



November 2009

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FDIC Adopts Interim Rule Amending Safe Harbor Protection for Securitization Transactions

The Federal Deposit Insurance Corporation (FDIC) adopted an [Interim Rule](#), effective immediately, at its November 12, 2009 meeting, to provide a safe harbor in its conservatorship and receivership rules through March 31, 2010 for participations or securitizations that would be adversely affected by recent changes to generally accepted accounting principles (GAAP) that are effective for reporting periods beginning after November 15, 2009.

The Interim Rule is intended to forestall ratings downgrades as market participants take into account the risk that the FDIC as conservator or receiver of a failed depository institution might reclaim or recharacterize securitized financial assets or participations. The Interim Rule thus benefits both holders of existing securitized assets and loan participations and FDIC-insured depository institutions that sell loans to the securitization markets or participations in loans.

Under the Federal Deposit Insurance Act, the FDIC has the power as the conservator or receiver of a failed depository institution, similar to that of a bankruptcy trustee, to disaffirm or repudiate any contract or lease to which a failed institution is a party if the FDIC determines that the performance of such contract or lease will be burdensome and its disaffirmance or repudiation will promote the orderly administration of

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the failed institution's affairs.

The FDIC adopted its [Securitization Rule](#) (12 C.F.R. § 360.6) in 2000 to provide a safe harbor for the transfer of financial assets by an insured depository institution in connection with a securitization or participation, provided that the transfer meets all conditions for sale accounting treatment under generally accepted accounting principles, other than the "legal isolation" condition. The Securitization Rule also required that the insured depository institution receive adequate consideration at the time of the transfer and that the documentation reflect the intent of the parties to treat the transaction as a sale, and not as a secured borrowing, for accounting purposes.

The Financial Accounting Standards Board finalized changes to GAAP in June 2009 effective for reporting periods that begin after November 15, 2009 (the GAAP Modification) that affect whether banks and other financial institutions must consolidate an issuing entity to which financial assets have been transferred for securitization on their balance sheets for financial reporting purposes even when the transferee entity is legally isolated. The GAAP Modification may also require institutions to treat loan participation transactions as secured borrowings rather than as sales. In either such case, the transfers will not qualify for the safe harbor provision of the existing Securitization Rule.

Thursday's FDIC action adds an additional temporary safe harbor to the Securitization Rule through March 31, 2010 for asset transfers made as part of a securitization or participation transaction, notwithstanding that such transfers do not satisfy all conditions for sale accounting treatment under the new GAAP Modification rules for reporting periods after November 15, 2009 so long as such transfer satisfied the conditions (except for the legal isolation requirement addressed elsewhere in the Securitization Rule) for sale accounting treatment under GAAP in effect for reporting periods before November 15, 2009.

The Interim Rule applies both to existing transactions and to transactions that close on or before March 31, 2010. Thus it creates a window to close transactions in the pipeline that close after the GAAP Modification effective date. It also applies to revolving securitization trusts, for which beneficial interests were issued on or before March 31, 2010, thus permitting these trusts to continue operating in the normal course during this window. The FDIC has requested public comment on the Interim Rule during the 45 days following publication so it can consider and address additional changes in any

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final rule. The FDIC stated that it intends to publish in December 2009 further rulemaking to amend the Securitization Rule for transactions occurring after March 31, 2010.

Banks and other participants in the securitization and loan participation markets should review their documentation to ensure that transactions that no longer qualify for non-consolidated treatment under the GAAP Modification rules reflect an intent to satisfy the FDIC's Interim Rule.

For more information about the FDIC's Interim Rule or assistance in reviewing documentation, contact your principal Squire Sanders lawyer or one of the individuals listed in this Alert.

The contents of this update are not intended to serve as legal advice related to individual situations or as legal opinions concerning such situations. Counsel should be consulted for legal planning and advice.

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2009

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