TESTIMONY BY

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CHAIRMAN AND CEO

CAMDEN PROPERTY TRUST

ON BEHALF OF THE

NATIONAL MULTI HOUSING COUNCIL

AND THE

NATIONAL APARTMENT ASSOCIATION

BEFORE THE

SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

SEPTEMBER 15, 2010

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Chairman Dodd, Ranking Member Shelby and distinguished Members of the Committee, I am Ric Campo, Chairman and CEO of Camden Property Trust, a publicly held apartment firm.

I am the immediate past Chairman of the National Multi Housing Council (NMHC) and am testifying today on behalf of NMHC and its joint legislative partner, the National Apartment Association (NAA).

Camden Property Trust is an S&P 400 Company and one of the largest publicly traded multifamily companies in the United States. Structured as a Real Estate Investment Trust (REIT), our company owns, develops, acquires and manages multifamily residential apartment communities. We are headquartered in Houston, TX and currently operate 187 properties containing 64,074 apartment homes. Our workforce totals nearly 1,800 employees.

NMHC and NAA represent the nation's leading apartment firms. Our combined memberships are engaged in all aspects of the industry, including ownership, development, management and finance. NMHC represents the principal officers of the industry's largest and most prominent firms. NAA is the largest national federation of state and local apartment associations with 170 state and local affiliates comprised of more than 50,000 members. Together they represent just under 6 million apartment homes.

We applaud the Senate Banking Committee for exploring alternative sources of capital to support housing. We believe that covered bonds could indeed provide some degree of additional liquidity to U.S. multifamily finance. We caution, however, that it is quite unlikely that covered bonds could provide the capacity, flexibility or pricing superiority necessary to adequately replace any of the U.S.'s traditional sources of multifamily mortgage credit.

I am not here today as an expert on covered bonds. Rather, I am hoping to provide you with some background on the apartment sector, its general credit needs and to share some insights into what role covered bonds could play in meeting those needs.

To understand the role or impact covered bonds might have on the apartment industry's access to credit, it is necessary first to have a broad understanding of the apartment industry's current capital sources—both before and during the crisis.

One-third of American households rent, and over 14 percent of households—16.7 million households—live in a rental apartment (buildings with five or more units). Our industry's ability to meet the nation's rental housing needs depends on reliable and sufficient sources of capital.

Multifamily Capital Markets and Industry Performance

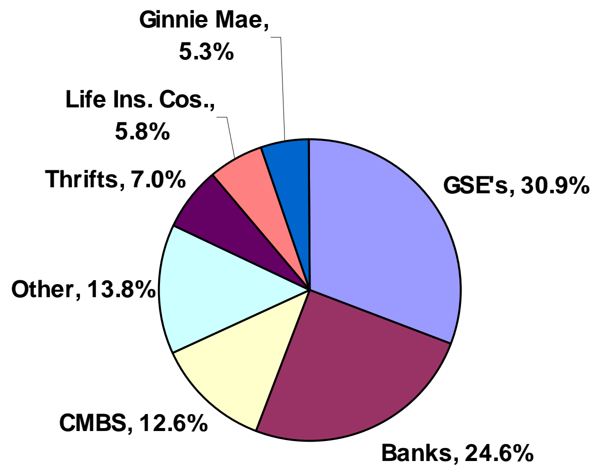
Since the onset of the financial meltdown, virtually all private mortgage lenders left the housing finance market, and the apartment industry has relied heavily on credit either insured or guaranteed by the federal government. Fully 8 out of 10 apartment loans issued in the first six months of 2010 had some form of government credit behind them, namely FHA, Fannie Mae or Freddie Mac. The FHA and Government Sponsored Enterprises (GSEs) are expected to account for 80-90 percent of the $50-$60 billion in credit provided to the apartment sector this year.

Historically, however, the apartment industry has enjoyed access to mortgage credit from a variety of capital sources. In addition to the FHA and GSEs, banks and thrifts, life insurance companies, pension funds and the commercial mortgage-backed securities market have all provided significant amounts of mortgage capital to the apartment industry. Prior to the financial crisis, these capital sources provided our sector with $100-$150 billion annually, reaching as high as $225 billion, to develop, refinance, purchase, renovate and preserve apartment properties.

These market sources have proven to be reliable and durable, with the exception of unique financial situations, such as the current economic crisis and the 1997-1998 Russian financial crisis.

As of the first quarter of 2010, there was approximately $872 billion in outstanding multifamily mortgage debt (see Table 1). In recent years, the industry has shifted from relying on whole loans from banks and life insurance companies to securitized loans. Currently, just under half (49 percent) of outstanding multifamily capital is held in the secondary market (31 percent by the GSEs, 13 percent in CMBS and 5 percent in Ginnie Mae.) Nevertheless, banks remain an important capital source, providing nearly one-quarter of the industry's mortgage capital.

Table 1
Multifamily Mortgage Debt Outstanding 2010 Q1

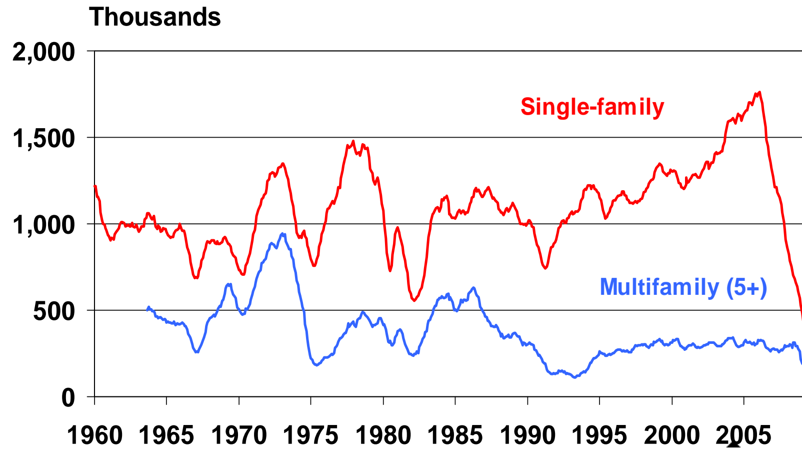


Source: Federal Reserve Outstanding Mortgage Debt 2010

As policymakers consider the causes of, and solutions to, the single-family meltdown, it is important to distinguish between performance in the single-family sector and the multifamily sector. The multifamily industry did not overbuild in the housing boom.

Table 2 below shows the stark contrast between the single-family housing production/bubble and resulting housing crisis and the relatively constant level of new production in the multifamily housing sector during the same period. Since the mid-1990s, the multifamily industry has started approximately 350,000-375,000 new units annually. During the same period, the single-family market almost doubled its production from around 1 million to 1.75 million units.

Table 2



Source: Census Bureau.

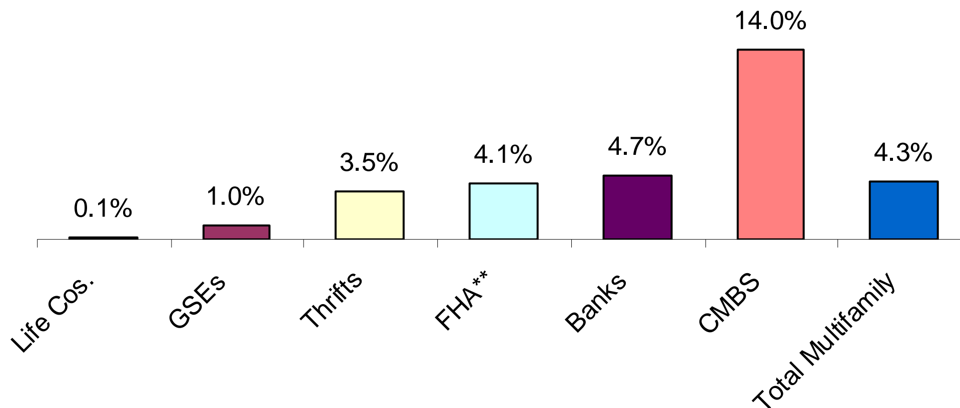
The discipline shown by the apartment industry has translated into stronger portfolio performance as well. Overall loan performance in the $853 billion multifamily sector remains relatively healthy, with delinquencies and default rates only a fraction of those seen in single-family. The 90 day delinquency rate of multifamily loans is estimated to be 4.3 percent or $31 billion. Compared to the single-family residential mortgage market where the mortgage debt outstanding is reported at $10.7 trillion as of March 30, 2010 and a 90-day delinquency rate of 9.2 percent or $984.4 billion.

There has been some stress recorded in bank loans and CMBS, particularly those originated between 2006 and 2008 when more aggressive underwriting and higher leverage was employed. However, that stress is largely a result of the overall economy and the worst job market in 40 years and not due to oversupply.

Many of those problematic loans were taken out to renovate and reposition existing properties. When property values plummeted and unemployment soared, those projects stalled and borrowers lost most of their equity. The problem is especially acute in some markets such as the boroughs of New York City and other major employment centers that have large concentrations of apartment properties.

Nevertheless, many of these distressed loans will be resolved, and most apartment residents will not be affected by loan delinquencies or even defaults, as such situations generally result in a smooth transition to a new operating entity with sufficient capital to maintain the property.

Table 3
Delinquency Rates of Multifamily Credit Sources



Seriously delinquent loans are defined as at least 90 days past due and defaulted FHA multifamily Section 221(d)(4) loans.

Sources: Federal Reserve Outstanding Multifamily Mortgage Debt, 2010 Q1, Fannie Mae, Freddie Mac 10K/10Q SEC Filing Statements, and HUD.

** Data provided for the Federal Housing Administration multifamily portfolio is restricted to market rate Section 221(d)(4) defaulted loans as of July 2010, that total $505 million in defaulted loans. It does not include the full portfolio of multifamily insured loans including hospitals and nursing homes.

Covered Bonds and the Multifamily Credit Market

The current housing finance system has worked extremely well in providing liquidity to the apartment sector in all economic climates. That said, we welcome Congressional efforts to create a framework for covered bonds so they may serve as an additional source of capital for apartments. We do not believe, though, as some have suggested, that covered bonds can resolve the current financial crisis or prevent future crises that might require government intervention.

It is clear that covered bonds offer some advantages to issuers and investors. They give issuers access to lower-cost funding for mortgage and other asset-backed credit with more favorable risk-based capital requirements than whole loans held in their portfolio. For investors, they

offer high credit quality, solid yield, low-risk and diversified investments. They also offer both issuer and investor the ability to substitute bond assets in the collateral pools if there is a problem with an individual loan or mortgage, thus reducing overall risk.

My comments focus on the value of covered bonds to multifamily borrowers. Under the right conditions and circumstances, covered bonds could serve as an added credit option for our sector by augmenting banks' mortgage credit activity. Therefore, we support efforts to create the legal and regulatory oversight needed to foster the use of covered bonds by banks.

For numerous reasons, though, it is quite unlikely that covered bonds could provide the capacity, flexibility or pricing superiority necessary to adequately replace the U.S.'s existing sources of multifamily mortgage credit.

It is unclear whether covered bonds would actually increase the amount of credit banks would make available to apartment firms. The covered bond structure limits issuer lending volumes by requiring them to hold loans on the issuer's balance sheet and retain capital reserves in case of losses. It is also possible that banks could simply replace some of their whole loans activities with covered bonds, which would not increase lending capacity except as it relates to how risk-based capital reserves are held by banks.

Covered bonds could allow banks to compete with other credit sources such as life companies, thrifts, CMBS and GSEs because the loan term for covered bonds is longer (10-year terms) than the 5-year term banks typically provide. Even then, however, larger banks that are anticipated to be a major source of covered bond issuance may choose not to issue covered loans for multifamily mortgages because many of these banks originate such mortgages for the GSEs or CMBS market and thereby avoid any balance sheet liability.

It is also unclear to what extent banks would use covered bonds for multifamily lending since so many asset classes qualify for covered bonds. Legislation pending in the House of Representatives (H.R. 5823, "The United States Covered Bond Act of 2010") would allow covered bonds to be used for single-family mortgages and equity loans, commercial and multifamily real estate mortgages, auto loans and leases, loans for public facilities and activities, student loans, small business loans and credit card and revolving credit loans to consumers. We question the capacity of covered bonds to meet the demand from all of these loan categories.

In Europe, the majority of real estate-related covered bond debt has been for public purposes and residential home mortgages. Unless there are allocations and diversification requirements for covered bond issuers, we expect the U.S. experience would be similar, with most of the additional credit created by covered bonds directed to the residential mortgage market and other consumer and loan assets and not toward rental housing.

It is also important to understand that the European experience with covered bonds for multifamily properties is not translatable to the U.S. In Europe, the rental markets operate on a condominium model comprised of small investors buying individual units and renting them out. For instance, in the United Kingdom, 73 percent of the rental stock is owned by "mom-and-pop" operators, and there is no institutional investment. There is little existing data or analysis determining to what degree European covered bonds actually finance commercially developed rental housing.

In addition to these issues, it also remains unclear whether the covered bond structure can become sufficiently flexible to accommodate broad-based public-sector participation in the U.S. affordable-housing finance arena. For instance, a significant proportion of apartment production in recent decades has been financed through Low-Income Housing Tax Credit (LIHTC) equity investments and various structures of tax-exempt or otherwise subsidized bonded debt. These specialized loans may not be able to gain access to covered bond credit capital.

Likewise, questions remain about whether a purely private American covered bond market could become a critical "backstop" capital source during periods of financial instability. While Europe's covered bond market came to something of a standstill during the global financial crisis, in the U.S. the GSEs, Fannie Mae and Freddie Mac, remained a critical liquidity source in the domestic multifamily finance field. They have served this role during other capital market dislocations, including the Russian economic collapse in the late 1990s, which caused a collapse of the U.S. commercial mortgage conduit market, and during the 2001-2003 recession.

Although the European covered bond market remained liquid longer than many other wholesale funding markets, it was ultimately rendered dormant for several months during the last quarter of 2008. In the wake of Lehman Brothers' collapse in September 2008, the European covered bond market went without a public issuance until early 2009 and some jurisdictions have still not

seen new issuance. The European Central Bank (ECB) reported earlier this year that the number of issuers has doubled since 2008 (from approximately 75 to 150 issuers).[1] But this was fueled in large part by ECB-sponsored bond purchase programs to facilitate liquidity.

Despite some €60 billion ($76.6 billion) in ECB-sponsored purchase commitments, however, the return of liquidity appears to be limited. Covered bonds over the past few calendar quarters have traded at historically low volumes and at historically wide yield spreads over their relevant benchmarks.

For all these reasons, we can only conclude that a covered bond market might augment—but would not adequately replace—any of the active components of the U.S. multifamily finance marketplace, including "conduit" financing through mortgage-backed securities issued by the GSEs and private Wall Street firms, along with mortgages funded by life companies, banks and other balance sheet lenders.

Maintaining Credit Capacity for the Apartment Market

The bursting of the housing bubble exposed serious flaws in our housing finance system. As policymakers undertake housing finance reform—including creating a framework for a U.S. covered bonds market—we urge you to ensure that any actions taken are not done so at the expense of the much smaller and less understood, but vital, multifamily sector.

Apartments are a critical component of the nation's housing market, and our industry depends on a reliable, reasonably priced and readily available supply of credit to meet the nation's growing demand for rental housing.

The U.S. is on the cusp of fundamental changes in our housing dynamics. Changing demographics are causing a surge in rental demand that will continue long after the economic recovery. This includes 78 million echo boomers entering the housing market, baby boomers downsizing and a dramatic decrease in the number of married couples with children to less than 22 percent of households.

[1] European Central Bank Annual Report, p. 19.

Between 2008 and 2015, nearly two-thirds of new households formed will be renters. That's 6 million new renter households. University of Utah Professor Arthur C. Nelson predicts that half of all new homes built between 2005 and 2030 will have to be rental units. The Harvard University Joint Center for Housing Studies estimates that we already have a shortage of some three million units of affordable rental housing.

Our industry cannot meet the nation's current or future housing needs—or refinance the approximately $200 billion in mortgage debt coming due over the next two years—without a fully functioning secondary mortgage market.

For these reasons it is critically important to maintain the existing level of liquidity for the multifamily market, in good times and bad. The strong performance of the sector, thanks in large part to the robust capital markets supporting it, has attracted an enormous amount of private investment. These investors have supported the expansion of the industry and a marked improvement in its professionalism. It has made the production of millions of units of workforce and market-rate housing possible.

For the past 50 years, the U.S. housing system has been the envy of the world in attracting private capital to meet our nation's housing needs. As lawmakers look for added mortgage credit sources and redesign the secondary mortgage market, we urge them to retain the successful elements of our present system, specifically those which contributed to the strength of the multifamily market, and understand the inherent limitations of new capital sources, such as covered bonds.

Tomorrow's Housing Policy: New Principles

I would also like to take a moment to address our national housing policy more broadly, as I feel that it underscores the importance of explicitly considering apartments in a reformed housing finance system.

For decades, the federal government has pursued a "homeownership at any cost" housing policy, ignoring the growing disconnect between the country's housing needs and its housing policy. In the process, many people were enticed into houses they could not afford, which in turn helped fuel a housing bubble that ultimately burst and caused a global economic crisis.

The nation is now paying the price for that misguided policy and learning firsthand that there is such a thing as too much homeownership; that aggressively pushing homeownership was not only disastrous for the hardworking families lured into unsustainable ownership, but also for our local communities and our national economy.

If there is a silver lining in this situation, it is the opportunity we now have to learn from our mistakes and rethink our housing policy. Housing our diverse nation means having a vibrant rental market along with a functioning ownership market. It's time we adopt a balanced housing policy that doesn't measure success solely by how much homeownership there is.

For many of America's most pressing challenges, from suburban sprawl to affordable housing, apartments are a much better solution. Apartments help create stronger and healthier communities by offering enough housing for the workers that businesses need, by reducing the cost of providing public services like water, sewer and roads and by creating vibrant live/work/play neighborhoods.

They will help us house our booming population without giving up all our green space and adding to pollution and traffic congestion. And they will help us reduce our greenhouse gas emissions by creating more compact communities that enable us to spend less time in our cars.

Elements of a Balanced Housing Policy

NMHC and NAA have joined together to advocate for a more balanced housing policy, one that respects the rights of individuals to choose housing that best meets their financial and lifestyle needs. We urge policymakers at all levels of government to work with the apartment industry to craft a smarter housing policy that:

- Assures that everyone has access to decent and affordable housing, regardless of his or her housing choice;
- Respects the rights of individuals to choose the housing that best meets their financial and lifestyle needs without disadvantaging, financially or otherwise, those who choose apartment living;

- Promotes healthy and livable communities by encouraging responsible land use and promoting the production of all types of housing;
- Recognizes that all decent housing, including apartments, and all citizens, including renters, make positive economic, political and social contributions to their communities; and
- Balances the expected benefits of regulations with their costs to minimize the impact on housing affordability.

In conclusion, our industry stands ready to meet the nation's growing demand for rental housing. We would encourage lawmakers to support us in those efforts by helping to craft a more balanced housing policy and by ensuring that housing finance reform efforts do not have an adverse effect on the apartment sector given that the sector was not responsible for the meltdown and has a long track record of strong performance.

# # #

Attachment: NMHC Analysis: Credit Capacity of Covered Bonds, July 2010

NMHC National Multi Housing Council®
Apartments: Smart Communities, Smarter Living

NATIONAL APARTMENT ASSOCIATION

WHITE PAPER

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June 30, 2010

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Analysis: Credit Capacity of Covered Bonds

- Covered bonds are similar to asset-backed securities, but some differences improve security for the bond buyer. The underlying security interests remain on the balance sheet of the issuing bank, and bondholders retain security interests even if the issuer becomes insolvent.
- Covered bonds are a $3 trillion marketplace in Europe, and some suggest that they should be used in American multifamily finance as well.
- This white paper gives background on covered bonds and provides a framework for understanding the risks, benefits and limitations inherent in establishing a similar market in the United States.
- NMHC/NAA's conclusion: A prospective U.S. covered bond market should not be considered an alternative or a replacement for, but rather a supplement to, the current secondary multifamily mortgage system and the GSEs.

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About the National Multi Housing Council

For more than 30 years, the National Multi Housing Council (NMHC) has provided strategic leadership to the apartment industry. Through its highly effective government affairs program, its business guidance and re-search reports, and its sought-after industry meetings, NMHC has developed a reputation as the apartment executive's best ally.

Based in Washington, DC, NMHC represents the largest and most prominent firms in the apartment industry, including owners, developers, managers, lenders and brokers. The Council benefits from a focused agenda and a membership that includes the principal officers of the most distinguished real estate organizations in the United States. With its joint legislative partner, the National Apartment Association, NMHC serves as the apartment industry's primary advocate on legislative and regulatory matters, such as housing policy, finance, tax, technology, property management, environmental issues and building codes.

In addition to providing leadership on public policy issues, NMHC is acknowledged as the preeminent source of apartment-related information. The Council is committed to expanding the scope of industry research by conducting and sponsoring research on such critical issues as apartment market conditions, resident demo-graphics, owning versus renting, industry structure and the impact of policy on market supply and demand. For more information on joining NMHC, contact the Council at 202/974-2300 or visit www.nmhc.org.

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EXECUTIVE SUMMARY

In response to the financial crisis and its severe impact on the U.S. residential and commercial/multifamily mortgage markets, some observers have suggested establishing a covered bond market similar to the European model as a means of improving liquidity in the real estate finance arena.

A careful analysis concludes that a thriving domestic covered bond market might indeed provide some additional liquidity to the mortgage marketplace. However the analysis also reveals that efforts to comprehensively replace prevailing multifamily mortgage financing mechanisms with a covered bond system would provide limited benefits at best.

Most notably it doesn't appear a covered bond marketplace would offer the flexibility and variety of loan structures, terms and rates that U.S. multifamily and commercial borrowers demand. Nor would it likely boost liquidity by a truly significant extent, given the need for bond issuers to retain the underlying mortgages on their balance sheets.

The European experience indicates that covered bonds, as a secondary-market mortgage financing mechanism, do indeed provide numerous benefits to various participating parties. Investors earn attractive risk-adjusted yields on instruments featuring low-risk "second recourse" security. Financial institutions that issue the bonds benefit from attractively priced funds and reduced risk-based capital requirements, along with meaningful collateral substitution capabilities.

These characteristics can combine to minimize borrowing costs to multifamily and commercial property borrowers. And any additional liquidity a covered bond market generates would boost the market's overall lending capacity.

But again for numerous reasons this report will detail, it is quite unlikely covered bonds could provide the capacity, flexibility or pricing superiority necessary to adequately replace the U.S.'s existing sources of multifamily mortgage credit.

Among the most significant:

- In contrast to U.S. commercial mortgage lenders' broad flexibility with respect to term and rate structures, the covered bond market is characterized as far more uniform and commoditized;
- In contrast to the U.S.'s generally thriving secondary mortgage markets, which allow originating lenders to remove loans from their balance sheets, the covered bond structure limits issuer lending volumes by requiring them to hold loans in portfolios and retain capital reserves in case of losses;
- In contrast to European markets, life insurers and other active U.S. apartment mortgage lenders would compete aggressively with covered bond issuers with regard to interest rates and loan terms;
- In contrast to the short-term lengths and consequential "balloon" repayment requirements associated with covered bonds, American apartment investors are accustomed to a variety of term choices including 10-year balloon loans and longer-term fully amortizing structures; and
- In contrast to covered bond issuers' prohibitions (or extreme limitations) of additional financing subordinate to first-priority mortgage debt, U.S. borrowers have seen lenders compete by allowing various secondary financing structures.

In addition to these issues, it also remains unclear whether the covered bond structure can become sufficiently flexible to accommodate broad-based public-sector participation in the U.S. affordable-housing finance arena. For instance a significant proportion of apartment production in recent decades has been financed through Low-

Income Housing Tax Credit (LIHTC) equity investments, and various structures of tax-exempt or otherwise subsidized bonded debt.

Likewise questions remain about whether a purely private American covered bond market could become a critical "back-stop" capital source during periods of financial instability. While Europe's covered bond market came to something of a standstill during the global financial crisis, the U.S. government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac remained a critical liquidity source in the domestic multifamily finance field.

Nor does the evidence suggest a covered bond market would provide more attractive multifamily borrowing rates and terms, nor any greater financial security to American taxpayers.

For all these reasons, our analysis can only conclude that a covered bond market might augment – but would not adequately replace – any of the active components of the U.S. multifamily finance marketplace, including "conduit" financing through mortgage-backed securities issued by the GSEs and private Wall Street firms, along with mortgages funded by life companies, banks and other balance-sheet lenders.

INTRODUCTION

This analysis provides background information on the nearly $3 trillion European covered bond marketplace, and assesses prospects for extending it into the U.S. multifamily finance arena. Its primary intent is to provide a framework for understanding the risks, benefits and limitations inherent in establishing a similar market in the United States.

In addition to defining covered bonds, their key features and market trends, this study details the history of the European covered bond market and discusses how this fully established market fared during the 2008 financial crisis.

In July of 2008, the U.S. Department of the Treasury, in cooperation with numerous large banks, announced that Treasury would begin establishing regulations aimed at jump-starting a covered bond market in the U.S. The purpose of the initiative was communicated as a means to provide an alternative form of residential mortgage-backed securities.

Several regulatory agencies have been promoting the covered bond model in an effort to "increase availability, and lower the cost of mortgage financing, to accelerate the return of normal home buying and refinancing activity," as former Treasury Secretary Henry M. Paulson put it.

DEFINING COVERED BONDS

In recent years, covered bonds have become the dominant source of residential mortgage credit in Europe. Some countries there even look to covered bonds to help finance public infrastructure development. They have also been used to finance ships.

Covered bonds are similar in many ways to asset-backed securities, but some noteworthy differences improve bond buyer security and hence attract a broader investor base. Most notably, underlying security interests in the cover pool of mortgage loans remain on the balance sheet of the issuing bank – and bondholders retain security interests in the cover pool even if the issuer becomes insolvent.

Accordingly, covered bonds eliminate risks associated with mortgage-derived cash flows because principal and interest are paid by bond issuers. The mortgages in the cover pool, which are controlled by the issuer, serve only as collateral for investors rather than the source of cash flow necessary to ensure interest and principal payments.[1]

[1] European Covered Bond Council Fact Book (2009), p. 325-335.

The collateral risk may likewise be lower than with typical mortgage-backed securities due to asset substitution rules and other factors. But issuing banks must nevertheless reserve against potential losses associated with mortgage loans.

In contrast, mortgage- and other asset-backed securities are typically off-balance-sheet transactions. Lenders sell loans to special purpose vehicles (SPV) that issue bonds, thereby removing the credits, along with their risks, from lenders' balance sheets. Absent detection of fraud, investors have no recourse to banks that sell mortgages to SPVs.

Again, covered bond issuers' ability to alter loan pools in order to maintain targeted credit quality is another important distinction, as it further protects bondholder interests. Issuers can also modify certain loan terms in order to boost credit quality. Collateral substitutions and loan modifications historically have not been allowed with securitized commercial mortgages in the U.S.

Nor do covered bonds entail material refinance risk, as underlying loans are typically leveraged no more than 80 percent – a rate securitized U.S. residential mortgages have often exceeded. And even if the issuing bank ultimately becomes insolvent, the assets in the cover pool are separated from the issuer's other assets solely for the benefit of the covered bondholders.

Based on the high quality of the loans in the cover pool, the strength of the issuing banks and other security characteristics, most covered bonds receive high credit ratings of double-A or triple-A. Bond maturities generally range from two to 10 years, although there has been a recent trend toward maturities beyond 10 years (but typically not more than 20), with amortization periods of 20 to 30 years.

European Regulatory Frameworks

Current regulations of covered bonds in the U.S. differ somewhat from those in Europe. For instance, 26 of 31 European nations where covered bonds are allowed (as of December 2007) treat them under "special law"-based regulatory frameworks, while a handful oversee them through "general law"-based frameworks.

Under special law frameworks, standardized uniform regulations more clearly detail legal rights of bond holders, including certain regulated investors that might benefit from preferential risk weightings.

Several key regulatory provisions are common to both legal frameworks:

- Bond are issued by – or bondholders otherwise have full recourse to – a lender (credit institution) subject to public supervision and regulation;
- Bondholders' claims against pools of financial assets covered by the bonds are superior to the credit institutions' unsecured creditors;
- The credit institution is obligated to maintain sufficient assets in the cover pool to satisfy the claims of covered bondholders at all times; and
- The obligations of the credit institution with respect to the cover pool are supervised by public or other independent bodies.[2]

According to the European Covered Bond Council (ECBC), the market for these instruments would be much smaller absent the regulatory frameworks. The ECBC states that without the general-law and special-law based frameworks, the volume of issued and outstanding covered bonds would be approximately 25% of what has been seen to date.

[2] European Covered Bond Council Fact Book (2009), p. 96

Regulations of covered bonds issued in the U.S. provide for additional bond holder access to pledged collateral in the event issuing institutions are taken over by the Federal Deposit Insurance Corp. or another regulator. Among those provisions:

- Cover pool assets must consist primarily of home mortgages (up to 10% of assets can be AAA-rated MBS);
- Covered bonds can account for no more than 4% of an issuer's total liabilities; and
- The covered bond asset pool's value must remain equal to or greater than the bond issue's outstanding principal balance.

Key Benefits, Limitations

The fundamental benefit of covered bonds in theory is that they allow issuers to funnel bond sale proceeds into additional mortgage (and other) lending, while also providing investors with additional security protections not seen with traditional mortgage-backed securities. The other commonly noted benefits of covered bonds to investors include:

- Strong credit quality;
- Attractive yields suitable for conservative portfolios; and
- Exceptional security via the extra recourse layer upon issuer default.

Nevertheless, regulation and industry practices also create a number of less attractive characteristics that may well tend to limit the U.S. market for covered bonds. Among the most notable limitations:

- Holding covered bonds on issuer balance sheets limits issuance volume and in turn new loan originations;
- Consequences for bond holders when regulators absorb insolvent issuers aren't yet absolutely clear;
- Bond term lengths defining the European market won't necessarily satisfy U.S. investors;
- Loan underwriting practices in the European covered bond market may prove too conservative for U.S. borrowers;
- No track record to date validates the viability of using commercial mortgages and commercial MBS in cover pools, rather than using residential assets exclusively; and
- Competition from covered bonds could potentially limit participation of life insurance companies and private capital sources in multifamily mortgage funding.

It should be noted that uncertainty over regulatory practices in cases of issuer insolvency – particularly regarding bond holder rights to cover pool assets – is thought to be a primary factor in the limited track record of covered bond issuance in the U.S. That is, while issuance of covered bonds is not prohibited in the U.S., to date only two U.S. financial institutions have issued covered bonds.

Past, Current Use

Over decades and even centuries, covered bonds have evolved into a key capital markets component in nearly all European countries. These instruments date back two centuries to their origination as a means of agricultural financing. They subsequently evolved into public interest and government operations, followed by residential and commercial real estate financing markets.

Use of covered bonds declined somewhat in the 20th century as European inter-bank finance markets came to prominence. But then issuances increased again rapidly in the 1990s to meet investor demand for highly liquid

financial products. Covered bonds currently play an important role in the European financial system, and thereby contribute to the efficient allocation of capital and ultimately economic development and prosperity.

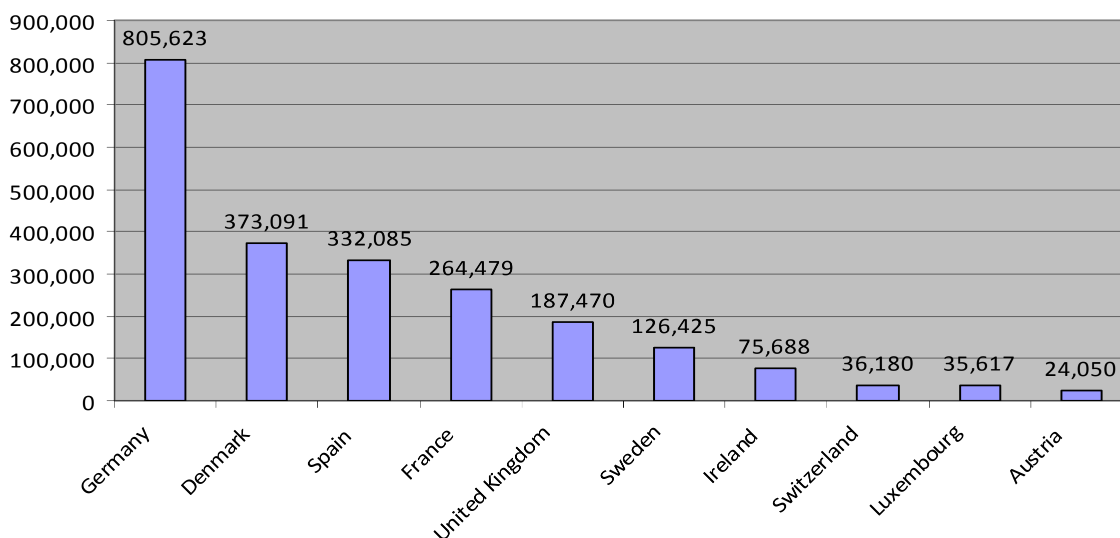
According to the most recent data available, covered bonds now equate to approximately 20% of outstanding residential mortgage debt in the European Union. The total principal outstanding at the end of 2008 amounted to €2.38 trillion ($2.84 trillion) worth of bonds covered by mortgage loans, public-sector loans and ship loans – up 12% from the year-earlier figure.[3]

Mortgage covered bonds continue to dominate the market, accounting for 78% of the gross supply and 64% of the outstanding volume of covered bonds at the end of 2008.[4] The five largest issuing countries in 2008 were Germany, Denmark, United Kingdom, France and Spain – with public-sector loans playing prominent roles in each.

Figure 1 shows the total volume of outstanding covered bonds by country for the fourth quarter of 2008 for the top 10 European countries. The U.S. ranked 15th of the 25 countries reportedly issuing covered bonds according to the ECBC, with a total outstanding volume of $15.4 billion in 2008.

In addition to the United States, other countries identified by ECBC but not depicted in this chart include: Norway, Netherlands, Portugal, Italy, Czech Republic, Hungary, Canada, Finland, Greece, Slovakia, Poland, Iceland, Latvia, and Ukraine. The combined outstanding principal of the top 10 issuing countries at the end of 2008 was €2.26 trillion ($2.7 trillion). The other 15 countries' combined outstanding volume at the end of 2008 totaled only €119.2 billion ($142.3 billion).[5]

Figure 1: Total Volume of Outstanding Covered Bonds (Top 10 European Countries)/Million



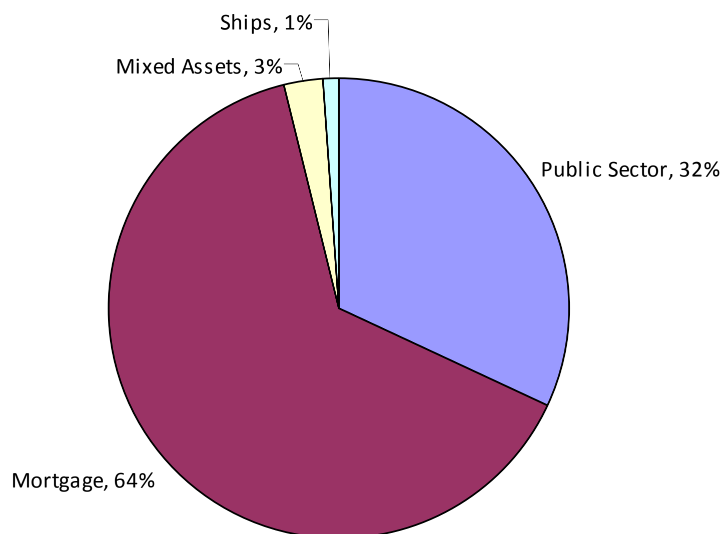
Source: European Covered Bond Council Fact Book (2009)

The major categories of covered bond assets are mortgage loans, public sector loans and ship loans. Regulators in each country specify the array of eligible cover pool assets. All European nations that allow covered bonds have activity in bonds backed by residential and commercial mortgages.

[3] European Covered Bond Council Fact Book (2009), p. 92.
[4] European Covered Bond Council Fact Book (2009), p. 93.
[5] European Covered Bond Council Fact Book (2009), p. 93.

Covered bonds issued to fund public sector lending play an important role in Germany, France, Ireland, Luxembourg, Austria, Italy and Spain. Covered bonds backed by ship loans are much less common, found mostly in Denmark and Germany.

Figure 2: Total Outstanding Covered Bonds by Asset Classification (European Market)



Source: European Covered Bond Council Fact Book (2009), p. 88.

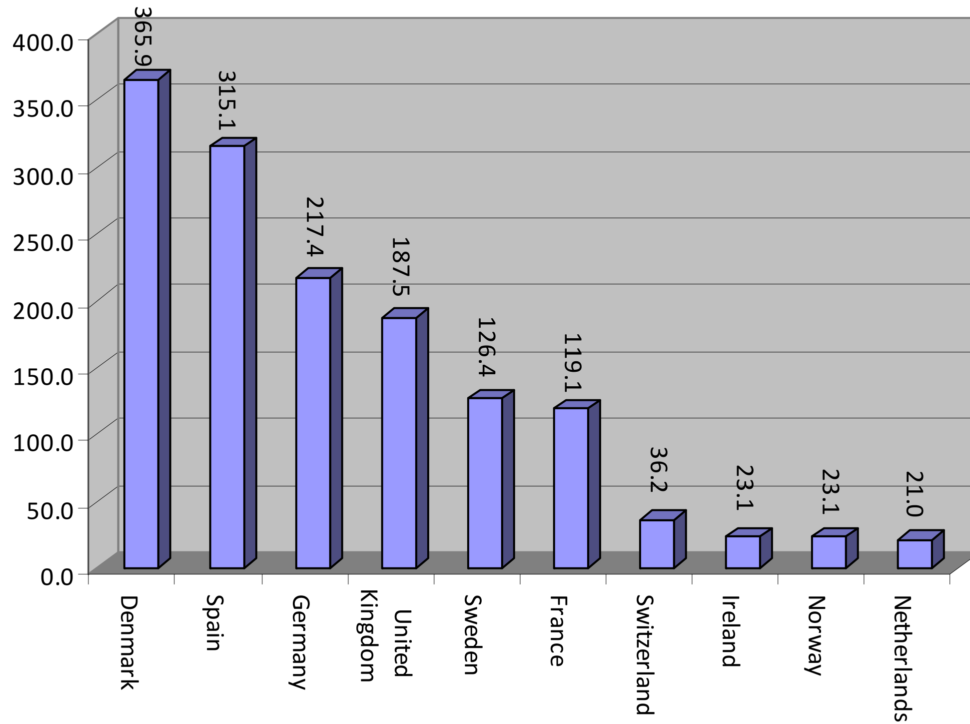
Mortgages are far and away the most heavily utilized classification among assets used as collateral for covered bonds issued throughout the European Union and the U.S. (see Figure 2). According to ECBC data, among the 25 countries currently issuing covered bonds (including the U.S.), 64% of outstanding issues are backed by mortgage collateral, and 32% are backed by public sector loans.

It's also informative to note that Germany alone accounts for €558 billion ($666 billion) of the approximately €773 billion ($923 billion) in outstanding covered bonds backed by public sector loans.[6] This indicates that use of mortgage collateral is even more widespread than the aggregate data alone might suggest.

Figure 3 shows the volume of covered bonds backed by mortgage assets for the top 10 issuing countries in Europe. Additionally the United States had a total of $15.4 billion in outstanding volume in 2008, all categorized as mortgage asset collateral, according to the ECBC.[7] Disbursement of covered bonds by category in the European Union outstanding at the end of 2008 is shown in Figure 4.

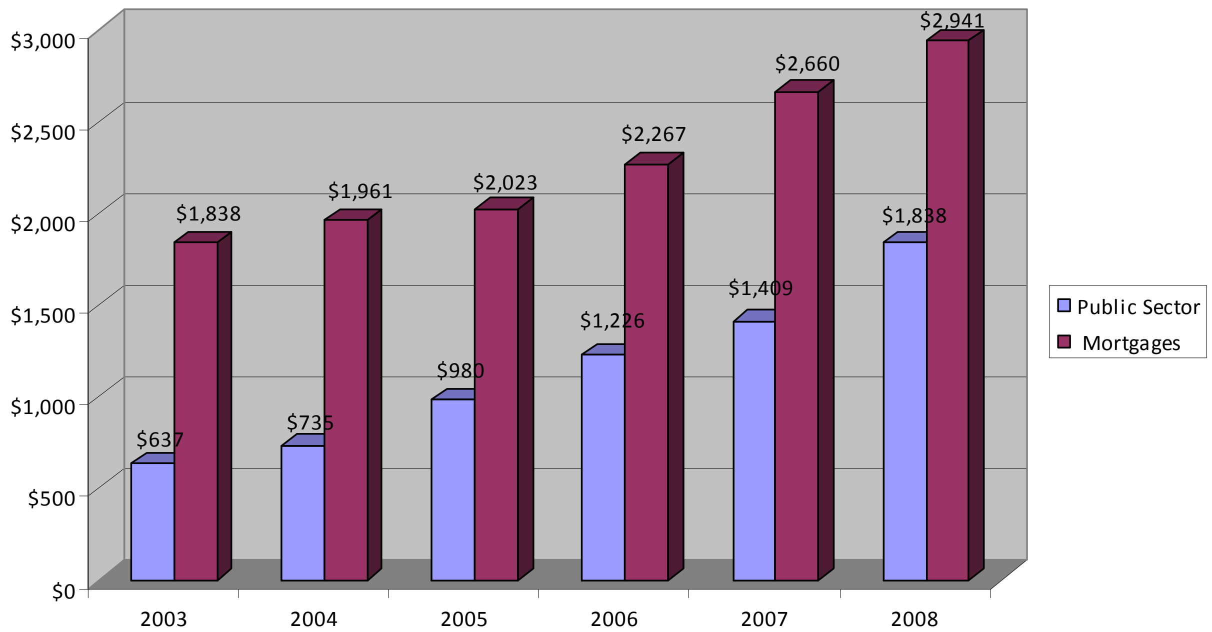
[6] European Covered Bond Council Fact Book (2009), p. 92-93.
[7] European Covered Bond Council Fact Book (2009), p. 92.

Figure 3: Total Volume of Covered Bonds Collateralized by Mortgage Assets (Euros/Billion)



Source: European Covered Bond Council Fact Book (2009), p. 92.

Figure 4: Total Covered Bonds Outstanding by Asset Class in Europe/Billion



Source: European Covered Bond Market Fact Book (2009), p. 88-92.

As for continued market expansion in Europe, the ECBC concludes: "there is a strong expectation that the covered bond market will continue to grow, especially since legislators across Europe have adopted modern covered bond regulations or modernized existing ones".[8]

U.S. POTENTIAL: REGULATORY FRAMEWORK

But just how well would the regulatory framework and other factors that have driven growth of the European covered bond market translate to U.S real estate capital markets? It's a difficult question to answer with any certainty, given that the European market has grown in part because Europe's borrowers and investors don't have access to American-style GSEs or Federal Home Loan Banks.

One way to approach that question is to consider key differences between covered bonds and the MBS marketplace that plays such a prominent role in U.S. commercial and multifamily finance. Our analysis identified four particularly significant differences between covered bonds and MBS as sources of long-term funding for mortgage loans:

- In the event the cover pool mortgages don't pay interest and principal as originally agreed, covered bonds provide investors with a second form of recourse, i.e., to the bond issuer. MBS do not provide this second form of recourse when borrowers are delinquent; bondholders simply face greater exposure to underlying real estate risks.

- European covered bond regulations allow an issuer to substitute collateral if some of the underlying mortgages default, under-perform or are prepaid; this helps maintain the cover pool's credit quality and in turn the bonds' ratings and values. U.S. "REMIC" (real estate mortgage investment conduit) rules require static MBS collateral pools rather than allowing for collateral substitution; this means an issue's repayment risk fluctuates in correlation to the credit quality of the original mortgages.

- Covered bonds minimize the risk of prepayment in the event an issuer defaults prior to maturity, by way of an investment contract guaranteeing payments on the bonds from default through maturity. MBS investors assume prepayment risk potentially resulting from both mortgage defaults and prepayment.

- In a typical MBS transaction, the securities issuer no longer carries the underlying mortgages on its balance sheet – which frees up capital with which to make additional loans. In a covered bond transaction the collateralized mortgages remain as liabilities on the issuer's balance sheet – hindering the volume of new lending capabilities compared to a U.S.-style securitization.

Another means of assessing the extent to which covered bonds might play a prominent role in U.S. commercial/multifamily real estate finance is to review significant legal and regulatory issues pertaining to structure and use of covered bonds here. And while a couple of institutions have issued these securities, it's hard to avoid the conclusion that the regulatory framework today remains insufficient to support a thriving domestic covered bond market.

While legislation including covered bond regulation has been introduced, and relevant regulatory agencies have recommended frameworks, no current federal legislation or regulations clearly and unambiguously protect covered bond investor interests in the event of insolvency of an insured depository institution.

Nevertheless covered bonds generally are subject to some federal laws and regulations, including the Uniform Commercial Code (UCC), Rule 144A under the Securities Act, Regulation S under the Securities Act, and the Federal Deposit Insurance Act (FDIA).[9]

[8] European Covered Bond Council Fact Book (2009), p. 92-93.
[9] European Covered Bond Council Fact Book (2009), p. 325-335.

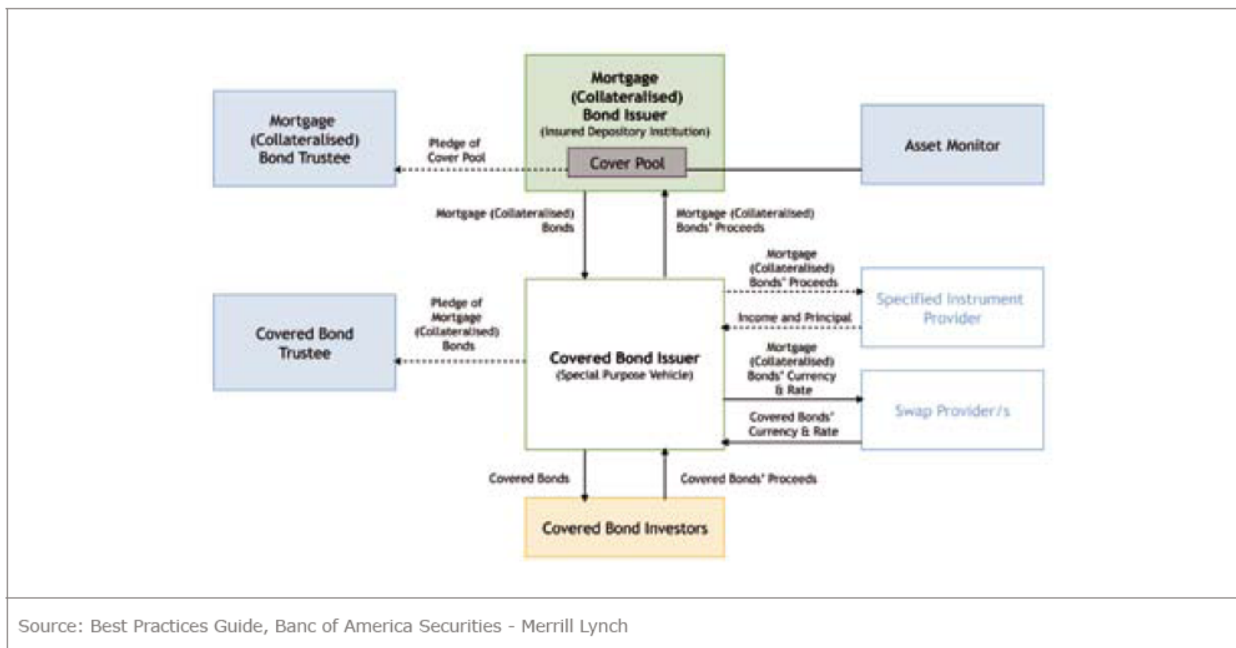
While more dedicated legislation has been under development (see below), covered bond issuance, including issues backed by mortgage collateral, has increased somewhat in recent years.

The U.S. Department of Treasury advocates establishing a definitive legislative and regulatory framework that would promote investor confidence and sound market integration. Treasury already provides a "Best Practices for Covered Bonds" guide encouraging domestic market development (see Appendix A).

The FDIC approved a final Covered Bond Policy Statement (Appendix B) clarifying the agency's position on qualifying covered bond transactions in July of 2008. The statement provides a common template to promote the development of a standardized covered bond market in the U.S.

Two large domestic financial institutions, Bank of America and the former Washington Mutual Bank (subsequently absorbed by JPMorgan Chase), have helped pioneer early U.S. covered bond issuances. These private-label issues aimed to comply with state laws of New York and Delaware. The general covered bond structure utilized by U.S. banks is depicted in Figure 5.

Figure 5: Simplified (SPV) Covered Bond Structure Currently Used by US Banks

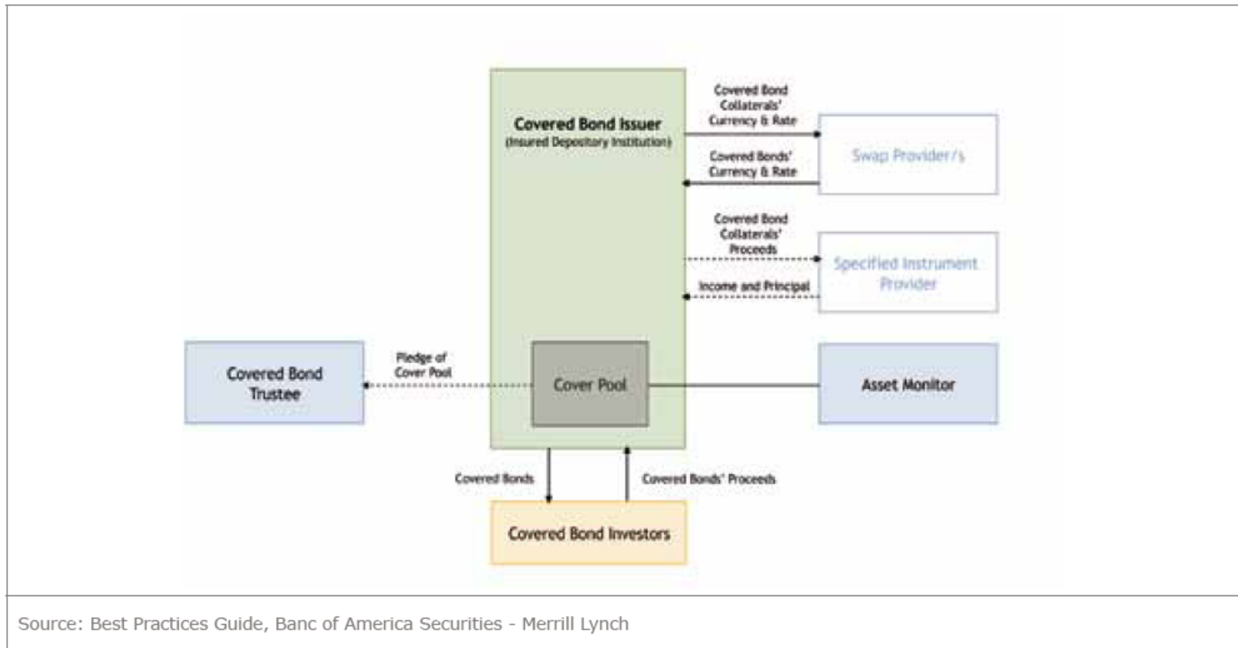


Source: European Covered Bond Market Fact Book (2009), p. 327.

Bank of America, Citigroup, JPMorgan Chase and Wells Fargo have announced their support for the two key statements addressing important U.S. policies regarding covered bonds. These institutions have also shown interest in setting up programs using the guidelines, or aligning existing covered bond programs to the standards under the final FDIC Covered Bond Policy Statement and the Treasury Department Best Practices Guide.

The structure proposed under this policy statement, and under consideration by those institutions, is depicted in Figure 6.

***Figure 6**: Potential US Covered Bond Issuance Structure*



Source: European Covered Bond Market Fact Book (2009), p. 327.

Although some U.S. regulatory authorities have shown reluctance to establish dedicated covered bond regulations, the Treasury Secretary in early 2009 suggested such legislation should be considered in the context of broader housing finance reform efforts. Again, Treasury maintains that dedicated legislation clearly addressing investor interests in the event of issuer insolvency could help instill investor confidence in covered bonds.

Multiple legislative proposals have been introduced in an attempt to regulate the U.S. covered bond market. The most recent proposed legislation, The U.S. Covered Bond Act (H.R. 4884) aims to facilitate a covered bond market and provide a more comprehensive legislative framework than preceding bills.

The Act would establish regulatory oversight of covered bond markets, including broad provisions for default and insolvency of covered bond issuers, and would subject covered bonds to oversight by federal securities regulators. The legislation also directs the U.S. Securities and Exchange Commission to develop a registration process for covered bonds that are not exempt from SEC oversight.

Eligible asset classes under the proposed legislation include: residential mortgages, home equity loans, commercial mortgages, public agency debt, auto loans, student loans, credit card debt, small business loans, and other asset classes not yet identified by the regulator.[10]

Opponents of the legislation question whether a covered bond market would improve liquidity in the U.S. mortgage market. They also cite the additional bank failure risks to which covered bonds would subject the FDIC, along with the related hikes in FDIC deposit insurance rates. Proponents counter that H.R. 4884 is not intended to facilitate a U.S. covered bond market that would replace existing sources of finance, but instead aims to provide additional liquidity complementing other forms of mortgage funding.

Financial Crisis Impact

Though long considered a reliable and durable source of mortgage capital, the European covered bond market nevertheless suffered its share of distress during the latest global financial meltdown. It remained liquid longer

[10] Treasury Department Best Practices Guide for Covered Bonds, p. 9.

than many other wholesale funding markets, but was ultimately rendered dormant for several months during the last quarter of 2008.

In the wake of Lehman Brothers' collapse in September 2008, the European covered bond market went without a public issuance until early 2009. Nevertheless, the market did record some positive growth over the course of 2008. While some European jurisdictions haven't seen new issues since then, the European Central Bank reports that the number of issuers has doubled since 2008 (from approximately 75 to 150 issuers).[11] Of course it helped that the European Central Bank (ECB) sponsored bond purchase programs to facilitate liquidity.

Despite some €60 billion in ECB-sponsored purchase commitments, however, the return of liquidity appears to be limited. Covered bonds over the past few calendar quarters have traded at historically low volumes and at historically wide yield spreads over their relevant benchmarks.

And now, in 2010, as the perplexing European debt crisis continues to unfold, the expectation is that efforts to resolve state fiscal issues will deflect interest in the covered bond market somewhat. Despite these challenges, new players continue entering the market, and existing issuers are able to expand programs, offer multiple products and diversify funding sources.

CONCLUSION

Based on NMHC's analysis, we conclude covered bonds would appeal to U.S. investors due to the generally strong credit quality of the underlying mortgages and real estate and the attractive yields they might generate without altering risk profiles of conservative portfolios. Covered bonds can also help diversify portfolios while protecting investors through the additional recourse they provide in the event of default.

Accordingly, it appears an active, unambiguously regulated covered bond marketplace would provide some degree of additional liquidity to the domestic multifamily finance arena.

However, based on the performance of the fully regulated and long-established covered bond market in Europe during the financial crisis of 2008, it is clear that this investment category has limitations. Likewise U.S. regulatory authorities have expressed concerns about a covered bond market's potential for increasing the risks that the FDIC or other agency might have to bear.

Therefore NMHC also concludes that a prospective U.S. covered bond market should not be considered an alternative or a replacement for, but rather a supplement to, the current secondary multifamily mortgage system and the GSEs.

[11] European Central Bank Annual Report, p. 19.

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APPENDIX A
FDIC POLICY STATEMENT

Allotments, Television Broadcast Stations (Riverside, California) (MB Docket No. 08–30).

Number of Petitions Filed: 1.

Subject: In the Matter of Improving Public Safety Communications in the 800 MHz Band (WT Docket No. 02–55). New 800 MHz Band Plan for U.S.-Canada Border Region.

Number of Petitions Filed: 1.

Marlene H. Dortch,

Secretary.

[FR Doc. E8–17276 Filed 7–25–08; 8:45 am]

BILLING CODE 6712–01–P

FEDERAL DEPOSIT INSURANCE CORPORATION

Covered Bond Policy Statement

AGENCY: Federal Deposit Insurance Corporation (FDIC).

ACTION: Final Statement of Policy.

SUMMARY: The Federal Deposit Insurance Corporation (the FDIC) is publishing a final policy statement on the treatment of covered bonds in a conservatorship or receivership. This policy statement provides guidance on the availability of expedited access to collateral pledged for certain covered bonds after the FDIC decides whether to terminate or continue the transaction. Specifically, the policy statement clarifies how the FDIC will apply the consent requirements of section 11(e)(13)(C) of the Federal Deposit Insurance Act (FDIA) to such covered bonds to facilitate the prudent development of the U.S. covered bond market consistent with the FDIC's responsibilities as conservator or receiver for insured depository institutions (IDI). As the U.S. covered bond market develops, future modifications or amendments may be considered by the FDIC.

DATES: *Effective Date:* July 28, 2008.

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

On April 23, 2008, the FDIC published the Interim Final Covered Bond Policy Statement for public comment. 73 FR 21949 (April 23, 2008). After carefully reviewing and considering all comments, the FDIC has adopted certain limited revisions and clarifications to the Interim Policy Statement (as discussed in Part II) in the Final Policy Statement.[1]

Currently, there are no statutory or regulatory prohibitions on the issuance of covered bonds by U.S. banks. Therefore, to reduce market uncertainty and clarify the application of the FDIC's statutory authorities for U.S. covered bond transactions, the FDIC issued an Interim Policy Statement to provide guidance on the availability of expedited access to collateral pledged for certain covered bonds by IDIs in a conservatorship or a receivership. As discussed below, under section 11(e)(13)(C) of the FDIA, any liquidation of collateral of an IDI placed into conservatorship or receivership requires the consent of the FDIC during the initial 45 days or 90 days after its appointment, respectively. Consequently, issuers of covered bonds have incurred additional costs from maintaining 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 during these periods after any decision by the FDIC 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 expedited access to pledged covered bond collateral.

Covered bonds are general, non-deposit 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. These 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'').[2] 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.

The FDIC 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 conditions and circumstances under which the FDIC will grant automatic consent to access pledged covered bond collateral. The FDIC believes that the prudential limitations set forth 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 insight 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 discussion, when we refer to ''covered bond obligation,'' we are referring to 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 the FDIA, 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

[1] For ease of reference, the Interim Final Covered Bond Policy Statement, published on April 23, 2008, will be referred to as the Interim Policy Statement. The Final Covered Bond Policy Statement will be referred to as the Policy Statement.

[2] The FDIC understands that certain potential issuers may propose a different structure that does not involve the use of an SPV. The FDIC expresses no opinion about the appropriateness of SPV or so-called ''direct issuance'' covered bond structures, although both may comply with this Statement of Policy.

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.[3] During this period, the FDIC must still comply with otherwise enforceable provisions of the contract. The FDIC also may terminate or repudiate any contract 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.[4]

As conservator or receiver for an IDI, the FDIC has three options in responding to a properly structured covered bond transaction of the IDI: (1) Continue to perform on the covered bond transaction under its terms; (2) pay off the covered bonds in cash up to the value of the pledged collateral; or (3) allow liquidation of the pledged collateral to pay off the covered bonds. If the FDIC adopts the first option, it would continue to make the covered bond payments as scheduled. The second or third options would be triggered if the FDIC repudiated the transaction or if a monetary default occurred. In both cases, the par value of the covered bonds plus interest accrued to the date of the appointment of the FDIC as conservator or receiver would be paid in full up to the value of the collateral. If the value of the pledged collateral exceeded the total amount of all valid claims held by the secured parties, this excess value or over collateralization would be returned to the FDIC, as conservator or receiver, for distribution as mandated by the FDIA. On the other hand, if there were insufficient collateral pledged to cover all valid claims by the secured parties, the amount of the claims in excess of the pledged collateral would be unsecured claims in the receivership.

While the FDIC can repudiate the underlying contract, and thereby terminate any continuing obligations under that contract, the FDIA prohibits the FDIC, as conservator or receiver from avoiding any legally enforceable or perfected security interest in the assets of the IDI unless the interest was taken in contemplation of the IDI's insolvency or with the intent to hinder, delay, or defraud the IDI or its creditors.[5] This statutory provision ensures protection for the valid claims of secured creditors up to the value of the pledged collateral. After a default or repudiation, the FDIC as conservator or receiver may either pay resulting damages in cash up to the value of the collateral or turn over the collateral to the secured party for liquidation. For example, if the conservator or receiver repudiated a covered bond transaction, as discussed in Part II below, it would pay damages limited to par value of the covered bonds and accrued interest up to the date of appointment of the conservator or receiver, if sufficient collateral was in the cover pool, or turn over the collateral for liquidation with the conservator or receiver recovering any proceeds in excess of those damages. In liquidating any collateral for a covered bond transaction, it would be essential that the secured party liquidate the collateral in a commercially reasonable and expeditious manner taking into account the then-existing market conditions.

As noted above, existing covered bond transactions by U.S. issuers have used SPVs. However, nothing in the Policy Statement requires the use of an SPV. Some questions have been posed about the treatment of a subsidiary or SPV after appointment of the FDIC as conservator or receiver. The 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. While the determination of whether a subsidiary or SPV has been organized and maintained as a separate entity from the IDI must be determined based on the specific facts and circumstances, the standards for such decisions are set forth in generally applicable judicial decisions and in the FDIC's regulation governing subsidiaries of insured state banks, 12 CFR 362.4.

The requests 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 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 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 Final Covered Bond Policy Statement in order to provide covered bond issuers with final guidance on how the FDIC will treat covered bonds in a conservatorship or receivership.

II. Overview of the Comments

The FDIC received approximately 130 comment letters on the Interim Policy Statement; these included comments from national banks, Federal Home Loan Banks, industry groups and individuals.

Most commenters encouraged the FDIC to adopt the Policy Statement to clarify how the FDIC would treat covered bonds in the case of a conservatorship or receivership and, thereby, facilitate the development of the U.S. covered bond market. The more detailed comments focused on one or more of the following categories of issues: (1) The FDIC's discretion regarding covered bonds that do not comply with the Policy Statement; (2) application to covered bonds completed prior to the Policy Statement; (3) the limitation of the Policy Statement to covered bonds not exceeding 4 percent of liabilities; (4) the eligible collateral for the cover pools; (5) the measure of damages provided in the event of default or repudiation; (6) the covered bond term limit; and (7) federal home loan bank advances and assessments.

Certain banks and industry associations sought clarification about the treatment of covered bonds that do not comply with the Policy Statement by the FDIC as conservator or receiver. Specifically, commenters asked the FDIC to clarify that if a covered bond issuance is not in conformance with the Policy Statement, the FDIC retains discretion to grant consent prior to expiration of the 45 or 90 day period on a case-by-case basis. Under Section 11(e)(13)(C) of the FDIA, the exercise of any right or power to terminate, accelerate, declare a default, or otherwise affect any contract of the IDI, or to take possession of any property of the IDI, requires the consent of the conservator or receiver, as appropriate,

[3] *See* 12 U.S.C. 1821(e)(13)(C).

[4] *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).

[5] *See* 12 U.S.C. 1821(e)(12).

during the 45-day period or 90-day period after the date of the appointment of the conservator or receiver, as applicable. By the statutory terms, the conservator or receiver retains the discretion to give consent on a case-by-case basis after evaluation by the FDIC upon the failure of the issuer.

Comments from banks who issued covered bonds prior to the Policy Statement requested either 'grandfathering' of preexisting covered bonds or an advance determination by the FDIC before any appointment of a conservator or receiver that specific preexisting covered bonds qualified under the Policy Statement. After carefully considering the comments, the FDIC has determined that to 'grandfather' or otherwise permit mortgages or other collateral that do not meet the specific requirements of the Policy Statement to support covered bonds would not promote stable and resilient covered bonds as encompassed within the Policy Statement. If preexisting covered bonds, and their collateral, otherwise qualify under the standards specified in the Policy Statement, those covered bonds would be eligible for the expedited access to collateral provided by the Policy Statement.

A number of commenters requested that the limitation of eligible covered bonds to no more than 4 percent of an IDI's total liabilities should be removed or increased. Commenters also noted that other countries applying a cap have based the limitation on assets, not liabilities. The Policy Statement applies to covered bond issuances that comprise no more than 4 percent of an institution's total liabilities since, in part, as the proportion of secured liabilities increases, the total unpledged assets available to satisfy the claims of uninsured depositors and other creditors from the Deposit Insurance Fund decrease. As a result, the FDIC must focus on the share of an IDI's liabilities that are secured by collateral and balance the additional potential losses in the failure of an IDI against the benefits of increased liquidity for open institutions. The 4 percent limitation under the Policy Statement is designed to permit the FDIC, and other regulators, an opportunity to evaluate the development of the covered bond market within the financial system of the United States, which differs in many respects from that in other countries deploying covered bonds. Consequently, while changes may be considered to this limitation as the covered bond market develops, the FDIC has decided not to make any change at this time.

A number of commenters sought expansion of the mortgages defined as ''eligible mortgages'' and the expansion of collateral for cover pools to include other assets, such as second-lien home equity loans and home equity lines of credit, credit card receivables, mortgages on commercial properties, public sector debt, and student loans. Other commenters requested that ''eligible mortgages'' should be defined solely by their loan-to-value (LTV) ratios. After considering these comments, the FDIC has determined that its interests in efficient resolution of IDIs, as well as in the initial development of a resilient covered bond market that can provide reliable liquidity for well-underwritten mortgages, support retention of the limitations on collateral for qualifying covered bonds in the Interim Policy Statement. Recent market experience demonstrates that many mortgages that would not qualify under the Policy Statement, such as low documentation mortgages, have declined sharply in value as credit conditions have deteriorated. Some of the other assets proposed are subject to substantial volatility as well, while others would not specifically support additional liquidity for well-underwritten residential mortgages. As noted above, certain provisions of the Policy Statement may be reviewed and reconsidered as the U.S. covered bond market develops.

With regard to the comments that LTV be used as a guide to determine an ''eligible mortgage,'' the FDIC does not believe that LTV can substitute for strong underwriting criteria to ensure sustainable mortgages. In response to the comments, and the important role that LTV plays in mortgage analysis, the Policy Statement will urge issuers to disclose LTV for mortgages in the cover pool to enhance transparency for the covered bond market and promote stable cover pools. However, no specific LTV limitation will be imposed.

Two commenters suggested that the Policy Statement should be clarified to permit the substitution of cash as cover pool collateral. The Policy Statement has been modified to allow for the substitution of cash and Treasury and agency securities. The substitution of such collateral does not impair the strength of the cover pool and may be an important tool to limit short-term strains on issuing IDIs if eligible mortgages or AAA-rated mortgage securities must be withdrawn from the cover pool.

A number of commenters requested guidance on the calculation of damages the receiver will pay to holders of covered bonds in the case of repudiation or default. Under 12 U.S.C. 1821(e)(3), the liability of the conservator or receiver for the disaffirmance or repudiation of any contract is limited to ''actual direct compensatory damages'' and determined as of the date of appointment of the conservator or receiver. In the repudiation of contracts, such damages generally are defined by the amount due under the contract repudiated, but excluding any amounts for lost profits or opportunities, other indirect or contingent claims, pain and suffering, and exemplary or punitive damages. Under the Policy Statement, the FDIC agrees that ''actual direct compensatory damages'' due to bondholders, or their representative(s), for repudiation of covered bonds will be limited to the par value of the bonds plus accrued interest as of the date of appointment of the FDIC as conservator or receiver. The FDIC anticipates that IDIs issuing covered bonds, like other obligations bearing interest rate or other risks, will undertake prudent hedging strategies for such risks as part of their risk management program.

Many commenters suggested that the 10-year term limit should be removed to permit longer-term covered bond maturities. After reviewing the comments, the FDIC agrees that longer-term covered bonds should not pose a significant, additional risk and may avoid short-term funding volatility. Therefore, the FDIC has revised the Interim Policy Statement by increasing the term limit for covered bonds from 10 years to 30 years.

A number of the Federal Home Loan Banks, and their member institutions, objected to the inclusion of FHLB advances in the definition of ''secured liabilities,'' any imposed cap on such advances, and any change in assessment rates. Under 12 CFR part 360.2 (Federal Home Loan Banks as Secured Creditors), secured liabilities include loans from the Federal Reserve Bank discount window, Federal Home Loan Bank (FHLB) advances, repurchase agreements, and public deposits. However, the Policy Statement does not impose a cap on FHLB advances and has no effect on an IDI's ability to obtain FHLB advances or its deposit insurance assessments. The Policy Statement solely addresses covered bonds.

However, as noted above, where an IDI relies very heavily on secured liabilities to finance its lending and other business activities, it does pose a greater risk of loss to the Deposit Insurance Fund in any failure. Should the covered bond market develop as a significant source of funding for IDIs, and should that development create

substantial increases in an IDI's reliance on secured funding, it would increase the FDIC's losses in a failure and perhaps outweigh the benefits of improved liquidity. As a result, it is appropriate for the FDIC to consider the risks of such increased losses. Consideration of these risks may occur in a possible future request for comments on secured liabilities, but they are not addressed in this Policy Statement.

III. Final Statement of Policy

For the purposes of this final Policy Statement, a ''covered bond'' is defined as a non-deposit, recourse debt obligation of an IDI with a term greater than one year and no more than thirty years, that is secured directly or indirectly by a pool of eligible mortgages 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 percent 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. 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 percent of a financial institution's total liabilities after issuance.

In order to limit the risks to the deposit insurance fund, application of the Policy Statement is restricted to covered bond issuances secured by perfected security interests under applicable state and federal law on performing eligible mortgages on one-to-four family residential properties, underwritten at the fully indexed rate and relying on documented income, a limited volume of AAA-rated mortgage securities, and certain substitution collateral. The Policy Statement provides that the mortgages shall be underwritten at the fully indexed rate relying on documented income, and comply 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 additional guidance applicable at the time of loan origination. In addition, the Policy Statement requires that the eligible mortgages and other collateral pledged for the covered bonds be held and owned by the IDI. This requirement is designed to protect the FDIC's interests in any over collateralization and avoid structures involving the transfer of the collateral to a subsidiary or SPV at initiation or prior to any IDI default under the covered bond transaction.

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 percent 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. In addition, substitution collateral for the covered bonds may include cash and Treasury and agency securities as necessary to prudently manage the cover pool. Securities backed by tranches in other securities or assets (such as Collateralized Debt Obligations) are not considered to be acceptable collateral.

The Policy Statement provides that the consent of the FDIC, as conservator or receiver, is provided to covered bond obligees to exercise their contractual rights over collateral for covered bond transactions conforming to the Interim 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 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 and therefore the FDIC may consider future amendment (with appropriate notice) of this Policy Statement as the U.S. covered bond market develops.

IV. 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.

The Board of Directors of the FDIC has adopted a 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 non-deposit, recourse debt obligation of an IDI with a term greater than one year and no more than thirty years, that is secured directly or indirectly by perfected security interests under applicable state and federal law on assets held and owned by the IDI consisting of eligible mortgages, or AAA-rated mortgage-backed securities secured by eligible mortgages if for no more than ten percent of the collateral for any covered bond issuance or series. Such covered bonds may permit substitution of cash and United States Treasury and agency securities for the initial collateral as necessary to prudently manage the cover pool.

(2) The term ''eligible mortgages'' shall mean performing first-lien mortgages on one-to-four family residential properties, underwritten at the fully indexed rate [6] and relying on documented income, and complying 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 additional guidance applicable at the time of loan origination. Due to the predictive quality of loan-to-value ratios in evaluating residential mortgages, issuers should disclose loan-to-value ratios for the cover pool to enhance transparency for the covered bond market.

[6] The fully indexed rate equals the index rate prevailing at origination plus the margin to be added to it after the expiration of an introductory interest rate. For example, assume that a loan with an initial fixed rate of 7% will reset to the six-month London Interbank Offered Rate (LIBOR) plus a margin of 6%. If the six-month LIBOR rate equals 5.5%, lenders should qualify the borrower at 11.5% (5.5% + 6%), regardless of any interest rate caps that limit how quickly the fully indexed rate may be reached.

(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 IDI's total covered bond obligation as a result of such issuance comprises no more than 4 percent of an IDI's total liabilities, and only so long as the assets securing the covered bond obligation are eligible mortgages or AAA-rated mortgage securities on eligible mortgages, if not exceeding 10 percent of the collateral for any covered bond issuance, Substitution for the initial cover pool collateral may include cash and Treasury and agency securities as necessary to prudently manage the cover pool.

(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 and expeditious methods taking into account existing market conditions, 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 due 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 and expeditious methods taking into account existing market conditions, provided no involvement of the receiver or conservator is required.

(3) The liability of a conservator or receiver for the disaffirmance or repudiation of any covered bond issuance obligation, or for any monetary default on, any covered bond issuance, shall be limited to the par value of the bonds issued, plus contract interest accrued thereon to the date of appointment of the conservator or receiver.

(d) Consent. Any party 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 Deputy Director, Division of Resolutions and Receiverships, Federal Deposit Insurance Corporation, 550 17th Street, NW., F–7076, 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 repealed by the FDIC upon 30 days notice provided in the **Federal Register**, but any repeal shall not apply to any covered bond issuance made in accordance with this policy statement before such repeal.

By order of the Board of Directors.

Dated at Washington, DC this 22d day of July, 2008.

Federal Deposit Insurance Corporation.

Robert E. Feldman,

Executive Secretary.

[FR Doc. E8–17168 Filed 7–25–08; 8:45 am]

BILLING CODE 6714–01–P

FEDERAL MARITIME COMMISSION

Agency Information Collection Activities: Submission for OMB Review; Comment Request

AGENCY: Federal Maritime Commission.

ACTION: Notice.

SUMMARY: The Federal Maritime Commission (FMC or Commission) is giving public notice that the agency has submitted to OMB for approval the information collections described in this notice. The public is invited to comment on the proposed information collections pursuant to the Paperwork Reduction Act of 1995.

DATES: Written comments must be submitted to OMB at the address below on or before August 27, 2008 to be assured of consideration.

ADDRESSES: Send comments to the Office of Information and Regulatory Affairs, Office of Management and Budget, *Attention:* Desk Officer for FMC, 725 17th Street, NW., Washington, DC 20503, *OIRA_Submission@OMB.EOP.GOV* or fax (202) 395–5806.

FOR FURTHER INFORMATION CONTACT: Requests for additional information or copies of the proposed information collections and supporting statements should be directed to Jane Gregory at telephone number 202–523–5800 or *jgregory@fmc.gov*.

SUPPLEMENTARY INFORMATION: Pursuant to the Paperwork Reduction Act of 1995 (Pub. L. 104–13), the FMC invites the general public and other Federal agencies to comment on proposed information collections. On May 13, 2008, the FMC published a notice and request for comments in the **Federal Register** (73 FR 27537) regarding the agency's request for continued approval from OMB for information collections as required by the Paperwork Reduction Act of 1995. The FMC received no comments on any of the requests for extensions of OMB clearance. The FMC has submitted the described information collections to OMB for approval.

In response to this notice, comments and suggestions should address one or more of the following points: (1) The necessity and utility of the proposed information collection for the proper performance of the agency's functions; (2) the accuracy of the estimated burden; (3) ways to enhance the quality, utility, and clarity of the information to be collected; and (4) the use of automated collection techniques or other forms of information technology to minimize the information collection burden.

Information Collections Open for Comment

Title: 46 CFR part 540—Application for Certificate of Financial Responsibility/Form FMC–131.

OMB Approval Number: 3072–0012 (Expires September 30, 2008).

Abstract: Sections 2 and 3 of Public Law 89–777 (46 U.S.C. 44105 and 44106) require owners or charterers of passenger vessels with 50 or more passenger berths or stateroom accommodations and embarking passengers at United Stated ports and territories to establish their financial responsibility to meet liability incurred for death or injury to passengers and other persons, and to indemnify passengers in the event of nonperformance of transportation. The Commission's Rules at 46 CFR part 540 implement Public Law 89–777 and specify financial responsibility coverage requirements for such owners and charterers.

Current Actions: There are no changes to this information collection, and it is being submitted for extension purposes only.

Type of Review: Extension.

Needs and Uses: The information will be used by the Commission's staff to ensure that passenger vessel owners and charterers have evidenced financial responsibility to indemnify passengers and others in the event of nonperformance or casualty.

Frequency: This information is collected when applicants apply for a certificate or when existing certificants change any information in their application forms.

Type of Respondents: The types of respondents are owners, charterers and operators of passenger vessels with 50 or more passenger berths that embark passengers from U.S. ports or territories.

Number of Annual Respondents: The Commission estimates an annual respondent universe of 50.

Estimated Time Per Response: The time per response ranges from .5 to 8 person-hours for reporting and recordkeeping requirements contained in the rules, and 8 person-hours for completing Application Form FMC–131.

Total Annual Burden: The Commission estimates the total person-hour burden at 1,478 person-hours.

Title: 46 CFR part 565—Controlled Carriers.

OMB Approval Number: 3072–0060 (Expires September 30, 2008).

Abstract: Section 9 of the Shipping Act of 1984 (46 U.S.C. 40701–40706) requires that the FMC monitor the practices of controlled carriers to ensure that they do not maintain rates or charges in their tariffs and service contracts that are below a level that is just and reasonable; nor establish, maintain or enforce unjust or unreasonable classifications, rules or regulations in those tariffs or service contracts which result or are likely to result in the carriage or handling of cargo at rates or charges that are below a just and reasonable level. 46 CFR part

APPENDIX B
TREASURY DEPARTMENT BEST PRACTICES GUIDE FOR COVERED BONDS

BEST PRACTICES FOR RESIDENTIAL COVERED BONDS

THE DEPARTMENT OF THE TREASURY

UNITED STATES DEPARTMENT OF THE TREASURY
BEST PRACTICES FOR RESIDENTIAL COVERED BONDS

July 2008

Henry M. Paulson, Jr.
Secretary of the Treasury

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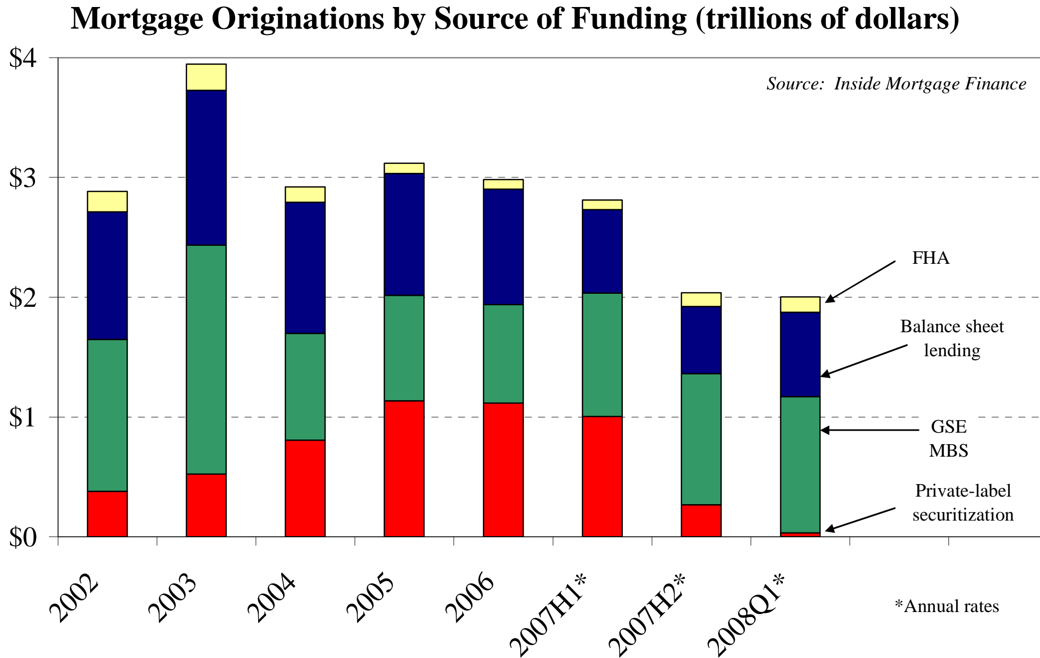
I. Background

This Best Practices guide has been prepared by the Department of the Treasury ("Treasury") in order to encourage the growth of the Covered Bond market in the United States. Treasury believes that Covered Bonds represent a potential additional source of financing that could reduce borrowing costs for homeowners, improve liquidity in the residential mortgage market, and help depository institutions strengthen their balance sheets by diversifying their funding sources.

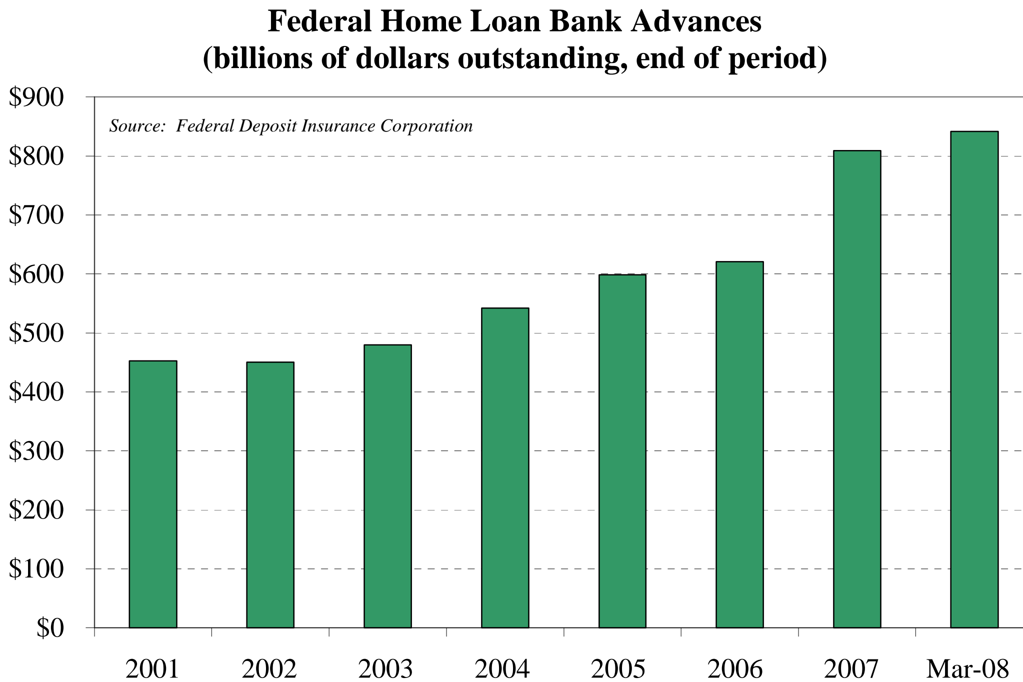
U.S. depository institutions have historically utilized several different funding sources to originate new residential mortgage loans, both for sale to investors and for their own portfolios. For loans sold into the market, depository institutions' funding options included selling the loans directly to investors, Fannie Mae, or Freddie Mac, and via private-label securitization. For loans retained on their balance sheets, depository institutions' funding options included utilizing their customers' deposits, issuing unsecured debt, and pledging their mortgages as collateral for advances from the Federal Home Loan Banks.

Recent market turmoil has severely limited the ability of depository institutions to sell loans to investors via private-label securitization. Consistent with their important public policy mission, the government-sponsored enterprises, Fannie Mae, Freddie Mac and the Federal Home Loans Banks, as well as the Federal Housing Administration have been playing a critical role by providing mortgage finance during this strained period. Even so, many depository institutions are keeping more mortgage loans on their balance sheets and are therefore seeking new sources of on-balance sheet financing. Many U.S. depository institutions are examining the potential of Covered Bonds to provide this financing while at the same time diversifying their overall funding portfolio.

Private-label securitization has become strained. The GSEs, FHA and balance sheet lending have expanded in response. Nonetheless, total mortgage originations have fallen.

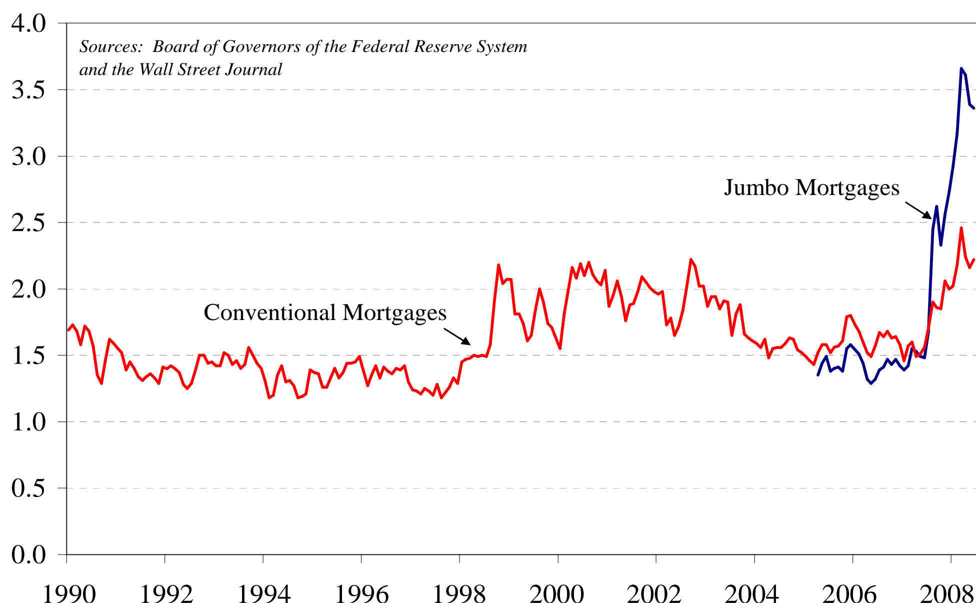


The Federal Home Loan Banks are playing an important and expanded role funding lenders' balance sheets.



Even with the expanded roles of Fannie Mae, Freddie Mac, the Federal Home Loan Banks and the Federal Housing Administration, mortgage spreads are increasing for all classes of mortgage loans.

Mortgage Rate Spreads to 10-Year Treasury (percent)



Covered Bonds present an alternative source of funding for institutions that can complement other sources of financing for a wide range of high-quality assets. In Europe, Covered Bonds are highly liquid instruments which are typically sold to rate-product investors rather than credit-product investors. While a Covered Bond market is already well-established in Europe, to date only two U.S. depository institutions have issued Covered Bonds. Given current challenges in other financing markets, U.S. institutions may find Covered Bonds to be an attractive source of funding for mortgage loans.

Treasury expects private-label securitization to return to the U.S. mortgage market, enabling homeowners to benefit from a broad, global investor base. Given the size of the U.S. residential mortgage market, Treasury believes there will be a role for all sources of mortgage funding in the future.

II. Objective

In preparing this report, Treasury seeks to bring increased clarity and homogeneity to the United States Covered Bond market by developing a series of Best Practices. Although the United States does not have dedicated Covered Bond legislation, Treasury believes these Best Practices may serve as a starting-point for the market, by encouraging issuers to use a common and simplified structure with high quality collateral for Covered Bond issuances. However, this document does not imply that Treasury favors Covered Bonds over other financing options available to depository institutions. Instead, Treasury views Covered Bonds as an additional, complementary funding source for the $11 trillion residential mortgage market.

Treasury has limited these Best Practices specifically to Covered Bonds backed by collateral consisting of high quality residential mortgage loans for two reasons. First, a liquid Covered Bond market based on residential mortgages may provide additional funding for the housing market, in turn lowering mortgage rates for homeowners. Second, focusing on one type of collateral while the market is nascent will provide simplicity for market participants. However, Treasury expects that the Covered Bond market to develop over time and the collateral securing Covered Bonds may eventually include other asset classes.

It should be noted that these Best Practices serve as a complement to the Federal Deposit Insurance Corporation's *Final Covered Bond Policy Statement* dated July 15, 2008 (see Appendix B). This statement specifies actions that the FDIC will take during an insolvency or receivership if the Covered Bond meets certain minimum requirements.

Finally, while these Best Practices have been developed to facilitate the growth of the Covered Bond market, they should not constrain the market in the future. Treasury fully expects the structure, collateral and other key terms of Covered Bonds to evolve with the growth of this market in the United States.

In preparing this Best Practices document, Treasury discussed the potential development of the U.S. Covered Bond market with both U.S. and European regulators, as well as numerous market participants, including potential issuers, investors, underwriters, rating agencies, law firms, financial counterparties, service providers and trade associations.

III. Covered Bond Definition

For the purposes of this document, a Covered Bond is defined as follows:

A Covered Bond is a debt instrument secured by a perfected security interest in a specific pool of collateral ("Cover Pool"). A Covered Bond provides funding to a depository institution ("issuer") that retains a Cover Pool of residential mortgage assets and related credit risk on its balance sheet. Interest on the Covered Bond is paid to investors from the issuer's general cash flows, while the Cover Pool serves as secured collateral. This Cover Pool consists of a portfolio of performing residential mortgage loans that meet specified underwriting criteria and are actively managed by the issuer to meet certain characteristics. If assets within the Cover Pool become non-performing, they must be replaced with performing assets. Finally, the issuer must maintain a Cover Pool in excess of the notional value of the Covered Bond ("overcollateralization") at all times. Multiple issuances for a depository institution may utilize a common Cover Pool.

In the event of an issuer default, Covered Bond investors first have recourse to the Cover Pool. In the event the Cover Pool returns less than par in liquidation, investors retain an unsecured claim on the issuer ranking pari passu with other unsecured creditors. Hence, Covered Bonds provide dual recourse to both the Cover Pool and the issuer, and the overcollateralization of the Cover Pool helps to mitigate the risk that investors would receive less than par in the event of an issuer default.

Comparison to Unsecured Debt

Unsecured debt differs significantly from Covered Bonds because of the absence of secured collateral underlying the obligation of the issuer. While unsecured debt investors retain an unsecured claim on the issuer in the event of issuer default, Covered Bond investors possess dual recourse to both the underlying collateral of a Covered Bond and to the individual issuer. Accordingly, Covered Bonds provide investors with additional protection on their investment compared with unsecured debt.

Comparison to Mortgage-Backed Securities

Although both mortgage-backed securities ("MBS") and Covered Bonds are a potential source of long-term funding for residential mortgage loans, there are several essential differences between Covered Bonds and MBS that make each attractive to different types of investors:

- Mortgages that secure a Covered Bond remain on the issuer's balance sheet, unlike MBS where mortgages are packaged and sold to investors.

- The cash flow from the mortgages and credit enhancements in MBS are generally the only source of principal and interest payments to the MBS investors. In a Covered Bond, principal and interest are paid by the issuer's cash flows, while the mortgages in the Cover Pool only serve as collateral for investors.

- The collateral underlying Covered Bonds is dynamic and non-performing (or prepaying) assets within the Cover Pool must be substituted with performing mortgages. Mortgages underlying MBS are static and remain in each MBS until maturity.

- In the case of an issuer default, Covered Bonds are structured to avoid prepayment prior to the date of maturity. This is accomplished through swap agreements and deposit agreements (e.g., guaranteed investment contracts). MBS investors, in contrast, are exposed to prepayment risk in the case of a mortgage default or prepayment.

- In the event that the Covered Bonds do accelerate and repay investors at an amount less than the principal and accrued interest, investors retain an unsecured claim on the issuer. MBS investors generally do not retain any claim on the issuer in the event of repayment at an amount less than the principal and interest owed.

IV. History of the Covered Bond Market

The Covered Bond market has a long and extensive history in Europe, dating back more than 230 years to the initial Prussian issuance in 1770. Covered Bonds were initially used to finance agriculture and later became focused on residential and commercial real estate markets. While Covered Bonds remained popular throughout the 19th century, during the 20th century they were somewhat eclipsed given other advances in the inter-bank financing markets. However, in 1995 the first German jumbo Covered Bond was issued, meeting investor demand for increasingly liquid products.[1] Since that time, the Covered Bond market has accelerated in Europe, partly due to the fact that Europe does not have government-sponsored enterprises such as Fannie Mae, Freddie Mac or the Federal Home Loan Banks. Furthermore, the collateral behind European Covered Bonds includes residential and commercial mortgages as well as public sector debt. At the end of 2007, the Covered Bond market stood at over EUR 2.11 trillion.[2] To date, two U.S. institutions have issued Covered Bonds.

Nearly all European countries have adopted Covered Bonds into their financial system. Depending on the jurisdiction, Covered Bonds may be governed by legislation (i.e. a "legislative framework") or by contract (i.e. a "structured framework"). Typically, a legislative framework exists in nations with a long history of Covered Bonds while nations with a relatively young Covered Bond market, such as Canada and Japan have a structured framework. In countries with a legislative framework there is often a dedicated regulator that governs the issuance and repayment of Covered Bonds. Moreover, a legislative framework helps to standardize Covered Bonds, providing homogeneity and simplicity to the market. This Best Practices document seeks to offer such structure to the U.S. market.

V. Important Considerations

The purpose of this document is to present a standardized model for Covered Bonds issued in the United States in the absence of dedicated legislation. Investors should recognize that like all investments, Covered Bonds carry risk. Investors should perform their own due diligence and review risk factors and associated disclosure before investing in any Covered Bond. These Best Practices only serve as a template for market participants and do not in any way provide or imply a government guarantee of any kind. It should also be understood that these Best Practices do not attempt to address requirements arising from federal securities laws or any other legal framework.

VI. Best Practices Template

For a Covered Bond program to be consistent with this Best Practices Template, the program's documentation must conform to the following provisions throughout the life of the program, not only at the time of issuance. *Italics indicate provisions that are specified in the final FDIC policy statement*[3].

Issuer

The issuer may be:

- *A newly created, bankruptcy-remote SPV ("SPV Structure")*[4]
- *A depository institution and/or a wholly-owned subsidiary of a depository institution ("Direct Issuance Structure")*

Security

Under the current SPV Structure, the issuer's primary assets must be a mortgage bond purchased from a depository institution. The mortgage bond must be secured at the depository institution by a dynamic pool of residential mortgages.

Under the Direct Issuance Structure, the issuing institution must designate a Cover Pool of residential mortgages as the collateral for the Covered Bond, which remains on the balance sheet of the depository institution.

In both structures, the Cover Pool must be owned by the depository institution. Issuers of Covered Bonds must provide a first priority claim on the assets in the Cover Pool to bond holders, and the assets in the Cover Pool must not be encumbered by any other lien. The issuer must clearly identify the Cover Pool's assets, liabilities, and security pledge on its books and records.

Maturity

The maturity for Covered Bonds shall be greater than one year and no more than thirty years. While the majority of early issuances will likely have maturities between one and ten years, we expect longer dated issuances may develop over time.

Eligible Cover Pool Collateral

The collateral in the Cover Pool must meet the following requirements at all times:

- *Performing mortgages on one-to-four family residential properties*
- *Mortgages shall be underwritten at the fully-indexed rate*[5]
- *Mortgages shall be underwritten with documented income*
- *Mortgages must comply 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 additional guidance applicable at the time of loan origination*
- *Substitution collateral may include cash and Treasury and agency securities as necessary to prudently manage the Cover Pool*
- Mortgages must be current when they are added to the pool and any mortgages that become more than 60-days past due must be replaced
- Mortgages must be first lien only
- Mortgages must have a maximum loan-to-value ("LTV") of 80% at the time of inclusion in the Cover Pool
- A single Metro Statistical Area cannot make up more than 20% of the Cover Pool
- Negative amortization mortgages are not eligible for the Cover Pool
- Bondholders must have a perfected security interest in these mortgage loans.

Over-collateralization

Issuers must maintain an overcollateralization value at all times of at least 5% of the outstanding principal balance of the Covered Bonds (see "Asset Coverage Test").

For the purposes of calculating the minimum required overcollateralization in the Covered Bond, only the 80% portion of the updated LTV will be credited. If a mortgage in the Cover Pool has a LTV of 80% or less, the full outstanding principal value of the mortgage will be credited. If a mortgage has a LTV over 80%, only the 80% LTV portion of each loan will be credited (see Appendix A for examples).

	Issuers must update the LTV of mortgages in the Cover Pool on a quarterly basis using a nationally-recognized, regional housing price index or other comparable measurement.
Currency	Covered Bonds may be issued in any currency.
Interest Type	Covered Bonds may either be fixed or floating instruments.
Interest Payment Swaps	Issuers may enter into one or more swap agreements or similar contractual arrangements at the time of issuance. The purpose of such agreements include: ▪ To provide scheduled interest payments on a temporary basis in the event the issuer becomes insolvent ▪ To mitigate any timing mismatch, to the extent applicable, between interest payments and interest income These swap agreements must be with financially sound counterparties and the identity of the counterparties must be disclosed to investors.
Currency Swap	If a Covered Bond is issued in a different currency than the underlying Cover Pool (or Mortgage Bond, if applicable), the issuer shall employ a currency swap.
Specified Investment Contract	Issuers must enter into a deposit agreement, e.g., guaranteed investment contract, or other arrangement whereby the proceeds of Cover Pool assets are invested (any such arrangement, a "Specified Investment") at the time of issuance with or by one or more financially sound counterparties. Following a payment default by the issuer or repudiation by the FDIC as conservator or receiver, the Specified Investment should pay ongoing scheduled interest and principal payments so long as the Specified Investment provider receives proceeds of the Cover Pool assets at least equal to the par value of the Covered Bonds. The purpose of the Specified Investment is to prevent an acceleration of the Covered Bond due to the insolvency of the issuer.

Cover Pool Disclosure	Issuers must make available descriptive information on the Cover Pool with investors at the time an investment decision is being made and on a monthly basis after issuance. The SEC's Regulation AB provides a helpful template for preparing pool level information, such as presenting summary information in tabular or graphical format and using appropriate groups or ranges. Issuers must make this information available to investors no later than 30 days after the end of each month. As the Covered Bond market develops, issuers should consider disclosing metrics on the Cover Pools from their prior Covered Bonds whenever a new issuance occurs.
Substitution	If more than 10% of the Cover Pool is substituted within any month or if 20% of the Cover Pool is substituted within any one quarter, the issuer must provide updated Cover Pool information to investors.
Issuer Disclosure	The depository institution and the SPV (if applicable) must disclose information regarding its financial profile and other relevant information that an investor would find material.
Asset Coverage Test	The issuer must perform an Asset Coverage Test on a monthly basis to ensure collateral quality and the proper level of overcollateralization and to make any substitutions that are necessary to meet the provisions of this template. The results of this Asset Coverage Test and the results of any reviews by the Asset Monitor must be made available to investors.
Asset Monitor	The issuer must designate an independent Asset Monitor to periodically determine compliance with the Asset Coverage Test of the issuer.
Trustee	The issuer must designate an independent Trustee for the Covered Bonds. Among other responsibilities, this Trustee must represent the interest of investors and must enforce the investors' rights in the collateral in the event of an issuer's insolvency.

Treatment of Covered Bond Proceeds	In the event of a default, any losses must be allocated pro rata across Covered Bond issuances that utilize a common Cover Pool, irrespective of the maturity of the individual issuances.
SEC Registration	Covered Bonds may be issued as registered securities or may be exempt from registration under securities laws. This template is not meant to address disclosure and other requirements for a security registered with the Securities and Exchange Commission.
Regulatory Authorization	*Issuers must receive consent to issue Covered Bonds from their primary federal regulator.* Upon an issuer's request, their primary federal regulator will make a determination based on that agencies policies and procedures whether to give consent to the issuer to establish a Covered Bond program. Only well-capitalized institutions should issue Covered Bonds. As part of their ongoing supervisory efforts, primary federal regulators monitor an issuer's controls and risk management processes.
Issuance Limitations	*Covered Bonds may account for no more than four percent of an issuers' liabilities after issuance.*
Event of Breach of the Asset Coverage Test	If the Asset Coverage Test of the Covered Bond program is breached, the issuer has one month to correct such breach. If, after one month, the breach remains, the Trustee may terminate the Covered Bond program and principal and accrued interest will be returned to investors. While such a breach exists, the issuer may not issue any additional Covered Bonds.

Insolvency Procedures

As conservator or receiver for an insured depository institution (IDI), the FDIC has three options in responding to a properly structured Covered Bond transaction of the IDI:

1) continue to perform on the Covered Bond transaction under its terms;
2) pay-off the Covered Bonds in cash up to the value of the pledged collateral; or
3) allow liquidation of the pledged collateral to pay-off the Covered Bonds.

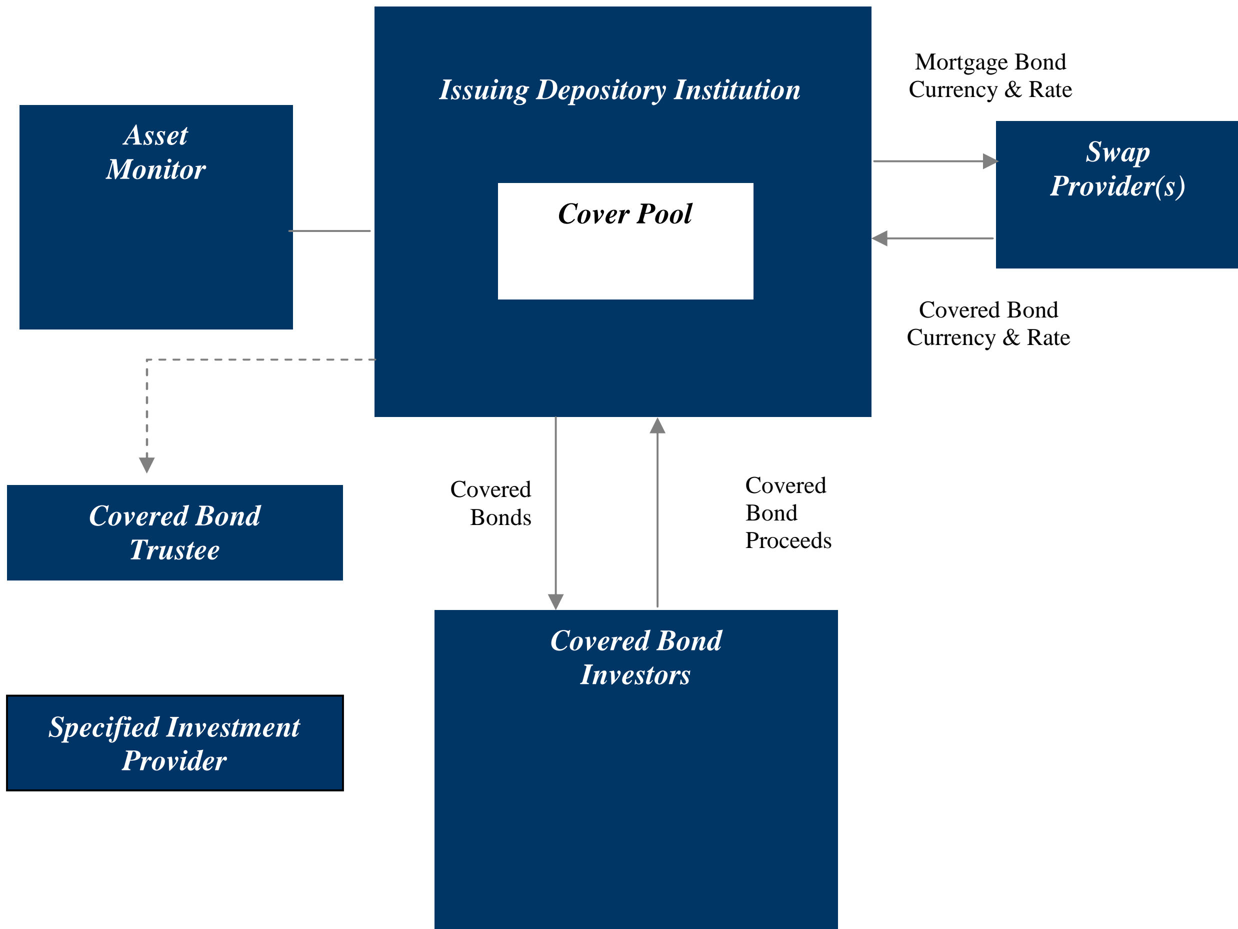
If the FDIC adopts the first option, it would continue to make the Covered Bond payments as scheduled. The second or third options would be triggered if the FDIC repudiated the transaction or if a monetary default occurred. In both cases, the par value of the Covered Bonds plus interest accrued to the date of the appointment of the FDIC as conservator or receiver would be paid in full up to the value of the collateral.

If the value of the pledged collateral exceeded the total amount of all valid claims held by the secured parties, this excess value or over collateralization would be returned to the FDIC, as conservator or receiver, for distribution as mandated by the Federal Deposit Insurance Act.

If there were insufficient collateral pledged to cover all valid claims by the secured parties, the amount of the claims in excess of the pledged collateral would be unsecured claims in the receivership.

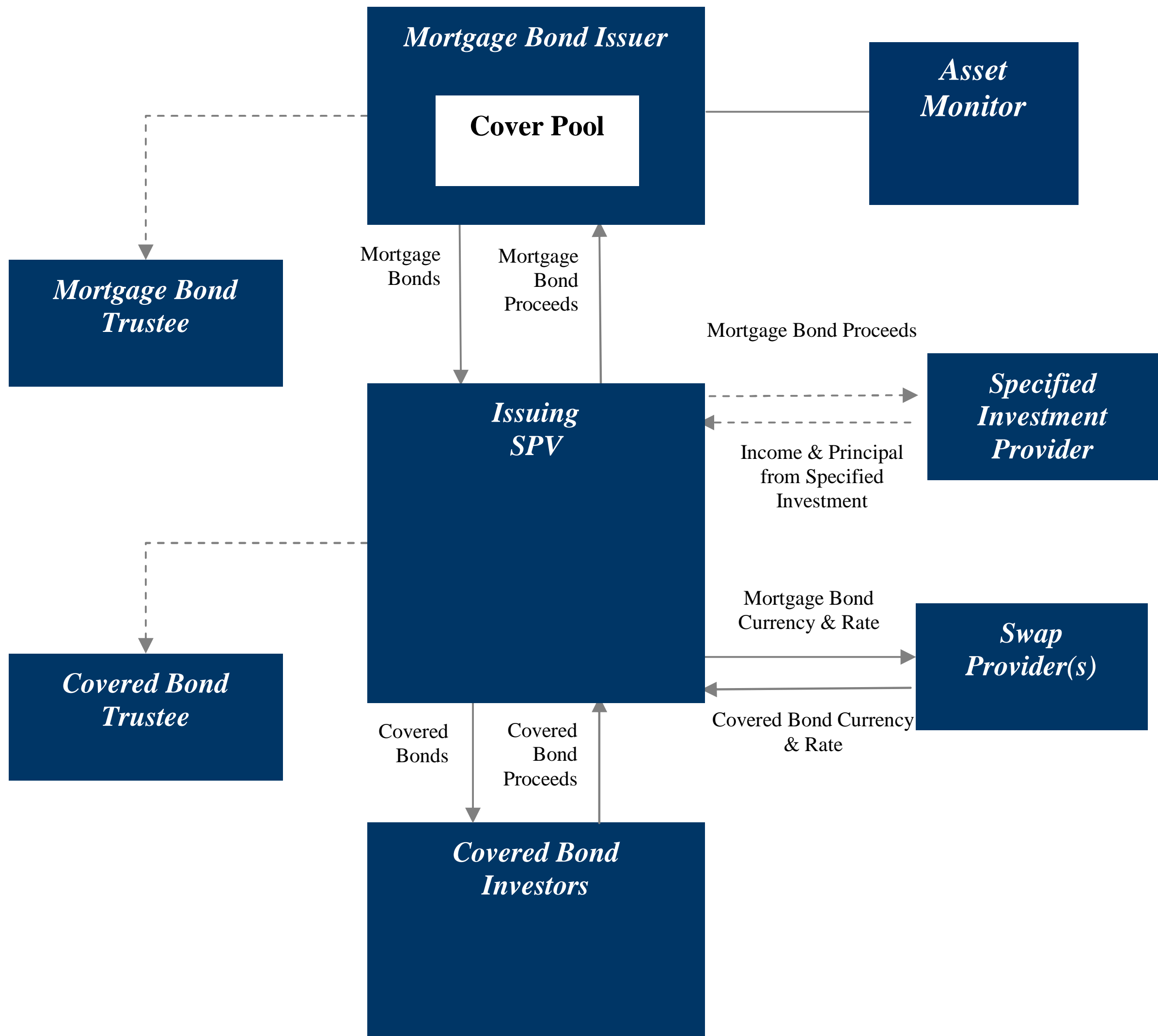
VII. Illustrative Direct Issuance

This diagram is meant to show what a potential structure could look like if the issuer of a Covered Bond were a depository institution. It is not intended to endorse a specific structure but rather serves an illustrative purpose. Issuers may develop other structures that are consistent with the template.



VIII. Illustrative SPV Issuance

This diagram is meant to show what a potential structure could look like if the issuer of a Covered Bond were a SPV. It is not intended to endorse a specific structure but rather serves an illustrative purpose. Issuers may develop other structures that are consistent with the template.



Endnotes

[1] European Covered Bond Council, December 2007.

[2] Ibid

[3] The FDIC's Final Covered Bond Policy Statement dated July 15, 2008 outlines specific actions that the FDIC will take during an insolvency or receivership if certain conditions are met. Italicized terms indicate provisions that are part of both the FDIC's statement and this Best Practices Template. However, these italicized terms are not meant to cover all of the provisions of the FDIC statement. Market participants should independently review the FDIC's statement to ensure conformity with all provisions.

[4] In addition to SPV programs with a single issuer, multiple depository institutions could potentially utilize a joint SPV to pool assets. Each issuer would be responsible for meeting appropriate requirements and receiving consent from its primary federal regulator.

[5] The fully indexed rate equals the index rate prevailing at origination plus the margin to be added to it after the expiration of an introductory interest rate. For example, assume that a loan with an initial fixed rate of 7% will reset to the six-month London Interbank Offered Rate (LIBOR) plus a margin of 6%. If the six-month LIBOR rate equals 5.5%, lenders should qualify the borrower at 11.5% (5.5% + 6%), regardless of any interest rate caps that limit how quickly the fully indexed rate may be reached.

Appendix A: Cover Pool Collateralization Calculation

As stated in Section VI., a minimum overcollateralization of 5% of the principal value of the Covered Bond must be maintained. Furthermore, mortgages must have a maximum LTV of 80% at the time of inclusion in the Cover Pool.

For the purposes of calculating the overcollateralization, 80% of the updated LTV will be credited towards the Cover Pool. For mortgages with an LTV of 80% or less, the full outstanding principal value will be credited. For mortgages with an LTV over 80%, only the 80% LTV portion of each loan will be credited.

This appendix provides examples of how loans may be credited against the required collateral of the Cover Pool.

ILLUSTRATIVE ASSUMPTIONS:

- $1,000 Covered Bond issuance
- Minimum overcollateralization of 5%
- Updated maximum LTV of 80% credited toward overcollateralization
- $1,050 of required collateral ($1,000 x 1.05)

Scenario A:

- Pool of $80 loans on homes with an updated value of $100
- $1,050 / ($80 x 1.0) = 13.125 loans required in Cover Pool

Scenario B:

- Pool of $60 loans on homes with an updated value of $100
- $1,050 / ($60 x 1.0) = 17.500 loans required in Cover Pool

Scenario C:

- Pool of $80 loans on homes with an updated value of $80
- $1,050 / ($80 x 0.8) = 16.406 loans required in Cover Pool

Appendix B: Final FDIC Covered Bond Policy Statement

FEDERAL DEPOSIT INSURANCE CORPORATION

Covered Bond Policy Statement

AGENCY: Federal Deposit Insurance Corporation (FDIC).

ACTION: Final Statement of Policy

SUMMARY: The Federal Deposit Insurance Corporation (the FDIC) is publishing a final policy statement on the treatment of covered bonds in a conservatorship or receivership. This policy statement provides guidance on the availability of expedited access to collateral pledged for certain covered bonds after the FDIC decides whether to terminate or continue the transaction. Specifically, the policy statement clarifies how the FDIC will apply the consent requirements of section 11(e)(13)(C) of the Federal Deposit Insurance Act (FDIA) to such covered bonds to facilitate the prudent development of the U.S. covered bond market consistent with the FDIC's responsibilities as conservator or receiver for insured depository institutions (IDI). As the U.S. covered bond market develops, future modifications or amendments may be considered by the FDIC.

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SUPPLEMENTARY INFORMATION

I. Background

On April 23, 2008, the FDIC published the Interim Final Covered Bond Policy Statement for public comment. 73 FR 21949 (April 23, 2008). After carefully reviewing and considering all comments, the FDIC has adopted certain limited revisions and clarifications to the Interim Policy Statement (as discussed in Part II) in the Final Policy Statement.[1]

Currently, there are no statutory or regulatory prohibitions on the issuance of covered bonds by U.S. banks. Therefore, to reduce market uncertainty and clarify the application of the FDIC's statutory authorities for U.S. covered bond transactions, the FDIC issued an Interim Policy Statement to provide guidance on the availability of expedited access to collateral pledged for certain covered bonds by IDIs in a conservatorship or a receivership. As discussed below, under section 11(e)(13)(C) of the FDIA, any liquidation of collateral of an IDI placed into

conservatorship or receivership requires the consent of the FDIC during the initial 45 days or 90 days after its appointment, respectively. Consequently, issuers of covered bonds have incurred additional costs from maintaining 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 during these periods after any decision by the FDIC 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 expedited access to pledged covered bond collateral.

Covered bonds are general, non-deposit 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. These 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").[2] 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.

The FDIC 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 conditions and circumstances under which the FDIC will grant automatic consent to access pledged covered bond collateral. The FDIC believes that the prudential limitations set forth 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 insight 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 discussion, when we refer to "covered bond obligation," we are referring to 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 the FDIA, 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.[3] During this period, the FDIC must still comply with otherwise enforceable provisions of the contract. The FDIC also may terminate or repudiate any contract 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.[4]

As conservator or receiver for an IDI, the FDIC has three options in responding to a properly structured covered bond transaction of the IDI: 1) continue to perform on the covered bond transaction under its terms; 2) pay-off the covered bonds in cash up to the value of the pledged collateral; or 3) allow liquidation of the pledged collateral to pay-off the covered bonds. If the FDIC adopts the first option, it would continue to make the covered bond payments as scheduled. The second or third options would be triggered if the FDIC repudiated the transaction or if a monetary default occurred. In both cases, the par value of the covered bonds plus interest accrued to the date of the appointment of the FDIC as conservator or receiver would be paid in full up to the value of the collateral. If the value of the pledged collateral exceeded the total amount of all valid claims held by the secured parties, this excess value or over collateralization would be returned to the FDIC, as conservator or receiver, for distribution as mandated by the FDIA. On the other hand, if there were insufficient collateral pledged to cover all valid claims by the secured parties, the amount of the claims in excess of the pledged collateral would be unsecured claims in the receivership.

While the FDIC can repudiate the underlying contract, and thereby terminate any continuing obligations under that contract, the FDIA prohibits the FDIC, as conservator or receiver from avoiding any legally enforceable or perfected security interest in the assets of the IDI unless the interest was taken in

contemplation of the IDI's insolvency or with the intent to hinder, delay, or defraud the IDI or its creditors.[5] This statutory provision ensures protection for

the valid claims of secured creditors up to the value of the pledged collateral. After a default or repudiation, the FDIC as conservator or receiver may either pay resulting damages in cash up to the value of the collateral or turn over the collateral to the secured party for liquidation. For example, if the conservator or receiver repudiated a covered bond transaction, as discussed in Part II below, it would pay damages limited to par value of the covered bonds and accrued interest up to the date of appointment of the conservator or receiver, if sufficient collateral was in the cover pool, or turn over the collateral for liquidation with the conservator or receiver recovering any proceeds in excess of those damages. In liquidating any collateral for a covered bond transaction, it would be essential that the secured party liquidate the collateral in a commercially reasonable and expeditious manner taking into account the then-existing market conditions.

As noted above, existing covered bond transactions by U.S. issuers have used SPVs. However, nothing in the Policy Statement requires the use of an SPV. Some questions have been posed about the treatment of a subsidiary or SPV after appointment of the FDIC as conservator or receiver. The 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. While the determination of whether a subsidiary or SPV has been organized and maintained as a separate entity from the IDI must be determined based on the specific facts and circumstances, the standards for such decisions are set forth in generally applicable judicial decisions and in the FDIC's regulation governing subsidiaries of insured state banks, 12 C.F.R. § 362.4.

The requests 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 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 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 Final Covered Bond Policy Statement in order to provide covered bond issuers with final guidance on how the FDIC will treat covered bonds in a conservatorship or receivership.

II. Overview of the Comments

The FDIC received approximately 130 comment letters on the Interim Policy Statement; these included comments from national banks, Federal Home Loan Banks, industry groups and individuals.

Most commenters encouraged the FDIC to adopt the Policy Statement to clarify how the FDIC would treat covered bonds in the case of a conservatorship or receivership and, thereby, facilitate the development of the U.S. covered bond market. The more detailed comments focused on one or more of the following categories of issues: (1) the FDIC's discretion regarding covered bonds that do not comply with the Policy Statement; (2) application to covered bonds completed prior to the Policy Statement; (3) the limitation of the Policy Statement to covered bonds not exceeding 4 percent of liabilities; (4) the eligible collateral for the cover pools; (5) the measure of damages provided in the event of default or repudiation; (6) the covered bond term limit; and (7) federal home loan bank advances and assessments.

Certain banks and industry associations sought clarification about the treatment of covered bonds that do not comply with the Policy Statement by the FDIC as conservator or receiver. Specifically, commenters asked the FDIC to clarify that if a covered bond issuance is not in conformance with the Policy Statement, the FDIC retains discretion to grant consent prior to expiration of the 45 or 90 day period on a case-by-case basis. Under Section 11(e)(13)(C) of the FDIA, the exercise of any right or power to terminate, accelerate, declare a default, or otherwise affect any contract of the IDI, or to take possession of any property of the IDI, requires the consent of the conservator or receiver, as appropriate, during the 45-day period or 90-day period after the date of the appointment of the conservator or receiver, as applicable. By the statutory terms, the conservator or receiver retains the discretion to give consent on a case-by-case basis after evaluation by the FDIC upon the failure of the issuer.

Comments from banks who issued covered bonds prior to the Policy Statement requested either 'grandfathering' of preexisting covered bonds or an advance determination by the FDIC before any appointment of a conservator or receiver that specific preexisting covered bonds qualified under the Policy Statement. After carefully considering the comments, the FDIC has determined that to 'grandfather' or otherwise permit mortgages or other collateral that does not meet the specific requirements of the Policy Statement to support covered bonds would not promote stable and resilient covered bonds as encompassed within the Policy Statement. If preexisting covered bonds, and their collateral, otherwise qualify under the standards specified in the Policy Statement, those covered bonds would be eligible for the expedited access to collateral provided by the Policy Statement.

A number of commenters requested that the limitation of eligible covered bonds to no more than 4 percent of an IDI's total liabilities should be removed or increased. Commenters also noted that other countries applying a cap have based the limitation on assets, not liabilities. The Policy Statement applies to covered bond issuances that comprise no more than 4 percent of an institution's total liabilities since, in part, as the proportion of secured liabilities increases the unpledged assets available to satisfy the claims of the Deposit Insurance Fund, uninsured depositors and other creditors decreases. As a result, the FDIC must focus on the share of an IDI's liabilities that are secured by collateral and balance the additional potential losses in the failure of an IDI against the benefits of increased liquidity for open institutions. The 4 percent limitation under the Policy Statement is designed to permit the FDIC, and other regulators, an opportunity to evaluate the development of the covered bond market within the financial system of the United States, which differs in many respects from that in other countries deploying covered bonds. Consequently, while changes may be considered to this limitation as the covered bond market develops, the FDIC has decided not to make any change at this time.

A number of commenters sought expansion of the mortgages defined as "eligible mortgages" and the expansion of collateral for cover pools to include other assets, such as second-lien home equity loans and home equity lines of credit, credit card receivables, mortgages on commercial properties, public sector debt, and student loans. Other commenters requested that "eligible mortgages" should be defined solely by their loan-to-value (LTV) ratios. After considering these comments, the FDIC has determined that its interests in efficient resolution of IDIs, as well as in the initial development of a resilient covered bond market that can provide reliable liquidity for well-underwritten mortgages, support retention of the limitations on collateral for qualifying covered bonds in the Interim Policy Statement. Recent market experience demonstrates that many mortgages that would not qualify under the Policy Statement, such as low documentation mortgages, have declined sharply in value as credit conditions have deteriorated. Some of the other assets proposed are subject to substantial volatility as well, while others would not specifically support additional liquidity for well-underwritten residential mortgages. As noted above, certain provisions of the Policy Statement may be reviewed and reconsidered as the U.S. covered bond market develops.

With regard to the comments that LTV be used as a guide to determine an "eligible mortgage," the FDIC does not believe that LTV can substitute for strong underwriting criteria to ensure sustainable mortgages. In response to the comments, and the important role that LTV plays in mortgage analysis, the Policy Statement will urge issuers to disclose LTV for mortgages in the cover pool to enhance transparency for the covered bond market and promote stable cover pools. However, no specific LTV limitation will be imposed.

Two commenters suggested that the Policy Statement should be clarified to permit the substitution of cash as cover pool collateral. The Policy Statement has been modified to allow for the substitution of cash and Treasury and agency securities. The substitution of such collateral does not impair the strength of the cover pool and may be an important tool to limit short-term strains on issuing IDIs if eligible mortgages or AAA-rated mortgage securities must be withdrawn from the cover pool.

A number of commenters requested guidance on the calculation of damages the receiver will pay to holders of covered bonds in the case of repudiation or default. Under 12 USC § 1821(e)(3), the liability of the conservator or receiver for the disaffirmance or repudiation of any contract is limited to "actual direct compensatory damages" and determined as of the date of appointment of the conservator or receiver. In the repudiation of contracts, such damages generally are defined by the amount due under the contract repudiated, but excluding any amounts for lost profits or opportunities, other indirect or contingent claims, pain and suffering, and exemplary or punitive damages. Under the Policy Statement, the FDIC agrees that "actual direct compensatory damages" due to bondholders, or their representative(s), for repudiation of covered bonds will be limited to the par value of the bonds plus accrued interest as of the date of appointment of the FDIC as conservator or receiver. The FDIC anticipates that IDIs issuing covered bonds, like other obligations bearing interest rate or other risks, will undertake prudent hedging strategies for such risks as part of their risk management program.

Many commenters suggested that the 10-year term limit should be removed to permit longer-term covered bond maturities. After reviewing the comments, the FDIC agrees that longer-term covered bonds should not pose a significant, additional risk and may avoid short-term funding volatility. Therefore, the FDIC has revised the Interim Policy Statement by increasing the term limit for covered bonds from 10 years to 30 years.

A number of the Federal Home Loan Banks, and their member institutions, objected to the inclusion of FHLB advances in the definition of "secured liabilities," any imposed cap on such advances, and any change in assessment rates. Under 12 C.F.R. Part 360.2 (Federal Home Loan Banks as Secured Creditors), secured liabilities include loans from the Federal Reserve Bank discount window, Federal Home Loan Bank (FHLB) advances, repurchase agreements, and public deposits. However, the Policy Statement does not impose a cap on FHLB advances and has no effect on an IDI's ability to obtain FHLB advances or its deposit insurance assessments. The Policy Statement solely addresses covered bonds.

However, as noted above, where an IDI relies very heavily on secured liabilities to finance its lending and other business activities, it does pose a greater risk of loss to the Deposit Insurance Fund in any failure. Should the covered bond market develop as a significant source of funding for IDIs, and should that development create substantial increases in an IDI's reliance on secured funding, it would increase the FDIC's losses in a failure and perhaps outweigh the benefits of improved liquidity. As a result, it is appropriate for the FDIC to consider the risks of such increased losses. Consideration of these risks may occur in a possible future request for comments on secured liabilities, but they are not addressed in this Policy Statement.

III. Final Statement of Policy

For the purposes of this final Policy Statement , a "covered bond" is defined as a non-deposit, recourse debt obligation of an IDI with a term greater than one year and no more than thirty years, that is secured directly or indirectly by a pool of eligible mortgages 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 percent 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. 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 percent of a financial institution's total liabilities after issuance.

In order to limit the risks to the deposit insurance fund, application of the Policy Statement is restricted to covered bond issuances secured by perfected security interests under applicable state and federal law on performing eligible mortgages on one-to-four family residential properties, underwritten at the fully indexed rate and relying on documented income, a limited volume of AAA-rated mortgage securities, and certain substitution collateral. The Policy Statement provides that the mortgages shall be underwritten at the fully indexed rate relying on

documented income, and comply 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 additional guidance applicable at the time of loan origination. In addition, the Policy Statement requires that the eligible mortgages and other collateral pledged for the covered bonds be held and owned by the IDI. This requirement is designed to protect the FDIC's interests in any over collateralization and avoid structures involving the transfer of the collateral to a subsidiary or SPV at initiation or prior to any IDI default under the covered bond transaction.

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 percent 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. In addition, substitution collateral for the covered bonds may include cash and Treasury and agency securities as necessary to prudently manage the cover pool. Securities backed by tranches in other securities or assets (such as Collateralized Debt Obligations) are not considered to be acceptable collateral.

The Policy Statement provides that the consent of the FDIC, as conservator or receiver, is provided to covered bond obligees to exercise their contractual rights over collateral for covered bond transactions conforming to the Interim 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 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 and therefore the FDIC may consider future amendment (with appropriate notice) of this Policy Statement as the U.S. covered bond market develops.

IV. 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.

The Board of Directors of the FDIC has adopted a 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 non-deposit, recourse debt obligation of an IDI with a term greater than one year and no more than thirty years, that is secured directly or indirectly by perfected

security interests under applicable state and federal law on assets held and owned by the IDI consisting of eligible mortgages, or AAA-rated mortgage-backed securities secured by eligible mortgages if for no more than ten percent of the collateral for any covered bond issuance or series. Such covered bonds may permit substitution of cash and United States Treasury and agency securities for the initial collateral as necessary to prudently manage the cover pool.

(2) The term "eligible mortgages" shall mean performing first-lien mortgages on one-to-four family residential properties, underwritten at the fully indexed rate[6] and relying on documented income, and complying 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 additional guidance applicable at the time of loan origination. Due to the predictive quality of loan-to-value ratios in evaluating residential mortgages, issuers should disclose loan-to-value ratios for the cover pool to enhance transparency for the covered bond market.

(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 IDI's total covered bond obligation as a result of such issuance comprises no more than 4 percent of an IDI's total liabilities, and only so long as the assets securing the covered bond obligation are eligible mortgages or AAA-rated mortgage securities on eligible mortgages, if not exceeding 10 percent of the collateral for any covered bond issuance, Substitution for the initial cover pool collateral may include cash and Treasury and agency securities as necessary to prudently manage the cover pool.

(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 and expeditious methods taking into account existing market conditions, 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 due 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 and expeditious methods taking into account existing market conditions, provided no involvement of the receiver or conservator is required.

(3) The liability of a conservator or receiver for the disaffirmance or repudiation of any covered bond issuance obligation, or for any monetary default on, any covered bond issuance, shall be limited to the par value of the bonds issued, plus contract interest accrued thereon to the date of appointment of the conservator or receiver.

(d) Consent. Any party 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 Deputy Director, Division of Resolutions and Receiverships, Federal Deposit Insurance Corporation, 550 17th Street, NW, F-7076, 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 repealed by the FDIC upon 30 days notice provided in the Federal Register, but any repeal shall not apply to any covered bond issuance made in accordance with this policy statement before such repeal.

By order of the Board of Directors
Dated at Washington, DC this ______ day of ______, 2008.
Federal Deposit Insurance Corporation

Robert E. Feldman
Executive Secretary

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1 For ease of reference, the Interim Final Covered Bond Policy Statement, published on April 23, 2008, will be referred to as the Interim Policy Statement. The Final Covered Bond Policy Statement will be referred to as the Policy Statement.

2 The FDIC understands that certain potential issuers may propose a different structure that does not involve the use of an SPV. The FDIC expresses no opinion about the appropriateness of SPV or so-called "direct issuance" covered bond structures, although both may comply with this Statement of Policy.

3 See 12 U.S.C. § 1821(e)(13)(C).

4 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).

5 See 12 U.S.C. §1821(e) (12).

6 The fully indexed rate equals the index rate prevailing at origination plus the margin to be added to it after the expiration of an introductory interest rate. For example, assume that a loan with an initial fixed rate of 7% will reset to the six-month London Interbank Offered Rate (LIBOR) plus a margin of 6%. If the six-month LIBOR rate equals 5.5%, lenders should qualify the borrower at 11.5% (5.5% + 6%), regardless of any interest rate caps that limit how quickly the fully indexed rate may be reached.

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