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News Bulletin

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Covered Bonds: 2011 – The Senate

Finally! The important second leg of the legislation is on the table. The long awaited covered bond bill was introduced in the U.S. Senate today. The bill, "The United States Covered Bond Act of 2011,"[1] was introduced by Senator Kay Hagan (D-NC) and Senator Bob Corker (R-TN) and co-sponsored by Chuck Schumer (D-NY) and Mike Crapo (R-ID). The language of the bill is very close to H.R. 940 that passed the House Financial Services Committee on a bipartisan vote of 44-7 in June.[2]

In a release accompanying the introduction, Senator Hagan said, "This bill would level the playing field for U.S. financial institutions and help strengthen our U.S. economy." Senator Schumer said, "With the housing market still struggling to recover, covered bonds are a common sense solution that can help bring private capital back into the housing market."

Comparison to H.R. 940

This Senate bill very closely tracks the language of H.R. 940. The few differences are described below. First, the definition of "eligible issuer" has been expanded to include broker-dealers and insurance companies. Second, the covered bond regulator and a majority of covered bond holders will have the power to replace the independent asset monitor. Third, for covered bond issuers that are not subject to the jurisdiction of a federal banking agency, the covered bond regulator will be the Federal Reserve Board rather than the Treasury. Fourth, and maybe most importantly, all tax provisions of H.R. 940 have been eliminated in the Senate bill.

Elimination of the tax provisions is reportedly a strategic amendment to avoid assignment of the bill to the Senate Finance Committee in addition to the Senate Banking Committee. Recall that in the House, H.R. 940 was assigned jointly to the Financial Services Committee and the Ways and Means Committee. Although the Financial Services Committee passed the bill in June, the Ways and Means Committee has yet to act on the bill. Apparently, the hope is that the Senate bill will move more quickly through the Senate without the tax provisions.

Prospects

Certainly, starting the legislative process in the Senate is a very important first step. This is the first covered bond legislation to be introduced in the Senate and it represents the critically important beginning of building support for covered bonds.

[1] The full text of the bill is available at http://www.hagan.senate.gov/files/111109_CoveredBond_BillText.pdf.
[2] See our Client Alert on the HSFC action at http://www.mofo.com/files/Uploads/Images/110629-Covered-Bonds.pdf.

The next step will be one or more hearings on the bill before the Banking Committee. It is expected that the FDIC's concerns with covered bond legislation will be heard and likely addressed in some fashion. Those concerns are:

- first, to have the power to repudiate covered bonds in a bank insolvency, paying par plus accrued interest to the covered bond trustee in exchange for the cover pool;
- second, to remove the one year limit for the FDIC's decision on whether to transfer the covered bonds to an assuming bank or permit the creation of a separate estate, allowing the FDIC an unlimited amount of time; and
- third, to acknowledge the FDIC complaints that the Treasury should not be the agency to establish the rules for the covered bond regulatory oversight program because the Treasury is not a prudential regulator.

Most of the other FDIC concerns were addressed by various amendments to H.R. 940 in the markup hearings.

It does not appear likely that the hearings will be held before the end of the year. The deliberations of the supercommittee on deficit reduction and the automatic across the board cuts to be applied if the supercommittee fails to reach agreement are likely to take much of the available Senate focus in November and December. The deadline for a supercommittee decision is November 23, 2011. Meanwhile the House bill remains in the Ways and Means Committee with no apparent activity, although it is reported that the committee's concerns with the bill are technical only.

Contacts

Jerry Marlatt
(212) 468-8024
jmarlatt@mofo.com

Melissa Beck
(212) 336-4319
mbeck@mofo.com

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