October 9, 2008

MEMORANDUM TO: The Board of Directors

FROM: Sara A. Kelsey
General Counsel

SUBJECT: Interim Rule on Temporary Increase in Standard Coverage Amount and on Mortgage Servicing Accounts

Recommendation

The staff recommends that the Board authorize the issuance of the attached draft interim rule recognizing the recent temporary increase in the deposit insurance coverage limit from $100,000 to $250,000 and simplifying the deposit insurance coverage rules for mortgage servicing accounts. The interim rule would become effective immediately (as to all existing and future mortgage servicing accounts) upon the Board vote to approve it. It would then be published in the Federal Register with a sixty-day comment period.

Reasons for the Rulemaking

The two reasons for this recommended rulemaking are to: (1) update our current coverage rules to reflect the amendment to the standard maximum deposit insurance amount made by the Emergency Economic Stability Act of 2008; and (2) make the coverage rules for mortgage servicing accounts simpler to understand and simpler to apply. Also, staff believes the interim rule would result in faster deposit insurance determinations after bank closings and would help improve public confidence in the banking system.

Temporary Increase in Coverage

The Emergency Economic Stabilization Act of 2008 temporarily increased the standard maximum deposit insurance amount ("SMDIA") from $100,000 to $250,000, effective October 3, 2008, and ending December 31, 2009. After that date, the SMDIA will, by law, return to $100,000. The interim rule would amend the FDIC's deposit insurance regulations to reflect the temporary increase in the SMDIA.

Mortgage Servicing Accounts

Currently, under the FDIC's deposit insurance rules, accounts maintained by a mortgage servicer comprised of principal and interest payments made by mortgagors/borrowers are insured based on the ownership interest of each mortgagee/lender (investor or security holder) in those accounts. Also, accounts maintained by a mortgage servicer comprised

of payments by mortgagors/borrowers of taxes and insurance premiums are insured as the individually owned funds of the respective mortgagor/borrower.

Over the past several years, securitization methods and vehicles for mortgages have become more layered and complex. Staff believes that it has become much more difficult and time-consuming for a servicer to identify and determine the share of any investor in a securitization and in the principal and interest funds on deposit at an insured depository institution.

In the event of the failure of an FDIC-insured depository institution, staff is concerned that there could be unexpected loss to securitization investors of principal and interest payments, deposited at the institution by a securitization servicer. As noted above, these accounts may involve multi-layered securitization structures, and it may prove difficult for the servicer holding a deposit account in the institution to identify every security holder in the securitization and determine his or her share. In addition, some investor holdings may far exceed the current $250,000 per-depositor/investor insurance limit. Application of the current rule under these circumstances could result in delays in the servicer receiving the insured amounts and in losses for amounts that, because of the complexity of the securitization agreements, cannot be attributed to the particular investors to whom the funds belong. This outcome could increase losses to otherwise insured depositors, lead to withdrawal of deposits for principal and interest payments from depository institutions, and unnecessarily reduce liquidity for such institutions.

Under the interim rule, the coverage afforded in connection with a mortgage servicing account would be based on the mortgagors' payments of principal and interest into the mortgage servicing account, up to $250,000 per mortgagor. In effect, coverage would be provided to the mortgagees/investors, as a collective group, based on the cumulative amount of the mortgagors' payments of principal and interest into the account. This insurance coverage afforded in connection with principal and interest payments in mortgage servicing accounts would not be aggregated with or otherwise affect the coverage provided to mortgagors in connection with other accounts the mortgagors might maintain at the same insured depository institution. As under the current insurance rules, under the interim rule amounts in a mortgage servicing account constituting payments of taxes and insurance premiums would be insured on a *pass-through* basis as the funds of each respective mortgagor. Such funds would be added to other individually owned funds held by each such mortgagor at the same institution and insured to the applicable limit.

Conclusion

For the reasons discussed above, the staff recommends that the Board adopt the attached interim rule and authorize its issuance in the Federal Register.

Attachment

Staff contacts: Kym Copa (x88832) and Joe DiNuzzo (x87349)