12-13.

18 Adopting Release at p. 14.

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