

January 2011 / Special Alert

A legal update from Dechert's Financial Institutions, Finance and Real Estate, and Business Restructuring and Reorganization Groups

## FDIC Acts to Facilitate Securitizations by Covered Financial Companies

The Federal Deposit Insurance Corporation ("FDIC") has acted to address a threat to the operation of the securitization market for nonbank financial companies, including bank holding companies ("covered financial companies"). This threat arose from uncertainty as to whether any particular covered financial company may be placed in a Dodd-Frank Act ("Act") Title II receivership because it is determined, among other things, that the company's failure and resolution under otherwise applicable law would have serious adverse effects on U.S. financial stability. Thus, virtually any securitization involving such companies could at some point in the future become subject to Title II receivership rules. In that event an issue could arise as to whether and how the FDIC might apply its repudiation authority, and might interpret the requirement that a party obtain FDIC consent to exercise rights in regard to receivership property during the 90-day period following the FDIC's appointment as receiver.

On January 14, 2011, the FDIC's Acting General Counsel Michael Krimminger issued an opinion intended to temporarily resolve this uncertainty. The opinion indicates that the FDIC will apply sale principles under bankruptcy law rather than make determinations under the FDIC's repudiation authority in deciding how the FDIC will treat securitizations by a covered financial company that is placed in a receivership and that the interpretation will remain in effect for securitizations issued until at least June 30, 2011.

### January 14, 2011 Opinion

Participants in the securitization market recently became concerned about how the FDIC might apply the repudiation and consent provisions contained in Title II to a receivership. These provisions are essentially the same as those that apply to

failed depository institutions under the Federal Deposit Insurance Act. In September 2010, the FDIC issued a regulation that set forth requirements for favorable treatment by the FDIC of securitizations by a failed depository institution occurring after December 31, 2010, whether the securitization was treated by the FDIC as a sale or as a secured borrowing ("FDIC Safe Harbor"). Among other things, the FDIC Safe Harbor requires that the sponsor of a securitization retain an economic interest in not less than five percent of the credit risk of the financial assets until the risk retention rules under section 941(b) of the Act become effective.

Although the FDIC has issued rules regarding certain aspects of Title II<sup>1</sup> and the Acting General Counsel has issued an opinion regarding the harmonization of the exercise of Title II avoidance powers with bankruptcy law avoidance provisions,<sup>2</sup> the FDIC had not indicated how it would treat a securitization by a covered financial company that is placed in receivership. Thus, to the extent that a covered financial company participated in a securitization and was subsequently placed in receivership, it was unclear how the FDIC might treat the assets transferred in a securitization, including whether it might seek to apply principles contained in the FDIC Safe Harbor to reclaim or recover such assets. This uncertainty could have prevented participants from proceeding with securitizations potentially subject to a subsequent receivership.

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<sup>1</sup> See our October 2010 *DechertOnPoint* "[FDIC Begins Action on Its Super-Resolution Rules for Covered Financial Companies.](#)"

<sup>2</sup> See our January 2011 *DechertOnPoint* "[FDIC Issues Opinion Clarifying Treatment of Securitizations by Financial Companies Subject to Resolution Under Title II of the Dodd-Frank Act.](#)"

The Acting General Counsel responded promptly to this concern by issuing an opinion on the topic on January 14, 2011. The opinion states that until the FDIC Board of Directors adopts a regulation addressing the application of the Title II provisions regarding repudiation and consent, the FDIC as receiver for a covered financial company will not reclaim, recover or recharacterize as property of the covered financial company or the receiver assets transferred by the covered financial company prior to the end of the applicable transition period of such FDIC regulation, provided that such transfer would satisfy the conditions for exclusion of such transferred assets from the property of the estate of the covered financial company under the Bankruptcy Code. The opinion states that the FDIC as receiver cannot repudiate a contract unless it has been appointed as receiver for the entity that entered into the contract or that entity's separate existence may be disregarded under other applicable law. The opinion further notes that the consent requirement in Title II does not apply to any assets or contracts that are not property of the covered financial company.

The opinion concludes by stating that the FDIC staff anticipates recommending consideration of further Title II regulations at a meeting of the FDIC Board of Directors later this year. The Acting General Counsel states that he will recommend that such regulations incorporate a transition period of 90 days for any provisions

affecting the repudiation power and that as a result the interpretation contained in the opinion will remain in effect until at least June 30, 2011.

## Conclusion

The opinion attempts to reduce the uncertainty created by Congress when, at least as a theoretical matter, it established the possibility that competing resolution schemes with different rules and outcomes might apply to a covered financial company. Attention will now turn to a future FDIC rulemaking proceeding.

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