

Clients & Friends Alert

S&P Reconsiders De-Linked Rating for Bank-Sponsored Securitizations That Fall Outside FDIC's Final Safe Harbor Rule

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Standard & Poor's issued an update (the "Update") last week indicating that it could issue a de-linked, asset-based credit rating for securities issued in a securitization sponsored by an insured depository institution ("Bank") that qualifies as a sale under GAAP, even if the transaction fails to comply with the Federal Deposit Insurance Corporation's new securitization safe harbor rule (the "Rule").¹

The Update modifies S&P's earlier position announced in October 14, 2010, which many had interpreted to mean that all Bank-sponsored securitizations must comply with the Rule, regardless of legal and accounting sale conclusions, in order to obtain a rating based solely on the credit strength of the assets.² In the Update, S&P indicates that it could issue a de-linked credit rating under certain circumstances, namely, where the transaction qualifies as a sale under GAAP and the Bank retains no economic interest in the securitized assets.

At issue is the scope of the power of the FDIC, as conservator or receiver, to repudiate securitization contracts of a failed Bank under the Federal Deposit Insurance Act ("FDIA").³ Last month, the FDIC suggested to S&P that it could repudiate Bank-sponsored securitizations that failed to comply with the Rule, leading S&P to respond that it likely would analyze those transactions as secured loans to the Bank. According to the Update, in a subsequent conversation with S&P, the FDIC confirmed to S&P that the Rule is not exclusive. Further, the FDIC explained that in determining whether to exercise its repudiation power with respect to GAAP sale transactions, it would focus on whether the failed Bank retained an economic interest in the transferred financial assets. The FDIC's determination would be fact specific, and would be applied

¹ 12 C.F.R. § 360.6; Final Rule Regarding Safe Harbor Protection for Treatment by the Federal Deposit Insurance Corporation as Conservator or Receiver of Financial Assets Transferred by an Insured Depository Institution in Connection With a Securitization or Participation After September 30, 2010. <http://www.fdic.gov/news/board/10Sept27no4.pdf>.

² See Cadwalader's Client & Friends Memo dated October 27, 2010, titled "S&P Likely to Refuse De-Linked Ratings for Bank-Sponsored Securitizations That Fail to Meet FDIC's Final Safe Harbor Rule"; http://www.cadwalader.com/assets/client_friend/102710_S&PLikelytoRefuseDeLinkedRatings.pdf.

³ 12 U.S.C. §§ 1811-1835a.

to any transfer, regardless of whether it was made to a bankruptcy remote special purpose subsidiary of the Bank, a non-bank affiliate or a third party.

S&P to Consider True Sale Opinion and Other Factors

S&P responded by stating that in analyzing whether to issue an asset-based rating for a non-Rule securitization, S&P will consider the FDIC's position above. It also will consider the legal true sale opinion issued in connection with the transaction. However, because a legal true sale opinion can be issued even if the seller retains an economic interest in securitized assets, S&P will not view a legal true sale/ GAAP sale transaction as invulnerable to the potential exercise of the FDIC's repudiation power. Accordingly, S&P would consider other factors, such as those noted below, in determining whether a transaction should qualify for an independent rating:

- A Bank's retention of a *pari passu* or subordinate interest in the transferred assets, whether such interest is direct or indirect (e.g., a deferred purchase price);
- A Bank's obligation to support the assets, even if that obligation is limited.

Takeaway

Although S&P's view opens the door for an de-linked credit rating to be issued for a legal true sale/ GAAP sale transaction, much is left open to question given the myriad features of a securitization that could constitute a retained economic interest. It depends on what "no economic interest" means – with the 20-20 hindsight available to the FDIC once a Bank fails. Although the Update states that a Bank's retention of servicing rights alone would not constitute an economic interest justifying deployment of the repudiation power, it provides no other guidance with respect to any other interests that may be permissible to retain. S&P also noted that a Bank transfer that qualifies as a sale under GAAP could involve a retained economic interest that would preclude it from qualifying for a de-linked rating unless the transaction complies with the Rule, including a Bank's "transfer of assets to a subsidiary in a typical securitization." Although somewhat ambiguous in its reference to a "typical securitization," we read this statement to mean that a two-step transaction in which a Bank retains an ownership interest in a subsidiary that directly or indirectly issues securities and retains an interest in transferred assets post-securitization would not qualify for a de-linked credit rating.

Finally, S&P cautioned that, paradoxically, "[a Bank's] lack of retention of an economic interest in an asset transfer may be difficult to achieve if applicable statutory or regulatory provisions require the

[Bank] to retain some of the risks associated with the assets.” Because many of these provisions remain to be resolved, the financial industry will have to continue to revisit securitization structures in order to achieve acceptable ratings.

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