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DEVELOPMENTS OF NOTE

FDIC Issues Notice of Proposed Rulemaking Regarding Safe Harbor for Bank-Sponsored Securitizations

On May 11, 2010, the FDIC's board of directors issued a Notice of Proposed Rulemaking (the "NPR") regarding proposed revisions (the "Proposed Rule") to the safe harbor provided at 12 C.F.R. §360.6 (the "Safe Harbor").

The original Safe Harbor, which was established by the FDIC in 2000 as a "clarification" of existing rules, offered federally insured depository institution ("IDI") sponsors of securitizations, as well as investors and rating agencies, assurance that the FDIC would not use its powers as a conservator or receiver for a failed IDI to disaffirm or repudiate contracts in order to reclaim, recover or recharacterize as property of the failed IDI any financial assets transferred by that IDI in connection with a securitization or participated, so long as the transfer or participation satisfied the conditions for sale treatment under generally accepted accounting principles (the "GAAP").

Revisions to the Safe Harbor became necessary because of changes to GAAP, for sale treatment of certain transactions and for consolidation of certain entities, threatened the effectiveness of the Safe Harbor – specifically, FAS No. 166, Accounting for Transfers of Financial Assets, an Amendment of FASB Statement No. 140 ("FAS 166") and FAS No. 167, Amendments to FASB Interpretation No. 46(R) ("FAS 167"), which are effective for reporting periods that begin after November 15, 2009. (For more information on FAS 166 and FAS 167, see the June 16, 2009 *Alert*.) In response, the FDIC issued an interim rule (initially in November and subsequently extended in March) (the "Interim Rule") that continues until September 30, 2010 the protections afforded to transactions that comply with the Safe Harbor under the prior accounting rules. (For more information on the

Interim Rule and the need for revisions to the Safe Harbor, see the November 17, 2009 *Alert* and the March 16, 2010 *Alert*).

As with its December 15, 2009 Advance Notice of Proposed Rulemaking (the "ANPR"), which was discussed in the December 22, 2009 *Alert*, the five-member board approved the issuance of the NPR by a vote of 3-2, with Comptroller of the Currency John Dugan and Acting Director of the Office of Thrift Supervision John Bowman voting against approval. In particular, Comptroller Dugan noted that, with Congress on the verge of passing comprehensive and coordinated legislation on financial regulatory reform that would apply to all securitizations (as opposed to securitizations issued by IDIs only), he believed the FDIC should defer acting at this time. Chairman Sheila Bair, however, argued that it is prudent to act now, especially considering that the legislative process might take another several months to complete. Chairman Bair further noted that the NPR is consistent with the approach currently being contemplated by Congress and the SEC's proposed new rules for asset-backed securities ("Proposed New Reg. AB") that would make significant revisions to Regulation AB and other rules regarding asset-backed securities. (For more information on Proposed New Reg. AB, see the April 13, 2010 *Alert*.) She also stated that the FDIC would be happy to work with other regulators down the road if any changes are necessary.

The Proposed Rule builds on many of the revisions proposed in the ANPR. However, there are several notable differences from the ANPR, including: (1) the removal of the 12-month seasoning requirement for securitizations that include residential mortgages ("RMBS"); (2) the addition of a requirement that sponsors reserve 5% of the cash proceeds from any RMBS for one year to cover repurchase obligations; (3) the addition of a requirement to disclose whether a conflict of interest exists in the servicing of the assets; (4) a limitation of the requirement that compensation be paid over time (rather than at the closing of the offering) to apply to only credit rating agencies, which may be paid no more than 60% of their compensation at closing; and (5) certain changes to the disclosure requirements to conform to Proposed Reg. AB.

Safe Harbor Under the Proposed Rule

Under the Proposed Rule, the Safe Harbor would offer the following protections.

First, for participations and securitizations issued on or before September 30, 2010, so long as such securitizations and participations satisfy the rules for sale accounting (under GAAP rules effective for reporting periods ending prior to November 15, 2009), the existing Safe Harbor would continue to apply regardless of whether the transaction complied with the conditions specified in the Proposed Rule.

Second, for securitizations issued after September 30, 2010 that receive sale treatment under current GAAP, the Proposed Rule would provide Safe Harbor treatment so long as such securitizations comply with the conditions specified in the Proposed Rule, i.e., the FDIC would not use its powers as a conservator or receiver for a failed IDI to disaffirm or repudiate contracts in order to reclaim, recover or recharacterize as property of the failed IDI any financial assets transferred in the securitization.

Third, for securitizations issued after September 30, 2010 that do not receive sale treatment under current GAAP, but do meet the conditions specified in the Proposed Rule, the Proposed Rule would afford safe harbor treatment (i.e., it would make payment or provide

expedited access to the applicable financial assets) as a secured borrowing in accordance with Section 11(e) of the Federal Deposit Insurance Act. More specifically, under the Proposed Rule, if the FDIC were in monetary default or repudiated such a securitization or participation, but failed to pay damages due within 10 business days, the FDIC would be deemed to have given consent to the exercise of any contractual rights under the transaction. In addition, until such damages were paid or such contractual rights were exercised, the Proposed Rule would authorize continued servicing operations and the payment of all contractual amounts, except for provisions that take effect upon the appointment of the conservator or receiver.

Finally, for participations that receive sale treatment under current GAAP, the Proposed Rule would provide Safe Harbor treatment, i.e., the FDIC would not use its powers as a conservator or receiver for a failed IDI to disaffirm or repudiate contracts in order to reclaim, recover or recharacterize as property of the failed IDI any financial assets that have been participated.

A summary of the conditions imposed under the Proposed Rule (principally in Paragraphs (b) and (c)) in order for a securitization issued after September 30, 2010 to obtain the benefits of the Safe Harbor follows. Notably, the Proposed Rule maintains a number of conditions focused on RMBS. For example, consistent with its July 2008 Final Covered Bond Policy, in order for an RMBS to gain the protections of the Safe Harbor, the FDIC would require all residential mortgage loans in that RMBS would be required to comply with all statutory and regulatory standards in effect at the time of origination, including that the residential mortgages are underwritten at the fully indexed rate and rely on documented income and comply with all existing supervisory guidance governing the underwriting of residential mortgages. Certain other requirements for RMBS are highlighted below.

Origination and Risk Retention

Under the Proposed Rule, the sponsor of any securitization would be required to retain an economic interest in a material portion of the credit risk of the financial assets in the form of either (1) an interest in at least 5% of each credit tranche or (2) an interest in a representative sample of the securitized financial assets equal to at least 5% of the principal amount the financial assets at transfer. The sponsor IDI would not be permitted to transfer or hedge this retained interest during the life of the transaction. This retention requirement would be generally consistent with the Proposed Reg. AB. Additionally, with respect to any RMBS, the sponsor would also be required to establish a reserve fund equal to at least 5% of the cash proceeds due to it, which reserve the sponsor would be required to maintain for 12 months in order to cover any repurchase obligations from a breach of representations and warranties during the first year of a securitization.

Disclosure

In the NPR, the FDIC states its expectation that disclosure for securitization issuances seeking the protection of the Safe Harbor would include the types of information required under current Regulation AB or any successor disclosure requirements with the level of specificity that would apply to public issuances, even if the obligations are issued in a private placement or are not otherwise required to be registered. Under the Proposed Rule, securitizations would have to include disclosure of the structure of the securitization and the credit and payment performance of the obligations, including the relevant capital or tranche structure and any liquidity facilities and credit enhancements. The Proposed Rule would

require disclosure of the securitized financial assets at the loan, pool and security-level to enable evaluation and analysis of the credit risk and performance of the obligations and the financial assets during the term of the securitization. The FDIC notes in the NPR that while financial asset level disclosures are required, pool level disclosures would be permitted with respect to certain asset classes, such as credit cards, because loan level data is less relevant in certain asset classes.

The Proposed Rule would also require additional disclosure of (1) compensation paid to any mortgage or other broker, each servicer, rating agency or third-party advisor, and the originator or sponsor and (2) the extent to which any risk of loss on the underlying financial assets is retained by any of them for such securitization. The FDIC expects these disclosures will enable investors to assess potential conflicts of interests and how the compensation structure affects the quality of the assets securitized or the securitization as a whole. For example, the Proposed Rule would require servicers to disclose any ownership interest of the servicer or its affiliates in other whole loans secured by the same real property that secures a loan included in the financial asset pool.

Capital Structure and Financial Assets

The NPR proposes several structural requirements for securitizations. Unfunded and synthetic securitizations would be excluded from the Safe Harbor under the Proposed Rule. All re-securitizations, including static re-securitizations and managed CDOs, would be required to make significant disclosures with respect to the underlying securitizations, including their structure, all of their obligations and the financial assets supporting each of the underlying securitization obligations (and not just the tranches or obligations transferred into the re-securitization). The capital structure of RMBS would be limited to six tranches or less and, subject to limited exception, could not include sub-tranches. In addition, RMBS could not benefit from external credit support at the issuing entity or pool level (but would be able to use liquidity facilities to cover the temporary payment of principal and interest).

Compensation

As mentioned above, the NPR’s proposals on compensation (other than disclosure) do not include the broad limits proposed under the ANPR and would instead impose certain requirements on RMBS only. The Proposed Rule would require that compensation to rating agencies or similar third-party evaluation companies be payable over a five-year period and be based on the performance of surveillance services and the financial assets, with no more than 60% of the total estimated compensation due at closing. Compensation to servicers in RMBS transactions would be required to include incentives for servicing, including payment for loan restructuring or other loss mitigation activities, which maximizes the net present value of the financial assets in the RMBS.

Documentation and Recordkeeping

The Proposed Rule provides that, for all securitizations, the operative agreements should define all necessary rights and responsibilities of the parties, including but not limited to representations and warranties, ongoing disclosure requirements and any measures to avoid conflicts of interest. In addition, for RMBS, contractual provisions in the servicing agreement would be required to provide servicers with the authority to modify loans to address reasonably foreseeable defaults and to take such other action necessary or required

to maximize the value and minimize losses on the securitized financial assets. Moreover, the documents would need to require that the servicer act for the benefit of all investors rather than any particular class of investors and require the servicer to commence action to mitigate losses no later than 90 days after an asset first becomes delinquent.

45- Day Public Comment Period

Interested parties will have 45 days following the NPR's publication in the *Federal Register* to provide comments on the NPR to the FDIC.

FDIC Proposes Contingent Resolution Plan Requirement for Largest Banks

The FDIC issued a Notice of Proposed Rulemaking (the "NPR") that would require certain insured depository institutions ("IDIs") to submit a contingent resolution plan outlining how the IDI could be separated from its parent structure and wound down in an orderly and timely manner. The requirement would apply to IDIs with greater than $10 billion in total assets and that are subsidiaries of a holding company with total assets of more than $100 billion. As of the fourth quarter of 2009, 40 institutions were identified as meeting the criteria and together represent 47.9% of all deposits insured by the FDIC.

The FDIC noted that IDIs that are part of complex organizations pose unique issues during the receivership process, as the relationships between the parent holding company, IDI and the IDI's affiliates often affect resolution strategies. The information provided as part of the contingent resolution plan is intended to assist the FDIC in preserving franchise value, maximizing recovery to creditors and minimizing systemic impacts on the financial system during the resolution process through an understanding of the IDI's business lines, operations, risks and activities, the interrelationships between the IDI and its affiliates, and the non-obvious risks embedded within the distinct business entities.

Under the NPR, a covered IDI's contingent resolution plan must include a summary analysis of its ability to be resolved in an orderly fashion in the event of its receivership, or the insolvency of its parent company or a key affiliate, including the disclosure of any material obstacles to resolution. In addition, the contingent resolution plan must identify the covered IDI's organizational structure, material interrelationships within the structure, key personnel, intra-group funding relationships, accounts and exposures, systematically important functions, events that have had a material effect on the IDI and its relationship with its parent or affiliates, and cross-border interrelationships and exposures. The covered IDI must also describe its capital structure and corporate financing relationships, as well as that of its parent, subsidiaries and key affiliates. The contingent resolution plan must be approved by the covered IDI's board of directors or a designated executive committee, provide a time frame within which remediation efforts may be achieved, and be updated at least annually.

The NPR provides that the IDI's contingent resolution plan must be submitted within six months of the effective date of the rule. The penalties for not complying with the NPR, if implemented, would be a regulatory violation that would allow the FDIC to either initiate the process of deposit insurance termination or use its backup enforcement authority. The latter permits the FDIC, after notice to the IDI's primary federal regulator, to pursue enforcement actions such as cease-and-desist orders, civil money penalties, and removal and prohibition actions. Comments on the NPR must be submitted on or before July 16, 2010.

Federal District Court Dismisses 401(k) Excessive Fee Litigation

In *Renfro, et al. v. Unisys Corp., et al.,* Case No. 2:07-cv-02098 (E.D. Pa. Apr. 26, 2010), the U.S. District Court for the Eastern District of Pennsylvania granted defendants' motions to dismiss claims under the Employee Retirement Income and Security Act of 1974, as amended, ("ERISA") challenging the fees charged to a large 401(k) plan.

One of more than a dozen similar lawsuits filed around the country by the same plaintiffs' law firm, the case involved allegations that the plan sponsor and the plan's service providers (the trustee, recordkeeper and the investment adviser to the plan investment options) breached duties owed under ERISA by charging excessive administrative and investment management fees to the plan, and by failing to take advantage of the plan's large size to negotiate lower fees for plan participants. In dismissing the claims, the court held that the service provider defendants were not relevant ERISA fiduciaries of the plan because they did not possess relevant fiduciary authority such that they could be liable under ERISA for any alleged breaches of duty. Specifically, the court held that the service providers did not have discretionary authority with respect to administration of the plan where the plan sponsor retained sole authority to determine what investment options were offered to the plan.

With respect to claims against the plan sponsor and named fiduciary, the court held that the plan offered a sufficient mix of investments to participants and that no rational trier of fact could find, based on the pleaded facts, that the named fiduciary breached an ERISA fiduciary duty by offering this particular array of investment vehicles. In support of this holding, the court cited to the Seventh Circuit's decision in *Hecker v. Deere & Co.*, 556 F.3d 575 (7th Cir. 2009), *petition for cert denied*, 130 S.Ct. 1141, 2010 WL 154965 (U.S. Jan. 19, 2010), in which the Seventh Circuit affirmed dismissal of similar claims involving another large 401(k) plan on the ground that a plan fiduciary is not obligated to select the cheapest funds available, and that where the plan offered sufficient range of options to afford participants control over their risk of loss, any loss to participants was attributable to their individual choice and could not form the basis for fiduciary liability. The *Hecker* decision was discussed in the February 17, 2009 *Alert*. Citing the *Hecker* decision, among other authorities, the court dismissed plaintiffs' second amended complaint in its entirety.

OTHER ITEMS OF NOTE

FinCEN Posts Comments Regarding Proposed FBAR Amendments

The U.S. Treasury Department's Financial Crimes Enforcement Network ("FinCEN") posted the comments that FinCEN has received from the public regarding FinCEN's proposed rule (the "Proposed Rule") to amend its regulations regarding the requirements for filing the Report of Foreign Bank and Financial Accounts ("FBAR") with the IRS on Form TD F 90-22. The Proposed Rule, which was published on February 26, 2010, was described in detail in the March 2, 2010 *Alert*. The comment period for the Proposed Rule closed on April 27, 2010.

SEC and DOL Issue Joint Investor Bulletin on Target Date Retirement Funds

The SEC and DOL have issued a joint bulletin designed to provide basic information for investors about target date retirement funds. In 2009, target date funds were the subject of a

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joint hearing by the SEC and DOL and congressional testimony by SEC Chairman Mary L. Schapiro and Andrew J. Donohue, Director of the SEC's Division of Investment Management.