



## Hearing on Covered Bond Legislation

The Financial Services Committee of the U.S. House of Representatives held a hearing on covered bonds on December 15, 2009. The Committee heard testimony on proposed legislation introduced by Representative Scott Garrett (R-NJ). A copy of the legislation is available at [http://www.house.gov/apps/list/speech/financialsvcs\\_dem/garrett\\_covered\\_bond\\_amendment\\_001\\_xml.pdf](http://www.house.gov/apps/list/speech/financialsvcs_dem/garrett_covered_bond_amendment_001_xml.pdf). The legislation would adopt a statutory structure for covered bonds issued by U.S. financial institutions similar to the structure used in Europe for covered bonds.

The key elements of the legislation are: (1) separation of the cover pool from the issuing bank in the event of the insolvency of the issuing bank, (2) designation of the Secretary of the Treasury as the trustee of the separated cover pool acting for the benefit of the covered bond holders, (3) the authority of the separate cover pool to borrow on a secured basis from the Federal Financing Bank in order to obtain liquidity to make required payments on the covered bonds, (4) a residual interest in the cover pool to be issued to the FDIC or other receiver, which will receive all excess value in the cover pool after payment in full of the covered bonds, and (5) a wide variety of eligible assets for the cover pool: residential mortgage loans, home equity loans, commercial mortgage loans, student loans, auto loans, credit card receivables, municipal and state obligations and small business loans. A covered bond program could utilize only one asset type however. The proposed legislation also would exempt covered bonds from the federal securities law other than regulations issued by the issuer's primary federal regulator and applicable anti-fraud rules.

In the event that the FDIC were appointed as conservator or receiver of the failed bank, the proposed legislation would provide a fifteen-day period for the FDIC to transfer the cover pool to an assuming bank. If the cover pool were not transferred to an assuming bank within the fifteen-day period, then the cover pool would be separated from the estate of the failed bank and treated as a separate estate.

The proposed legislation was initially introduced by Representative Garrett on October 29, 2009 and withdrawn at the request of Committee Chairman Barney Frank with the promise to hold a hearing on covered bonds in early December.

There was generally strong bipartisan support at today's hearing for covered bonds. A half dozen Congressmen spoke out in support of covered bonds. The fact that covered bonds have been used extensively in Europe and have proved quite resilient in recovering from the financial crisis was viewed favorably and evidence that covered bonds could provide essential liquidity to the U.S. mortgage market. The feature of covered bonds that the issuing bank retains ownership of mortgage loans or other assets in the cover pool was viewed as likely to improve underwriting standards and also to make it much easier for modifications to be made to a borrower's loan.

While there was generally support at today's hearing for the creation of a statutory structure for covered bonds in the U.S., there appeared to some disagreement about how strict the statutory requirements for collateral should

be and whether initially covered bonds should be restricted to longer term assets such as residential and commercial mortgage loans. The view was expressed that covered bonds from jurisdictions with more proscriptive statutory schemes appeared to price and trade better in turbulent markets.

The witnesses at the hearing included a member of the U.S. Covered Bond Council, a representative from a large investment manager, a journalist who specializes in banking matters, a representative of the Commercial Mortgage Securities Association and spokesman for a non-profit group that has provided consulting services in the Danish covered bond market.<sup>1</sup> Witness testimony and access to a webcast of the hearing is available at [http://www.house.gov/apps/list/hearing/financialsvcs\\_dem/fchr\\_121509.shtml](http://www.house.gov/apps/list/hearing/financialsvcs_dem/fchr_121509.shtml).

Although the atmosphere of the hearing was very supportive of covered bonds, there was no indication from the Committee of next steps. It seems unlikely that the Committee would proceed on the proposal without hearing from at least the federal bank regulators and the mortgage banking industry, but there was no mention made today of further hearings. With the holiday break upon us, it is clear that if additional hearings were to be held it would not be until January at the earliest.

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<sup>1</sup> The witnesses included: Mr. Alan Boyce, Chief Executive Officer, Absalon; Mr. Scott A. Stengel, Partner, Orrick, Herrington & Sutcliffe LLP on behalf of the U.S. Covered Bond Council; Mr. Bert Ely, Ely & Company Inc.; Mr. Wesley Phoa, Senior Vice President, Capital International Research, Inc.; and Mr. J. Christopher Hoeffel, Managing Director, Investcorp International Inc. on behalf of the Commercial Mortgage Securities Association.