FEDERAL DEPOSIT INSURANCE CORPORATION

Covered Bond Policy Statement

AGENCY: Federal Deposit Insurance Corporation (FDIC).

ACTION: Interim Final Statement of Policy

SUMMARY: The Federal Deposit Insurance Corporation (the FDIC) is publishing for comment an interim final policy statement ("Policy Statement") on the treatment of covered bonds in a conservatorship or receivership. The Policy Statement provides guidance on the availability of expedited access to collateral pledged for certain covered bonds in a receivership or a conservatorship, after the FDIC decides whether to terminate or continue the transaction. The Policy Statement provides guidance to facilitate the prudent and incremental development of the U.S. covered bond market while the FDIC, and other regulators, evaluate the benefits and risks of these products in the U.S. mortgage market. The Policy Statement is being published as "interim final" in order to provide immediate guidance, but with a view to possible later amendment in response to comments received.

EFFECTIVE DATE: [Insert date of publication in the Federal Register]. Comments must be submitted on or before [60 days after publication in the Federal Register].

ADDRESSES: You may submit comments by any of the following methods:

• Agency Web Site: http:// www.fdic.gov/regulations/laws/federal.

Follow instructions for submitting comments on the Agency Web Site.

• E-mail: Comments@FDIC.gov. Include ‘‘Covered Bond Policy’’ in the subject line of the message.

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

• Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

• Instructions: All comments received will be posted generally without change to http://www.fdic.gov/regulations/laws/federal/propose.html, including any personal information provided. Comments may be inspected at the FDIC Public Information Center, Room E-1022, 3502 North Fairfax Drive, Arlington, VA 22226, between 9 a.m. and 5 p.m. on business days.

FOR FURTHER INFORMATION CONTACT: Richard T. Aboussie, Associate General Counsel, Legal Division (703) 562-2452; Michael H. Krimminger, Special Advisor for Policy (202) 898-8950.

SUPPLEMENTARY INFORMATION

I. Background

The FDIC has received questions from interested parties about how covered bond transactions will be treated in a conservatorship or receivership of an insured depository institution (“IDI”). Currently, there are no statutory or regulatory prohibitions on the issuance of covered bonds by U.S. banks. Interested parties assert that if the FDIC were to issue a policy statement providing guidance on the availability of expedited access to collateral pledged for certain covered bonds in a conservatorship or a receivership, it would reduce market uncertainty and the additional costs of U.S. covered bond transactions. As discussed below, these costs are created by the additional liquidity needed to insure continued payment on outstanding bonds if the FDIC as conservator or receiver fails to make payment or provide access to the pledged collateral after the FDIC decides to terminate the covered bond transaction. The Policy Statement does not impose any new obligations on the FDIC, as conservator or receiver, but does define the circumstances and the specific covered bond transactions for which the FDIC will grant consent to access pledged covered bond collateral.

Covered bonds are general obligation bonds of the issuing bank secured by a pledge of loans that remain on the bank's balance sheet. Covered bonds originated in Europe, where they are subject to extensive statutory and supervisory regulation designed to protect the interests of covered bond investors from the risks of insolvency of the issuing bank. By contrast, covered bonds are a relatively new innovation in the U.S. with only two issuers to date: Bank of America, N.A. and Washington Mutual. The initial U.S. covered bonds were issued in September 2006.

In the covered bond transactions initiated in the U.S. to date, an IDI sells mortgage bonds, secured by mortgages, to a trust or similar entity ("special purpose vehicle" or "SPV"). The pledged mortgages remain on the IDI's balance sheet, securing the IDI's obligation to make payments on the debt, and the SPV sells covered bonds, secured by the mortgage bonds, to investors. In the event of a default by the IDI, the mortgage bond trustee takes possession of the pledged mortgages and continues to make payments to the SPV to service the covered bonds. Proponents argue that covered bonds provide new and additional sources of liquidity and diversity to an institution's funding base.

FDIC staff agrees that covered bonds may be a useful liquidity tool for IDIs as part of an overall prudent liquidity management framework and within the parameters set forth in the Policy Statement. While covered bonds, like other secured liabilities, could increase the costs to the Deposit Insurance Fund in a receivership, these potential costs must be balanced with diversification of sources of liquidity and the benefits that accrue from additional on-balance sheet alternatives to securitization for financing mortgage lending. The Policy Statement seeks to balance these considerations by clarifying the circumstances and the specific covered bond transactions for which the FDIC will grant consent to access pledged covered bond collateral. Staff believes that the prudential limitations identified in the Policy Statement permit the incremental development of the covered bond market, while allowing the FDIC, and other regulators, the opportunity to evaluate these transactions within the U.S. mortgage market. In fulfillment of its responsibilities as deposit insurer and receiver for failed IDIs, the FDIC will continue to review the development of the covered bond marketplace in the U.S. and abroad to gain further insights into the appropriate role of covered bonds in IDI funding and the U.S. mortgage market, and their potential consequences for the Deposit Insurance Fund. (For ease of reference, throughout this Policy Statement when we refer to "covered bond obligation," we are referencing the part of the covered bond transaction comprising the IDI's debt obligation, whether to the SPV, mortgage bond trustee, or other parties; and "covered bond obligee" is the entity to which the IDI is indebted.)

Under Federal Deposit Insurance Act, when the FDIC is appointed conservator or receiver of an IDI, contracting parties cannot terminate agreements with the IDI because of the insolvency itself or the appointment of the conservator or receiver. In addition, contracting parties must obtain the FDIC's consent during the forty-five day period after appointment of FDIC as conservator, or during the ninety day period after appointment of FDIC as receiver before, among other things, terminating any contract or liquidating any collateral pledged for a secured transaction. During this period, the FDIC must still comply with otherwise enforceable provisions of the contract. The FDIC also may terminate or repudiate any agreement of the IDI within a reasonable time after the FDIC's appointment as conservator or receiver if the conservator or receiver determines that the agreement is burdensome and that the repudiation will promote the orderly administration of the IDI's affairs.[1] The questions to the FDIC for guidance have focused principally on the conditions under which the FDIC would grant consent to obtain collateral for a covered bond transaction before the expiration of the forty-five day period after appointment of a conservator or the ninety day period after appointment of a receiver.

IDIs interested in issuing covered bonds have expressed concern that the requirement to seek the FDIC's consent before exercising on the collateral after a breach could interrupt payments to the covered bond obligee for as long as 90 days. IDIs can

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[1] See 12 U.S.C. §§ 1821(e)(3) and (13). These provisions do not apply in the manner stated to "qualified financial contracts" as defined in Section 11(e) of the FDI Act. See 12 U.S.C. § 1821(e)(8).

provide for additional liquidity or other hedges to accommodate this potential risk to the continuity of covered bond payments, but at an additional cost to the transaction. Interested parties have requested that the FDIC provide clarification about how FDIC would apply the consent requirement with respect to covered bonds. Accordingly, the FDIC has determined to issue this Policy Statement in order to provide covered bond issuers with guidance on how the FDIC will treat covered bonds in a conservatorship or receivership.

II. Interim Final Policy

For the purposes of this Policy Statement, a "covered bond" is defined as a recourse debt obligation of an insured depository institution with a term greater than one year and no more than ten years, that is secured directly or indirectly by a pool of mortgage loans or, not exceeding ten percent of the collateral, by AAA-rated mortgage bonds. The term "covered bond obligee" is the entity to which the IDI is indebted.

To provide guidance to potential covered bond issuers and investors, while allowing the FDIC to evaluate the potential benefits and risks that covered bond transactions may pose to the Deposit Insurance Fund in the U.S. mortgage market, the application of the policy statement is limited to covered bonds that meet the following standards.

This Policy Statement only applies to covered bond issuances made with the consent of the IDI's primary federal regulator in which the IDI's total covered bond obligations at such issuance comprise no more than 4% of an IDI's total liabilities. The FDIC is concerned that unrestricted growth while the FDIC is evaluating the potential benefits and risks of covered bonds could excessively increase the proportion of secured liabilities to unsecured liabilities on IDI balance sheets at the expense of the Deposit Insurance Fund. In a failure, secured liabilities on a financial institution's balance sheet are satisfied out of the pledged assets before any of the remaining value in those assets is made available to satisfy the claims of depositors (including the Deposit Insurance Fund as subrogee of the insured depositors) and general creditors. The larger the balance of secured liabilities on the balance sheet, the smaller the value of assets that are available to satisfy depositors and general creditors, and consequently the greater the potential loss to the Deposit Insurance Fund. To address these concerns, the Policy Statement is limited to covered bonds that comprise no more than 4% of a financial institution's total liabilities after issuance.

In order to limit the risks to the Deposit Insurance Fund, the Policy Statement limits its application to "eligible mortgages," defined as covered bond issuances secured by perfected security interests under applicable state and federal law on performing mortgages on one-to-four family residential properties, underwritten at the fully indexed rate and relying on documented income. The Policy Statement provides that eligible mortgages shall be underwritten in accordance with existing supervisory guidance governing the underwriting of residential mortgages, including the Interagency Guidance on Non-Traditional Mortgage Products, October 5, 2006, and the Interagency Statement on Subprime Mortgage Lending, July 10, 2007, and such other guidance applicable at the time such covered bonds are issued by any IDI.

The FDIC recognizes that some covered bond programs include mortgage-backed securities in limited quantities. Staff believes that allowing some limited inclusion of AAA-rated mortgage-backed securities as collateral for covered bonds during this interim, evaluation period will support enhanced liquidity for mortgage finance without increasing the risks to the Deposit Insurance Fund. Therefore, covered bonds that include up to 10% of their collateral in AAA-rated mortgage securities backed solely by mortgage loans that are made in compliance with guidance referenced above will meet the standards set forth in the Policy Statement. Securities backed by tranches in other securities or assets (such as Collateralized Debt Obligations) would not be considered to be acceptable collateral.

The Policy Statement provides that the consent of the FDIC, as conservator or receiver, is given to covered bond obligees to exercise their contractual rights over collateral for covered bond transactions conforming to the Policy Statement no sooner than ten (10) business days after a monetary default on an IDI's obligation to the covered bond obligee, as defined below, or ten (10) business days after the effective date of repudiation as provided in a written notice by the conservator or receiver.

The FDIC anticipates that future developments in the marketplace may present interim final covered bond structures and structural elements that are not encompassed within this Policy Statement. FDIC invites comment on whether this Policy Statement should be limited to the currently defined structures or open to future innovations in how covered bond transactions may be structured in the U.S., and if so, how any future policy should be applied to such innovative elements.

From an insurance perspective, the FDIC seeks comment on whether the issuances of covered bonds should increase an institution's insurance assessment rate or should be included in an institution's assessment base. If so, should such assessment rate increases or inclusion in assessment base only apply when an institution's covered bond liability exceeds 4% of its total liabilities. More generally, the FDIC seeks comment on whether an institution's percentage of secured liabilities to total liabilities should be factored into an institution's insurance assessment rate or whether the total secured liabilities should be included in the assessment base. Finally, FDIC also seeks comment on whether, as part of this Policy Statement, there should also be an overall cap for secured liabilities.

III. Scope and Applicability:

This Policy Statement applies to the FDIC in its capacity as conservator or receiver of an insured depository institution.

This Policy Statement only addresses the rights of the FDIC under 12 U.S.C. § 1821(e)(13)(C). A previous policy statement entitled "Statement of Policy on Foreclosure Consent and Redemption Rights," August 17, 1992, separately addresses consent under 12 U.S.C. § 1825(b), and should be separately consulted.

This Policy Statement does not authorize, and shall not be construed as authorizing, the waiver of the prohibitions in 12 U.S.C. § 1825(b)(2) against levy, attachment, garnishment, foreclosure or sale of property of the FDIC, nor does it authorize or shall it be construed as authorizing the attachment of any involuntary lien upon the property of the FDIC. The Policy Statement provides that it shall not be construed as waiving, limiting or otherwise affecting the rights or powers of the FDIC to take any action or to exercise any power not specifically mentioned, including but not limited to any rights, powers or remedies of the FDIC regarding transfers taken in contemplation of the institution's insolvency or with the intent to hinder, delay or defraud the institution or the creditors of such institution, or that is a fraudulent transfer under applicable law.

Request for Public Comment

The Board of Directors of the FDIC has adopted an interim final Covered Bond Policy Statement. The FDIC requests public comment on the interim final Covered Bond Policy Statement. The text of the Covered Bond Policy Statement follows:

COVERED BOND POLICY STATEMENT

Background

Insured depository institutions ("IDIs") are showing increasing interest in issuing covered bonds. Although covered bond structures vary, in all covered bonds the IDI issues a debt obligation secured by a pledge of assets, typically mortgages. The debt obligation is either a covered bond sold directly to investors, or mortgage bonds which are sold to a trust or similar entity ("special purpose vehicle" or "SPV") as collateral for the SPV to sell covered bonds to investors. In either case, the IDI's debt obligation is secured by a perfected first priority security interest in pledged mortgages, which remain on the IDI's balance sheet. Proponents argue that covered bonds provide new and additional sources of liquidity and diversity to an institution's funding base. Based upon the information available to date, the FDIC agrees that covered bonds may be a useful liquidity tool for IDIs as part of an overall prudent liquidity management framework and the parameters set forth in this policy statement. Because of the increasing interest IDIs have in issuing covered bonds, the FDIC has determined to issue this policy statement with respect to covered bonds.

(a) Definitions.

(1) For the purposes of this policy statement, a "covered bond" shall be defined as a recourse debt obligation of an IDI with a term greater than one year and no more than ten years, that is secured directly or indirectly by perfected security interests under applicable state and federal law on eligible mortgages, or, for no more than ten percent of the collateral for any covered bond issuance or series, AAA-rated mortgage-backed securities secured by eligible mortgages.

(2) The term "eligible mortgages" shall mean performing mortgages on one-to-four family residential properties, underwritten at the fully indexed rate and relying on documented income in accordance with existing supervisory guidance governing the underwriting of residential mortgages, including the Interagency Guidance on Non-Traditional Mortgage Products, October 5, 2006, and the Interagency Statement on Subprime Mortgage Lending, July 10, 2007, and such other guidance applicable at the time such covered bonds are issued by any IDI.

(3) The term “covered bond obligation,” shall be defined as the portion of the covered bond transaction that is the insured depository institution’s debt obligation, whether to the SPV, mortgage bond trustee, or other parties.

(4) The term “covered bond obligee” is the entity to which the insured depository institution is indebted.

(5) The term “monetary default” shall mean the failure to pay when due (taking into account any period for cure of such failure or for forbearance provided under the instrument or in law) sums of money that are owed, without dispute, to the covered bond obligee under the terms of any *bona fide* instrument creating the obligation to pay.

(6) The term “total liabilities” shall mean, for banks that file quarterly Reports of Condition and Income (Call Reports), line 21 “Total liabilities” (Schedule RC); and for thrifts that file quarterly Thrift Financial Reports (TFRs), line SC70 “Total liabilities” (Schedule SC).

(b) Coverage. This policy statement only applies to covered bond issuances made with the consent of the IDI’s primary federal regulator in which the insured depository institution’s total covered bond obligation at such issuance comprises no more than 4% of an insured depository institution’s total liabilities, and only so long as the assets securing the covered bond obligation are eligible mortgages. Additionally, no more than ten percent of the collateral for any covered bond issuance or series may consist of AAA-rated mortgage securities backed solely by eligible mortgages are considered to be acceptable collateral under the standards set forth in this policy statement.

(c) Consent to certain actions. The FDIC as conservator or receiver consents to a covered bond obligee's exercise of the rights and powers listed in 12 U.S.C. § 1821(e)(13)(C), and will not assert any rights to which it may be entitled pursuant to 12 U.S.C. § 1821(e)(13)(C), after the expiration of the specified amount of time, and the occurrence of the following events:

(1) If at any time after appointment the conservator or receiver is in a monetary default to a covered bond obligee, as defined above, and remains in monetary default for ten (10) business days after actual delivery of a written request to the FDIC pursuant to paragraph (d) hereof to exercise contractual rights because of such monetary default, the FDIC hereby consents pursuant to 12 U.S.C. § 1821(e)(13)(C) to the covered bond obligee's exercise of any such contractual rights, including liquidation of properly pledged collateral by commercially reasonable methods, provided no involvement of the receiver or conservator is required.

(2) If the FDIC as conservator or receiver of an insured depository institution provides a written notice of repudiation of a contract to a covered bond obligee, and the FDIC does not pay the damages pursuant to 12 U.S.C. § 1821(e) by reason of such repudiation within ten (10) business days after the effective date of the notice, the FDIC hereby consents pursuant to 12 U.S.C. § 1821(e)(13)(C) for the covered bond obligee's exercise of any of its contractual rights, including liquidation of properly pledged collateral by commercially reasonable methods, provided no involvement of the receiver or conservator is required.

(d) Consent. Anyone requesting the FDIC's consent as conservator or receiver pursuant to 12 U.S.C. § 1821(e)(13)(C) pursuant to this policy statement should provide to the Executive Secretary, Federal Deposit Insurance Corporation, 550 17th Street, NW, MB-2096, Washington DC 20429-0002, a statement of the basis upon which such request is made, and copies of all documentation supporting such request, including without limitation a copy of the applicable contract and of any applicable notices under the contract.

(e) Limitations. The consents set forth in this policy statement do not act to waive or relinquish any rights granted to the FDIC in any capacity, pursuant to any other applicable law or any agreement or contract. Nothing contained in this policy alters the claims priority of collateralized obligations. Nothing contained in this policy statement shall be construed as permitting the avoidance of any legally enforceable or perfected security interest in any of the assets of an insured depository institution, provided such interest is not taken in contemplation of the institution's insolvency, or with the intent to hinder, delay or defraud the IDI or its creditors. Subject to the provisions of 12 U.S.C. § 1821(e)(13)(C), nothing contained in this policy statement shall be construed as permitting the conservator or receiver to fail to comply with otherwise enforceable provisions of a contract or preventing a covered bond obligee's exercise of any of its contractual rights, including liquidation of properly pledged collateral by commercially reasonable methods.

(f) No waiver. This policy statement does not authorize, and shall not be construed as authorizing the waiver of the prohibitions in 12 U.S.C. § 1825(b)(2) against levy, attachment, garnishment, foreclosure, or sale of property of the FDIC, nor does it authorize nor shall it be construed as authorizing the attachment of any involuntary lien upon the property of the FDIC. Nor shall this policy statement be construed as waiving, limiting or otherwise affecting the rights or powers of the FDIC to take any action or to exercise any power not specifically mentioned, including but not limited to any rights, powers or remedies of the FDIC regarding transfers taken in contemplation of the institution's insolvency or with the intent to hinder, delay or defraud the institution or the creditors of such institution, or that is a fraudulent transfer under applicable law.

(g) No assignment. The right to consent under 12 U.S.C. § 1821(e)(13)(C) may not be assigned or transferred to any purchaser of property from the FDIC, other than to a conservator or bridge bank.

(h) Repeal. This policy statement may be amended or repealed by the FDIC upon no less than 30 days notice provided in the Federal Register, but any amendment or repeal shall not apply to any covered bonds issued in accordance with this policy statement before such amendment or repeal becomes effective,

By order of the Board of Directors

Dated at Washington, DC this ______ day of ______, 2008.

Federal Deposit Insurance Corporation

Robert E. Feldman
Executive Secretary