

UNITED STATES COVERED BOND ACT OF 2011

MARCH 5, 2012.—Ordered to be printed

Mr. BACHUS, from the Committee on Financial Services,  
submitted the following

R E P O R T

together with

MINORITY VIEWS

[To accompany H.R. 940]

[Including cost estimate of the Congressional Budget Office]

The Committee on Financial Services, to whom was referred the bill (H.R. 940) to establish standards for covered bond programs and a covered bond regulatory oversight program, and for other purposes, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The amendment is as follows:

Strike all after the enacting clause and insert the following:

**SECTION 1. SHORT TITLE.**

This Act may be cited as the “United States Covered Bond Act of 2011”.

**SEC. 2. DEFINITIONS.**

For purposes of this Act, the following definitions shall apply:

(1) **ANCILLARY ASSET.**—The term “ancillary asset” means—

(A) any interest rate or currency swap associated with 1 or more eligible assets, substitute assets, or other assets in a cover pool;

(B) any credit enhancement or liquidity arrangement associated with 1 or more eligible assets, substitute assets, or other assets in a cover pool;

(C) any guarantee, letter-of-credit right, or other secondary obligation that supports any payment or performance of 1 or more eligible assets, substitute assets, or other assets in a cover pool; and

(D) any proceeds of, or other property incident to, 1 or more eligible assets, substitute assets, or other assets in a cover pool.

(2) **CORPORATION.**—The term “Corporation” means the Federal Deposit Insurance Corporation.

(3) **COVER POOL.**—The term “cover pool” means a dynamic pool of assets that is comprised of—

- (A) in the case of any eligible issuer described in subparagraph (A), (B), or (C) of paragraph (9)—
  - (i) 1 or more eligible assets from a single eligible asset class; and
  - (ii) 1 or more substitute assets or ancillary assets; and
- (B) in the case of any eligible issuer described in paragraph (9)(D)—
  - (i) the covered bonds issued by each sponsoring eligible issuer; and
  - (ii) 1 or more substitute assets or ancillary assets.
- (4) COVERED BOND.—The term “covered bond” means any recourse debt obligation of an eligible issuer that—
  - (A) has an original term to maturity of not less than 1 year;
  - (B) is secured by a perfected security interest in or other perfected lien on a cover pool that is owned directly or indirectly by the issuer of the obligation;
  - (C) is issued under a covered bond program that has been approved by the applicable covered bond regulator;
  - (D) is identified in a register of covered bonds that is maintained by the Secretary; and
  - (E) is not a deposit (as defined in section 3(l) of the Federal Deposit Insurance Act (12 U.S.C. 1813(l))).
- (5) COVERED BOND PROGRAM.—The term “covered bond program” means any program of an eligible issuer under which, on the security of a single cover pool, 1 or more series or tranches of covered bonds may be issued.
- (6) COVERED BOND REGULATOR.—The term “covered bond regulator” means—
  - (A) for any eligible issuer that is subject to the jurisdiction of an appropriate Federal banking agency (as defined in section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q))), the appropriate Federal banking agency;
  - (B) for any eligible issuer that is described in paragraph (9)(D), that is not subject to the jurisdiction of an appropriate Federal banking agency, and that is sponsored by only 1 eligible issuer, the covered bond regulator for the sponsor;
  - (C) for any eligible issuer that is described in paragraph (9)(D), that is not subject to the jurisdiction of an appropriate Federal banking agency, and that is sponsored by more than 1 eligible issuer, the covered bond regulator for the sponsor whose covered bonds constitute the largest share of the cover pool of the issuer; and
  - (D) for any other eligible issuer that is not subject to the jurisdiction of an appropriate Federal banking agency, the Secretary.
- (7) ELIGIBLE ASSET.—The term “eligible asset” means—
  - (A) in the case of the residential mortgage asset class—
    - (i) any first-lien mortgage loan that is secured by 1-to-4 family residential property;
    - (ii) any mortgage loan that is insured under the National Housing Act (12 U.S.C. 1701 et seq.); and
    - (iii) any loan that is guaranteed, insured, or made under chapter 37 of title 38, United States Code;
  - (B) in the case of the commercial mortgage asset class, any commercial mortgage loan (including any multifamily mortgage loan);
  - (C) in the case of the public sector asset class—
    - (i) any security issued by a State, municipality, or other governmental authority;
    - (ii) any loan made to a State, municipality, or other governmental authority; and
    - (iii) any loan, security, or other obligation that is insured or guaranteed, in full or substantially in full, by the full faith and credit of the United States Government (whether or not such loan, security, or other obligation is also part of another eligible asset class);
  - (D) in the case of the auto asset class, any auto loan or lease;
  - (E) in the case of the student loan asset class, any student loan (whether guaranteed or nonguaranteed);
  - (F) in the case of the credit or charge card asset class, any extension of credit to a person under an open-end credit plan;
  - (G) in the case of the small business asset class, any loan that is made or guaranteed under a program of the Small Business Administration; and
  - (H) in the case of any other eligible asset class, any asset designated by the Secretary, by rule and in consultation with the covered bond regulators, as an eligible asset for purposes of such class.
- (8) ELIGIBLE ASSET CLASS.—The term “eligible asset class” means—
  - (A) a residential mortgage asset class;

- (B) a commercial mortgage asset class;
  - (C) a public sector asset class;
  - (D) an auto asset class;
  - (E) a student loan asset class;
  - (F) a credit or charge card asset class;
  - (G) a small business asset class; and
  - (H) any other eligible asset class designated by the Secretary, by rule and in consultation with the covered bond regulators.
- (9) ELIGIBLE ISSUER.—The term “eligible issuer” means—
- (A) any insured depository institution and any subsidiary of such institution;
  - (B) any bank holding company, any savings and loan holding company, and any subsidiary of any of such companies;
  - (C) any nonbank financial company (as defined in section 102(a)(4) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5311(a)(4))) that is supervised by the Board of Governors of the Federal Reserve System under section 113 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5323), including any intermediate holding company supervised as a nonbank financial company, and any subsidiary of such a nonbank financial company; and
  - (D) any issuer that is sponsored by 1 or more eligible issuers for the sole purpose of issuing covered bonds on a pooled basis.
- (10) OVERSIGHT PROGRAM.—The term “oversight program” means the covered bond regulatory oversight program established under section 3(a).
- (11) SECRETARY.—The term “Secretary” means the Secretary of the Department of the Treasury.
- (12) SUBSTITUTE ASSET.—The term “substitute asset” means—
- (A) cash;
  - (B) any direct obligation of the United States Government, and any security or other obligation whose full principal and interest are insured or guaranteed by the full faith and credit of the United States Government;
  - (C) any direct obligation of a United States Government corporation or Government-sponsored enterprise of the highest credit quality, and any other security or other obligation of the highest credit quality whose full principal and interest are insured or guaranteed by such corporation or enterprise, except that the outstanding principal amount of these obligations in any cover pool may not exceed an amount equal to 20 percent of the outstanding principal amount of all assets in the cover pool without the approval of the applicable covered bond regulator;
  - (D) any overnight investment in Federal funds;
  - (E) any other substitute asset designated by the Secretary, by rule and in consultation with the covered bond regulators; and
  - (F) any deposit account or securities account into which only an asset described in subparagraph (A), (B), (C), (D), or (E) may be deposited or credited.

**SEC. 3. REGULATORY OVERSIGHT OF COVERED BOND PROGRAMS ESTABLISHED.**

(a) ESTABLISHMENT.—

(1) IN GENERAL.—Not later than 180 days after the date of the enactment of this Act, the Secretary shall, by rule and in consultation with the covered bond regulators, establish a covered bond regulatory oversight program that provides for—

(A) covered bond programs to be evaluated according to reasonable and objective standards in order to be approved under paragraph (2), including any additional eligibility standards for eligible assets and any other criteria determined appropriate by the Secretary to further the purposes of this Act;

(B) covered bond programs to be maintained in a manner that is consistent with this Act and safe and sound asset-liability management and other financial practices; and

(C) any estate created under section 4 to be administered in a manner that is consistent with maximizing the value and the proceeds of the related cover pool in a resolution under this Act.

(2) APPROVAL OF EACH COVERED BOND PROGRAM.—

(A) IN GENERAL.—A covered bond shall be subject to this Act only if the covered bond is issued by an eligible issuer under a covered bond program that is approved by the applicable covered bond regulator.

(B) APPROVAL PROCESS.—Each covered bond regulator shall apply the standards established by the Secretary under the oversight program to evaluate a covered bond program that has been submitted by an eligible

issuer for approval. Each covered bond regulator also shall take into account relevant supervisory factors, including safety and soundness considerations, in evaluating a covered bond program that has been submitted for approval. Each covered bond regulator, promptly after approving a covered bond program, shall provide the Secretary with the name of the covered bond program, the name of the eligible issuer, and all other information reasonably requested by the Secretary in order to update the registry under paragraph (3)(A). Each eligible issuer, promptly after issuing a covered bond under an approved covered bond program, shall provide the Secretary with all information reasonably requested by the Secretary in order to update the registry under paragraph (3)(B).

(C) EXISTING COVERED BOND PROGRAMS.—A covered bond regulator may approve a covered bond program that is in existence on the date of the enactment of this Act. Upon such approval, each covered bond under the covered bond program shall be subject to this Act, regardless of when the covered bond was issued.

(D) MULTIPLE COVERED BOND PROGRAMS PERMITTED.—An eligible issuer may have more than 1 covered bond program.

(E) CEASE AND DESIST AUTHORITY.—The applicable covered bond regulator may direct an eligible issuer to cease issuing covered bonds under an approved covered bond program if the covered bond program is not maintained in a manner that is consistent with this Act and the oversight program and if, after notice that is reasonable under the circumstances, the issuer does not remedy all deficiencies identified by the applicable covered bond regulator.

(F) CAP ON THE AMOUNT OF OUTSTANDING COVERED BONDS.—

(i) IN GENERAL.—With respect to each eligible issuer that submits a covered bond program for approval, the applicable covered bond regulator shall set, consistent with safety and soundness considerations and the financial condition of the eligible issuer, the maximum amount, as a percentage of the eligible issuer's total assets, of outstanding covered bonds that the eligible issuer may issue.

(ii) REVIEW OF CAP.—The applicable covered bond regulator may, not more frequently than quarterly, review the percentage set under clause (i) and, if safety and soundness considerations or the financial condition of the eligible issuer has changed, increase or decrease such percentage. Any decrease made pursuant to this clause shall have no effect on existing covered bonds issued by the eligible issuer.

(3) REGISTRY.—Under the oversight program, the Secretary shall maintain a registry that is published on a Web site available to the public and that, for each covered bond program approved by a covered bond regulator, contains—

(A) the name of the covered bond program, the name of the eligible issuer, and all other information that the Secretary considers necessary to adequately identify the covered bond program and the eligible issuer; and

(B) all information that the Secretary considers necessary to adequately identify all outstanding covered bonds issued under the covered bond program (including the reports described in paragraphs (3) and (4) of subsection (b)).

(4) FEES.—Each covered bond regulator may levy, on the issuers of covered bonds under the primary supervision of such covered bond regulator, reasonably apportioned fees that such covered bond regulator considers necessary, in the aggregate, to defray the costs of such covered bond regulator carrying out the provisions of this Act. Such funds shall not be construed to be Government funds or appropriated monies and shall not be subject to apportionment for purposes of chapter 15 of title 31, United States Code, or any other provision of law.

(b) MINIMUM OVER-COLLATERALIZATION REQUIREMENTS.—

(1) REQUIREMENTS ESTABLISHED.—The Secretary, by rule and in consultation with the covered bond regulators, shall establish minimum over-collateralization requirements for covered bonds backed by each of the eligible asset classes. The minimum over-collateralization requirements shall be designed to ensure that sufficient eligible assets and substitute assets are maintained in the cover pool to satisfy all principal and interest payments on the covered bonds when due through maturity and shall be based on the credit, collection, and interest rate risks (excluding the liquidity risks) associated with the eligible asset class.

(2) ASSET COVERAGE TEST.—The eligible assets and the substitute assets in any cover pool shall be required, in the aggregate, to meet at all times the applicable minimum over-collateralization requirements.

(3) MONTHLY REPORTING.—On a monthly basis, each issuer of covered bonds shall submit a report on whether the cover pool that secures the covered bonds meets the applicable minimum over-collateralization requirements to—

- (A) the Secretary;
- (B) the applicable covered bond regulator;
- (C) the applicable indenture trustee;
- (D) the applicable covered bondholders; and
- (E) the applicable independent asset monitor.

(4) INDEPENDENT ASSET MONITOR.—

(A) APPOINTMENT.—Each issuer of covered bonds shall appoint the indenture trustee for the covered bonds, or another unaffiliated entity, as an independent asset monitor for the applicable cover pool.

(B) DUTIES.—An independent asset monitor appointed under subparagraph (A) shall, on an annual or other more frequent periodic basis determined by the Secretary under the oversight program—

- (i) verify whether the cover pool meets the applicable minimum over-collateralization requirements; and
- (ii) report to the Secretary, the applicable covered bond regulator, the applicable indenture trustee, and the applicable covered bondholders on whether the cover pool meets the applicable minimum over-collateralization requirements.

(5) NO LOSS OF STATUS.—Covered bonds shall remain subject to this Act regardless of whether the applicable cover pool ceases to meet the applicable minimum over-collateralization requirements.

(6) FAILURE TO MEET REQUIREMENTS.—

(A) IN GENERAL.—If a cover pool fails to meet the applicable minimum over-collateralization requirements, and if the failure is not cured within the time specified in the related transaction documents, the failure shall be an uncured default for purposes of section 4(a).

(B) NOTICE REQUIRED.—An issuer of covered bonds shall promptly give the Secretary and the applicable covered bond regulator written notice if the cover pool securing the covered bonds fails to meet the applicable minimum over-collateralization requirements, if the failure is cured within the time specified in the related transaction documents, or if the failure is not so cured.

(c) REQUIREMENTS FOR ELIGIBLE ASSETS.—

(1) REQUIREMENTS.—

(A) LOANS.—A loan shall not qualify as an eligible asset for so long as the loan is delinquent for more than 60 consecutive days.

(B) SECURITIES.—A security shall not qualify as an eligible asset for so long as the security does not meet any credit-quality requirement under this Act.

(C) ORIGINATION.—An asset shall not qualify as an eligible asset if the asset was not originated in compliance with any rule or supervisory guidance of a Federal agency applicable to the asset at the time of origination.

(D) NO DOUBLE PLEDGE.—An asset shall not qualify as an eligible asset for so long as the asset is subject to a prior perfected security interest or other prior perfected lien that has been granted in an unrelated transaction. Nothing in this Act shall affect such a prior perfected security interest or other prior perfected lien, and the rights of such lien holders.

(2) FAILURE TO MEET REQUIREMENTS.—Subject to paragraph (1)(D), if an asset in a cover pool does not satisfy any applicable requirement described in paragraph (1) or any other applicable standard or criterion described in this Act, the oversight program, or the related transaction documents, the asset shall not qualify as an eligible asset for purposes of the asset coverage test described in subsection (b)(2). A disqualified asset shall remain in the cover pool unless and until removed by the issuer in compliance with the provisions of this Act, the oversight program, and the related transaction documents. No disqualified asset may be removed from the cover pool after an estate has been created for the related covered bond program under section 4(b)(1) or 4(c)(2), except in connection with the management of the cover pool under section 4(d)(1)(E).

(d) OTHER REQUIREMENTS.—

(1) BOOKS AND RECORDS OF ISSUER.—Each issuer of covered bonds shall clearly mark its books and records to identify the assets that comprise the cover pool securing the covered bonds.

(2) SCHEDULE OF ELIGIBLE ASSETS AND SUBSTITUTE ASSETS.—Each issuer of covered bonds shall deliver to the applicable indenture trustee and the applicable independent asset monitor, on at least a monthly basis, a schedule that

identifies all eligible assets and substitute assets in the cover pool securing the covered bonds.

(3) SINGLE ELIGIBLE ASSET CLASS.—No cover pool described in section 2(3)(A) may include eligible assets from more than 1 eligible asset class. No cover pool described in section 2(3)(B) may include covered bonds backed by more than 1 eligible asset class.

**SEC. 4. RESOLUTION UPON DEFAULT OR INSOLVENCY.**

(a) UNCURED DEFAULT DEFINED.—For purposes of this section, the term “uncured default” means a default on a covered bond that has not been cured within the time, if any, specified in the related transaction documents.

(b) DEFAULT ON COVERED BONDS PRIOR TO CONSERVATORSHIP, RECEIVERSHIP, LIQUIDATION, OR BANKRUPTCY.—

(1) CREATION OF SEPARATE ESTATE.—If an uncured default occurs on a covered bond before the issuer of the covered bond enters conservatorship, receivership, liquidation, or bankruptcy, an estate shall be immediately and automatically created by operation of law and shall exist and be administered separate and apart from the issuer or any subsequent conservatorship, receivership, liquidating agency, or estate in bankruptcy for the issuer or any other assets of the issuer. A separate estate shall be created for each affected covered bond program.

(2) ASSETS AND LIABILITIES OF ESTATE.—Any estate created under paragraph (1) shall be comprised of the cover pool (including over-collateralization in the cover pool) that secures the covered bond. The cover pool shall be immediately and automatically released to and held by the estate free and clear of any right, title, interest, or claim of the issuer or any conservator, receiver, liquidating agent, or trustee in bankruptcy for the issuer or any other assets of the issuer. The estate shall be fully liable on the covered bond and all other covered bonds and related obligations of the issuer (including obligations under related derivative transactions) that are secured by a perfected security interest in or other perfected lien on the cover pool when the estate is created. The estate shall not be liable on any obligation of the issuer that is not secured by a perfected security interest in or other perfected lien on the cover pool when the estate is created. No conservator, receiver, liquidating agent, or trustee in bankruptcy for the issuer may charge or assess the estate for any claim of the conservator, receiver, liquidating agent, or trustee in bankruptcy or the conservatorship, receivership, liquidating agency, or estate in bankruptcy and may not obtain or perfect a security interest in or other lien on the cover pool to secure such a claim.

(3) RETENTION OF CLAIMS.—Any holder of a covered bond or related obligation for which an estate has become liable under paragraph (2) shall retain a claim against the issuer for any deficiency with respect to the covered bond or related obligation. If the issuer enters conservatorship, receivership, liquidation, or bankruptcy, any contingent claim for such a deficiency shall be allowed as a provable claim in the conservatorship, receivership, liquidating agency, or bankruptcy case. The contingent claim shall be estimated by the conservator, receiver, liquidating agent, or bankruptcy court for purposes of allowing the claim as a provable claim if awaiting the fixing of the contingent claim would unduly delay the resolution of the conservatorship, receivership, liquidating agency, or bankruptcy case.

(4) RESIDUAL INTEREST.—

(A) ISSUANCE OF RESIDUAL INTEREST.—Upon the creation of an estate under paragraph (1), a residual interest in the estate shall be immediately and automatically issued by operation of law to the issuer.

(B) NATURE OF RESIDUAL INTEREST.—The residual interest under subparagraph (A) shall—

- (i) be an exempted security as described in section 5;
- (ii) represent the right to any surplus from the cover pool after the covered bonds and all other liabilities of the estate have been fully and irrevocably paid; and
- (iii) be evidenced by a certificate executed by the trustee of the estate.

(5) OBLIGATIONS OF ISSUER.—

(A) IN GENERAL.—After the creation of an estate under paragraph (1), the issuer shall—

- (i) transfer to or at the direction of the trustee for the estate all property of the estate that is in the possession or under the control of the issuer, including all tangible or electronic books, records, files, and

other documents or materials relating to the assets and liabilities of the estate; and

(ii) at the election of the trustee or a servicer or administrator for the estate, continue servicing the applicable cover pool for 120 days after the creation of the estate in return for a fair-market-value fee, as determined by the trustee in consultation with the applicable covered bond regulator, that shall be payable from the estate as an administrative expense.

(B) OBLIGATIONS ABSOLUTE.—Neither the issuer, whether acting as debtor in possession or in any other capacity, nor any conservator, receiver, liquidating agent, or trustee in bankruptcy for the issuer or any other assets of the issuer may disaffirm, repudiate, or reject the obligation to turn over property or to continue servicing the cover pool as provided in subparagraph (A).

(c) DEFAULT ON COVERED BONDS UPON CONSERVATORSHIP, RECEIVERSHIP, LIQUIDATION, OR BANKRUPTCY.—

(1) CORPORATION CONSERVATORSHIP OR RECEIVERSHIP.—

(A) IN GENERAL.—If the Corporation is appointed as conservator or receiver for an issuer of covered bonds before an uncured default results in the creation of an estate under subsection (b), the Corporation as conservator or receiver shall have an exclusive right, during the 1-year period beginning on the date of the appointment, to transfer any cover pool owned by the issuer in its entirety, together with all covered bonds and related obligations that are secured by a perfected security interest in or other perfected lien on the cover pool, to another eligible issuer that meets all conditions and requirements specified in the related transaction documents. The Corporation as conservator or receiver may not remove any asset from the cover pool, except to the extent otherwise agreed by a transferee that has assumed the covered bond program pursuant to subparagraph (C).

(B) OBLIGATIONS DURING 1-YEAR PERIOD.—During the 1-year period described in subparagraph (A), the Corporation as conservator or receiver shall fully and timely satisfy all monetary and nonmonetary obligations of the issuer under all covered bonds and the related transaction documents and shall fully and timely cure all defaults by the issuer (other than its conservatorship or receivership) under the applicable covered bond program, in each case, until the earlier of—

(i) the transfer of the applicable covered bond program to another eligible issuer as provided in subparagraph (A); or

(ii) the delivery to the Secretary, the applicable covered bond regulator, the applicable indenture trustee, and the applicable covered bondholders of a written notice from the Corporation as conservator or receiver electing to cease further performance under the applicable covered bond program.

(C) ASSUMPTION BY TRANSFEREE.—If the Corporation as conservator or receiver transfers a covered bond program to another eligible issuer within the 1-year period as provided in subparagraph (A), the transferee shall take ownership of the applicable cover pool and shall become fully liable on all covered bonds and related obligations of the issuer that are secured by a perfected security interest in or other perfected lien on the cover pool.

(2) OTHER CIRCUMSTANCES.—An estate shall be immediately and automatically created by operation of law and shall exist and be administered separate and apart from an issuer of covered bonds and any conservatorship, receivership, liquidating agency, or estate in bankruptcy for the issuer or any other assets of the issuer, if—

(A) a conservator, receiver, liquidating agent, or trustee in bankruptcy, other than the Corporation, is appointed for the issuer before an uncured default results in the creation of an estate under subsection (b); or

(B) in the case of the appointment of the Corporation as conservator or receiver as described in paragraph (1)(A), the Corporation as conservator or receiver—

(i) does not complete the transfer of the applicable covered bond program to another eligible issuer within the 1-year period as provided in paragraph (1)(A);

(ii) delivers to the Secretary, the applicable covered bond regulator, the applicable indenture trustee, and the applicable covered bondholders a written notice electing to cease further performance under the applicable covered bond program; or

(iii) fails to fully and timely satisfy all monetary and nonmonetary obligations of the issuer under the covered bonds and the related trans-

action documents or to fully and timely cure all defaults by the issuer (other than its conservatorship or receivership) under the applicable covered bond program.

A separate estate shall be created for each affected covered bond program.

(3) ASSETS AND LIABILITIES OF ESTATE.—Any estate created under paragraph (2) shall be comprised of the cover pool (including over-collateralization in the cover pool) that secures the covered bonds. The cover pool shall be immediately and automatically released to and held by the estate free and clear of any right, title, interest, or claim of the issuer or any conservator, receiver, liquidating agent, or trustee in bankruptcy for the issuer or any other assets of the issuer. The estate shall be fully liable on the covered bonds and all other covered bonds and related obligations of the issuer (including obligations under related derivative transactions) that are secured by a perfected security interest in or other perfected lien on the cover pool when the estate is created. The estate shall not be liable on any obligation of the issuer that is not secured by a perfected security interest in or other perfected lien on the cover pool when the estate is created. No conservator, receiver, liquidating agent, or trustee in bankruptcy for the issuer may charge or assess the estate for any claim of the conservator, receiver, liquidating agent, or trustee in bankruptcy or the conservatorship, receivership, liquidating agency, or estate in bankruptcy and may not obtain or perfect a security interest in or other lien on the cover pool to secure such a claim.

(4) CONTINGENT CLAIM.—Any contingent claim against an issuer for a deficiency with respect to a covered bond or related obligation for which an estate has become liable under paragraph (3) shall be allowed as a provable claim in the conservatorship, receivership, liquidating agency, or bankruptcy case for the issuer. The contingent claim shall be estimated by the conservator, receiver, liquidating agent, or bankruptcy court for purposes of allowing the claim as a provable claim if awaiting the fixing of the contingent claim would unduly delay the resolution of the conservatorship, receivership, liquidating agency, or bankruptcy case.

(5) RESIDUAL INTEREST.—

(A) ISSUANCE OF RESIDUAL INTEREST.—Upon the creation of an estate under paragraph (2), and regardless of whether any contingent claim described in paragraph (4) becomes fixed or is estimated, a residual interest in the estate shall be immediately and automatically issued by operation of law to the conservator, receiver, liquidating agent, or trustee in bankruptcy for the issuer.

(B) NATURE OF RESIDUAL INTEREST.—The residual interest under subparagraph (A) shall—

- (i) be an exempted security as described in section 5;
- (ii) represent the right to any surplus from the cover pool after the covered bonds and all other liabilities of the estate have been fully and irrevocably paid; and
- (iii) be evidenced by a certificate executed by the trustee of the estate.

(6) OBLIGATIONS OF ISSUER.—

(A) IN GENERAL.—After the creation of an estate under paragraph (2), the issuer and its conservator, receiver, liquidating agent, or trustee in bankruptcy shall—

(i) transfer to or at the direction of the trustee for the estate all property of the estate that is in the possession or under the control of the issuer or its conservator, receiver, liquidating agent, or trustee in bankruptcy, including all tangible or electronic books, records, files, and other documents or materials relating to the assets and liabilities of the estate; and

(ii) at the election of the trustee or a servicer or administrator for the estate, continue servicing the applicable cover pool for 120 days after the creation of the estate in return for a fair-market-value fee, as determined by the trustee in consultation with the applicable covered bond regulator, that shall be payable from the estate as an administrative expense.

(B) OBLIGATIONS ABSOLUTE.—Neither the issuer, whether acting as debtor in possession or in any other capacity, nor any conservator, receiver, liquidating agent, or trustee in bankruptcy for the issuer or any other assets of the issuer may disaffirm, repudiate, or reject the obligation to turn over property or to continue servicing the cover pool as provided in subparagraph (A).

(d) ADMINISTRATION AND RESOLUTION OF ESTATES.—



## (1) TRUSTEE, SERVICER, AND ADMINISTRATOR.—

(A) IN GENERAL.—Upon the creation of any estate under subsection (b)(1) or (c)(2), the applicable covered bond regulator shall—

- (i) appoint the trustee for the estate;
- (ii) appoint 1 or more servicers or administrators for the cover pool held by the estate; and
- (iii) give the Secretary, the applicable indenture trustee, the applicable covered bondholders, and the owner of the residual interest written notice of the creation of the estate.

(B) TERMS AND CONDITIONS OF APPOINTMENT.—All terms and conditions of any appointment under paragraph (1), including the terms and conditions relating to compensation, shall conform to the requirements of this Act and the oversight program and otherwise shall be determined by the applicable covered bond regulator.

(C) QUALIFICATION.—The applicable covered bond regulator may require the trustee or any servicer or administrator for an estate to post in favor of the United States, for the benefit of the estate, a bond that is conditioned on the faithful performance of the duties of the trustee or the servicer or administrator. The covered bond regulator shall determine the amount of any bond required under this subparagraph and the sufficiency of the surety on the bond. A proceeding on a bond required under this subparagraph may not be commenced after two years after the date on which the trustee or the servicer or administrator was discharged.

(D) POWERS AND DUTIES OF TRUSTEE.—The trustee for an estate is the representative of the estate and, subject to the provisions of this Act, has capacity to sue and be sued. The trustee shall—

- (i) administer the estate in compliance with this Act, the oversight program, and the related transaction documents;
- (ii) be accountable for all property of the estate that is received by the trustee;
- (iii) make a final report and file a final account of the administration of the estate with the applicable covered bond regulator; and
- (iv) after the estate has been fully administered, close the estate.

(E) POWERS AND DUTIES OF SERVICER OR ADMINISTRATOR.—Any servicer or administrator for an estate—

- (i) shall—
  - (I) collect, realize on (by liquidation or other means), and otherwise manage the cover pool held by the estate in compliance with this Act, the oversight program, and the related transaction documents and in a manner consistent with maximizing the value and the proceeds of the cover pool;
  - (II) deposit or invest all proceeds and funds received in compliance with this Act, the oversight program, and the related transaction documents and in a manner consistent with maximizing the net return to the estate, taking into account the safety of the deposit or investment; and
  - (III) apply, or direct the trustee for the estate to apply, all proceeds and funds received and the net return on any deposit or investment to make distributions in compliance with paragraphs (3) and (4);
- (ii) may borrow funds or otherwise obtain credit, for the benefit of the estate, in compliance with paragraph (2) on a secured or unsecured basis and on a priority, *pari passu*, or subordinated basis;
- (iii) shall, at the times and in the manner required by the applicable covered bond regulator, submit to the covered bond regulator, the Secretary, the applicable indenture trustee, the applicable covered bondholders, the owner of the residual interest, and any other person designated by the covered bond regulator, reports that describe the activities of the servicer or administrator on behalf of the estate, the performance of the cover pool held by the estate, and distributions made by the estate; and
- (iv) shall assist the trustee in preparing the final report and the final account of the administration of the estate.

(F) SUPERVISION OF TRUSTEE, SERVICER, AND ADMINISTRATOR.—The applicable covered bond regulator shall supervise the trustee and any servicer or administrator for an estate. The covered bond regulator shall require that all reports submitted under subparagraph (E)(iii) do not contain any untrue statement of a material fact and do not omit to state a material fact

necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading.

(G) REMOVAL AND REPLACEMENT OF TRUSTEE, SERVICER, AND ADMINISTRATOR.—If the covered bond regulator determines that it is in the best interests of an estate, the covered bond regulator may remove or replace the trustee or any servicer or administrator for the estate. The removal of the trustee or any servicer or administrator does not abate any pending action or proceeding involving the estate, and any successor or other trustee, servicer, or administrator shall be substituted as a party in the action or proceeding.

(H) PROFESSIONALS.—The trustee or any servicer or administrator for an estate may employ 1 or more attorneys, accountants, appraisers, auctioneers, or other professional persons to represent or assist the trustee or the servicer or administrator in carrying out its duties. The employment of any professional person and all terms and conditions of employment, including the terms and conditions relating to compensation, shall conform to the requirements of this Act and the oversight program and otherwise shall be subject to the approval of the applicable covered bond regulator.

(I) APPROVED FEES AND EXPENSES.—Unless otherwise provided in the applicable terms and conditions of appointment or employment, all approved fees and expenses of the trustee, any servicer or administrator, or any professional person employed by the trustee or any servicer or administrator shall be payable from the estate as administrative expenses.

(J) ACTIONS BY OR ON BEHALF OF ESTATE.—The trustee or any servicer or administrator for an estate may commence or continue judicial, administrative, or other actions, in the name of the estate or in its own name on behalf of the estate, for the purpose of collecting, realizing on, or otherwise managing the cover pool held by the estate or exercising its other powers or duties on behalf of the estate.

(K) ACTIONS AGAINST ESTATE.—No court may issue an attachment or execution on any property of an estate. Except at the request of the applicable covered bond regulator or as otherwise provided in this subparagraph or subparagraph (J), no court may take any action to restrain or affect the resolution of an estate under this Act. No person (including the applicable indenture trustee and any applicable covered bondholder) may commence or continue any judicial, administrative, or other action against the estate, the trustee, or any servicer or administrator or take any other act to affect the estate, the trustee, or any servicer or administrator that is not expressly permitted by this Act, the oversight program, and the related transaction documents, except for a judicial or administrative action to compel the release of funds that—

- (i) are available to the estate;
- (ii) are permitted to be distributed under this Act and the oversight program; and
- (iii) are permitted and required to be distributed under the related transaction documents and any contracts executed by or on behalf of the estate.

(L) SOVEREIGN IMMUNITY.—Except in connection with a guarantee provided under paragraph (4) or any other contract executed by the applicable covered bond regulator under this section 4, the Secretary and the covered bond regulator shall be entitled to sovereign immunity in carrying out the provisions of this Act.

(2) BORROWINGS AND CREDIT.—

(A) IN GENERAL.—Any servicer or administrator for an estate created under subsection (b)(1) or (c)(2) may borrow funds or otherwise obtain credit, on behalf of and for the benefit of the estate, from any person in compliance with this paragraph (2) solely for the purpose of providing liquidity in the case of timing mismatches among the assets and the liabilities of the estate. Except with respect to an underwriter, section 5 of the Securities Act of 1933, the Trust Indenture Act of 1939, and any State or local law requiring registration for an offer or sale of a security or registration or licensing of an issuer of, underwriter of, or broker or dealer in a security does not apply to the offer or sale under this paragraph (2) of a security that is not an equity security.

(B) CONDITIONS.—A servicer or administrator may borrow funds or otherwise obtain credit under subparagraph (A)—

- (i) on terms affording the lender only claims or liens that are fully subordinated to the claims and interests of the applicable indenture trustee and the applicable covered bondholders and all other claims

against and interests in the estate, except for the residual interest, if the servicer or administrator certifies to the applicable covered bond regulator that, in the business judgment of the servicer or administrator, the borrowing or credit is in the best interests of the estate and is expected to maximize the value and the proceeds of the cover pool held by the estate; or

(ii) on terms affording the lender claims or liens that have priority over or are *pari passu* with the claims or interests of the applicable indenture trustee or the applicable covered bondholders or other claims against or interests in the estate, if—

(I) the servicer or administrator certifies to the applicable covered bond regulator that, in the business judgment of the servicer or administrator, the borrowing or credit is in the best interests of the estate and is expected to maximize the value and the proceeds of the cover pool held by the estate; and

(II) the applicable covered bond regulator authorizes the borrowing or credit.

(C) LIMITED LIABILITY.—A servicer or administrator shall not be liable for any error in business judgment when borrowing funds or otherwise obtaining credit under this paragraph (2) unless the servicer or administrator acted in bad faith or in willful disregard of its duties.

(D) STUDY ON BORROWINGS AND CREDIT.—The Comptroller General of the United States shall conduct a study on whether the Federal reserve banks should be authorized to lend funds or otherwise extend credit to an estate under this paragraph (2) and, if so, what conditions and limits should be established to mitigate any risk that the United States Government could absorb credit losses on the cover pool held by the estate. The Comptroller General shall submit a report to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives on the results of the study not later than 6 months after the date of enactment of this Act.

(3) DISTRIBUTIONS BY ESTATE.—All payments or other distributions by an estate shall be made at the times, in the amounts, and in the manner set forth in the covered bonds, the related transaction documents, and any contracts executed by or on behalf of the estate in compliance with this Act and the oversight program. To the extent that the relative priority of the liabilities of the estate are not specified in or otherwise ascertainable from their terms, distributions shall be made on each distribution date under the covered bonds, the related transaction documents, or any contracts executed by or on behalf of the estate—

(A) first, to pay accrued and unpaid superpriority claims under paragraph (2)(B)(ii);

(B) second, to pay accrued and unpaid administrative expense claims under paragraph (1)(I), paragraph (2)(B)(ii), section 4(b)(5)(A), or section 4(c)(6)(A);

(C) third, to pay—

(i) accrued and unpaid claims under the covered bonds and the related transaction documents according to their terms; and

(ii) accrued and unpaid *pari passu* claims under paragraph (2)(B)(ii); and

(D) fourth, to pay accrued and unpaid subordinated claims under paragraph (2)(B)(i).

(4) DISTRIBUTIONS ON RESIDUAL INTEREST.—After all other claims against and interests in an estate have been fully and irrevocably paid or defeased, the trustee shall or shall cause a servicer or administrator to distribute the remainder of the estate to or at the direction of the owner of the residual interest. No interim distribution on the residual interest may be made before that time, unless the applicable covered bond regulator—

(A) approves the distribution after determining that all other claims against and interests in the estate will be fully, timely, and irrevocably paid according to their terms; and

(B) provides an indemnity, for the benefit of the estate, assuring that all other claims against and interests in the estate will be fully, timely, and irrevocably paid according to their terms.

(5) CLOSING OF ESTATE.—After an estate has been fully administered, the trustee shall close the estate and, except as otherwise directed by the applicable covered bond regulator, shall destroy all records of the estate.

(6) NO LOSS TO TAXPAYERS.—Taxpayers shall bear no losses from the resolution of an estate under this Act. To the extent that the Secretary and the Corporation jointly determine that the Deposit Insurance Fund incurred actual

losses that are higher because the covered bond program of an insured depository institution was subject to resolution under this Act rather than as part of the receivership of the institution under the Federal Deposit Insurance Act (12 U.S.C. 1811 et seq.), the Corporation may exercise the powers available under section 7(b) of the Federal Deposit Insurance Act (12 U.S.C. 1817(b)) to recover an amount equal to those losses after consulting with the Secretary.

**SEC. 5. SECURITIES LAW PROVISIONS.**

(a) **EXISTING EXEMPTIONS APPLICABLE TO COVERED BONDS.—**

(1) **TREATMENT OF CERTAIN BANKS AND OTHER ENTITIES.—**Any covered bond issued or guaranteed by a bank or by an eligible issuer described in section 2(9)(D) and sponsored solely by 1 or more banks for the sole purpose of issuing covered bonds is and shall be treated as a security issued or guaranteed by a bank under section 3(a)(2) of the Securities Act of 1933 (15 U.S.C. 77c(a)(2)), section 3(c)(3) of the Investment Company Act of 1940 (15 U.S.C. 80a-3(c)(3)), and section 304(a)(4)(A) of the Trust Indenture Act of 1939 (15 U.S.C. 77ddd(a)(4)(A)). No covered bond issued or guaranteed by a bank or by an eligible issuer described in section 2(9)(D) and sponsored solely by 1 or more banks for the sole purpose of issuing covered bonds shall be treated as an asset-backed security (as defined in section 3 of the Securities and Exchange Act of 1934 (15 U.S.C. 78c)). Each covered bond regulator for 1 or more banks shall adopt disclosure and reporting regulations for offers or sales of covered bonds by a bank or an eligible issuer described in this paragraph. Such regulations shall provide for uniform and consistent standards for such covered bond issuers, to the extent possible, and shall be consistent with existing regulations governing offers or sales of nonconvertible debt.

(2) **TREATMENT OF CERTAIN ASSOCIATIONS AND COOPERATIVE BANKS.—**Any covered bond issued by an entity described in section 3(a)(5)(A) of the Securities Act of 1933 (15 U.S.C. 77c(a)(5)(A)) or by an eligible issuer described in section 2(9)(D) and sponsored solely by 1 or more such entities for the sole purpose of issuing covered bonds is and shall be treated as a security issued by such an entity under section 3(a)(5)(A) of the Securities Act of 1933 (15 U.S.C. 77c(a)(5)(A)), section 3(c)(3) of the Investment Company Act of 1940 (15 U.S.C. 80a-3(c)(3)), and section 304(a)(4)(A) of the Trust Indenture Act of 1939 (15 U.S.C. 77ddd(a)(4)(A)). No covered bond issued by an entity described in section 3(a)(5)(A) of the Securities Act of 1933 (15 U.S.C. 77c(a)(5)(A)) or by an eligible issuer described in section 2(9)(D) and sponsored solely by 1 or more such entities for the sole purpose of issuing covered bonds shall be treated as an asset-backed security (as defined in section 3 of the Securities and Exchange Act of 1934 (15 U.S.C. 78c)). Each covered bond regulator for 1 or more entities described in section 3(a)(5)(A) of the Securities Act of 1933 (15 U.S.C. 77c(a)(5)(A)) shall adopt, as part of the securities regulations of the covered bond regulator, a separate scheme of registration, disclosure, and reporting obligations and exemptions for offers or sales of covered bonds that are described in this paragraph. Such regulations shall provide for uniform and consistent standards for such covered bond issuers, to the extent possible, and shall be consistent with regulations governing offers or sales of similar securities.

(3) **CONSTRUCTION.—**No provision of this Act, including paragraph (1) or (2), may be construed or applied in a manner that impairs or limits any other exemption that is available under applicable securities laws.

(b) **EXEMPTIONS FOR ESTATES.—**Any estate that is or may be created under section 4(b)(1) or 4(c)(2) shall be exempt from all securities laws but—

(1) shall be subject to the reporting requirements established by the applicable covered bond regulator under section 4(d)(1)(E)(iii); and

(2) shall succeed to any requirement of the issuer to file such periodic information, documents, and reports in respect of the covered bonds as specified in section 13(a) of the Securities and Exchange Act of 1934 (15 U.S.C. 78m(a)) or rules established by an appropriate Federal banking agency.

(c) **EXEMPTIONS FOR RESIDUAL INTERESTS.—**Any residual interest in an estate that is or may be created under section 4(b)(1) or 4(c)(2) shall be exempt from all securities laws.

**SEC. 6. MISCELLANEOUS PROVISIONS.**

(a) **DOMESTIC SECURITIES.—**Section 106(a)(1) of the Secondary Mortgage Market Enhancement Act of 1984 (15 U.S.C. 77r-1(a)(1)) is amended—

(1) in subparagraph (C), by striking “or” at the end;

(2) in subparagraph (D), by adding “or” at the end; and

(3) by inserting after subparagraph (D) the following:

“(E) covered bonds (as defined in section 2 of the United States Covered Bond Act of 2011).”

(b) NO TAX IMPLICATIONS.—Any estate created under section 4(b)(1) or 4(c)(2) shall not be treated as an entity subject to taxation separate from the owner of the residual interest for purposes of the Internal Revenue Code of 1986 (26 U.S.C. 1 et seq.), including by reason of the taxable mortgage pool provisions of section 7701(i) of the Internal Revenue Code of 1986 (26 U.S.C. 7701(i)), but instead shall be treated as a disregarded entity that is owned by the owner of the residual interest for such purposes as described in applicable regulations of the Secretary, as in effect on the date of the enactment of this Act. No transfer or assumption of any asset or liability to or by an estate or an eligible issuer under section 4(b) or 4(c) shall cause or constitute an event in which gain or loss shall be recognized under section 1001 of the Internal Revenue Code of 1986 (26 U.S.C. 1001).

(c) REAL ESTATE MORTGAGE INVESTMENT CONDUITS.—Section 860G(a)(3) of the Internal Revenue Code of 1986 (26 U.S.C. 860G(a)(3)) is amended—

- (1) in subparagraph (B), by striking “and” at the end;
- (2) in subparagraph (C), by striking the period and inserting “, and”; and
- (3) by inserting after subparagraph (C) the following:

“(D) covered bonds that are secured by eligible assets from the residential mortgage asset class or the commercial mortgage asset class, as such terms are defined in section 2 of the United States Covered Bond Act of 2011.”.

(d) REAL ESTATE INVESTMENT TRUSTS.—To the extent provided by regulations that may be promulgated by the Secretary, a covered bond described in section 860G(a)(3)(D) of the Internal Revenue Code of 1986 shall be treated as a real estate asset in the same manner as a regular interest in a REMIC for purposes of section 856(c)(5)(E) of such Code.

(e) INVESTMENT TREATMENT FOR TAX PURPOSES.—The acquisition of any covered bond shall be treated as an acquisition of an investment security, and not as an acquisition of an interest in a loan or otherwise as a lending transaction, for purposes of determining the character of any related trade or business activity of the acquirer or any asset held by the acquirer under the Internal Revenue Code of 1986 (26 U.S.C. 1 et seq.).

(f) STATE AND LOCAL TAXES.—The Secretary may promulgate regulations under this Act that are similar to the provisions of section 346 of title 11, United States Code, including regulations to provide that—

(1) if an estate created under section 4(b)(1) or 4(c)(2) is not treated as an entity subject to taxation separate from the owner of the residual interest for purposes of the Internal Revenue Code of 1986 (26 U.S.C. 1 et seq.), no separate taxable entity shall be created with respect to the estate for purposes of any State or local law imposing a tax on or measured by income; and

(2) if a transfer or assumption of an asset or liability to or by an estate or an eligible issuer under section 4(b) or 4(c) does not cause or constitute an event in which gain or loss is recognized under section 1001 of the Internal Revenue Code of 1986 (26 U.S.C. 1001), the transfer or assumption shall not cause or constitute a disposition for purposes of any provision assigning tax consequences to a disposition in connection with any State or local law imposing a tax on or measured by income.

(g) NO CONFLICT.—The provisions of this Act shall apply, notwithstanding any provision of the Federal Deposit Insurance Act (12 U.S.C. 1811 et seq.), title 11, United States Code, title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5381 et seq.), or any other provision of Federal law with respect to conservatorship, receivership, liquidation, or bankruptcy. No provision of the Federal Deposit Insurance Act (12 U.S.C. 1811 et seq.), title 11, United States Code, title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5381 et seq.), or any other provision of Federal law with respect to conservatorship, receivership, liquidation, or bankruptcy may be construed or applied in a manner that defeats or interferes with the purpose or operation of this Act.

(h) ANNUAL REPORT TO CONGRESS.—The covered bond regulators shall, annually—

(1) submit a joint report to the Congress describing the current state of the covered bond market in the United States; and

(2) testify on the current state of the covered bond market in the United States before the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate.

#### PURPOSE AND SUMMARY

H.R. 940, the United States Covered Bond Act of 2011, establishes a comprehensive regulatory framework for the covered bond market in the United States. The legislation directs the Department of the Treasury, in consultation with the federal banking reg-

ulators, to establish rules governing the market and requires the prudential federal regulator for each issuer of a covered bond to serve as the “covered bond regulator” for that issuer. The legislation also creates legal certainty for investors by detailing what will happen if an issuer becomes insolvent or defaults on the covered bond.

A U.S. covered bond market would provide additional funding at lower costs for financial institutions, which in turn would provide more stable and longer term liquidity in the credit markets. Consumers would benefit from greater availability of credit and lower costs. In addition to providing liquidity, covered bonds would also allow financial institutions to better match the duration of their assets with their liabilities, which would help protect them against liability mismatches that led to runs on financial institutions in 2008. Because issuers of covered bonds retain ownership of the loans in the cover pools, covered bonds would strengthen the incentives of issuers to improve their loan underwriting and monitor loan performance. Retained ownership of the loans in the cover pools also makes it easier for issuers to modify troubled loans when appropriate. The benefits that covered bonds have to offer will not be realized until a legislative framework is in place that provides certainty to issuers and investors about how a covered bond market would work.

The covered bond framework set forth in H.R. 940 would help credit flow more readily from capital markets to households, small businesses, and state and local governments to enhance economic growth and the stability of the financial system. Additionally, covered bonds are an alternative to mortgage-backed securities issued and guaranteed by the government sponsored enterprises, Fannie Mae and Freddie Mac.

#### BACKGROUND AND NEED FOR LEGISLATION

A covered bond is a debt instrument issued by a financial institution for which a group of high quality assets—typically loans—is set aside in a “cover pool” for the benefit of the bondholders. The value of the assets in the cover pool is greater than the amount of the covered bond, which means that the covered bond is “overcollateralized.” Unlike the “originate to distribute” model, in which the issuer packages the underlying assets into an instrument that is sold into the market, the underlying assets in the cover pool remain on the issuer’s books. A covered bond is a “dual-recourse” debt instrument, which means that if the issuer becomes insolvent, bondholders have not only a secured interest in the cover pool’s assets but also an unsecured claim against the issuer, if the cover pool is insufficient to repay the bondholders.

In 2008, both the Department of the Treasury and the Federal Deposit Insurance Corporation (FDIC) issued policy statements on covered bonds. Although these regulatory initiatives were an initial step towards establishing a regulatory framework for covered bonds in the United States, they did not succeed in creating a robust U.S. covered bond market. To address the legal and regulatory uncertainty that has thus far prevented the establishment of a covered bond market in the United States, H.R. 940 was introduced by Representatives Garrett and Maloney to establish a legislative framework for the covered bond market in the United States.

The Subcommittee on Capital Markets and Government Sponsored Enterprises held a legislative hearing on H.R. 940 on March 11, 2011. During that hearing, the Subcommittee received testimony from a variety of financial market participants. A majority of witnesses expressed the view that covered bonds are an untapped but proven means of creating cost-effective funding from the private sector capital markets. The witnesses also testified that legal certainty concerning creditor claims and the collateral securing the covered bond is necessary for a covered bond market to exist in the United States, and that such certainty cannot be created by regulatory action alone. Accordingly, the witnesses strongly supported H.R. 940, which would create the certainty needed to establish a vibrant covered bond market. The FDIC submitted written testimony for the record at the March 11, 2011 hearing, which expressed support for establishing a covered bond market in the United States, but also highlighted certain concerns about the bill as introduced.

#### HEARINGS

On March 11, 2011, the Subcommittee on Capital Markets and Government Sponsored Enterprises held a hearing on “Legislative Proposals to Create a Covered Bond Regime in the United States.” The following witnesses testified:

- Mr. Scott Stengel, Partner, King & Spalding LLP, on behalf of the U.S. Covered Bond Council
- Mr. Bert Ely, Ely & Company, Inc.
- Mr. Tim Skeet, Amias Berman & Co., on behalf of the International Capital Market Association
- Mr. Ralph Daloisio, Managing Director, Natixis, on behalf of the American Securitization Forum
- Mr. Stephen G. Andrews, President and Chief Executive Officer, Bank of Alameda

#### COMMITTEE CONSIDERATION

The Subcommittee on Capital Markets and Government Sponsored Enterprises met in open session on May 3 and 4, 2011, and ordered H.R. 940, as amended, favorably reported to the full Committee by voice vote.

The Committee on Financial Services met in open session on June 22, 2011, and ordered H.R. 940, as amended, favorably reported to the House by a record vote of 44 yeas, 7 nays, and 3 present (Record vote no. FC-49).

#### COMMITTEE VOTES

Clause 3(b) of rule XIII of the Rules of the House of Representatives requires the Committee to list the record votes on the motion to report legislation and amendments thereto.

On June 22, 2011, the Committee on Financial Services met in open session and ordered H.R. 940, as amended, favorably reported to the House by a record vote of 44 yeas, 7 nays, and 3 present (Record vote no. FC-49). The names of the Members voting for, against, and present follow:

RECORD VOTE NO. FC-49

Representative	Aye	Nay	Present	Representative	Aye	Nay	Present
Mr. Bachus	X			Mr. Frank (MA)			X
Mr. Hensarling	X			Ms. Waters			X
Mr. King (NY)				Mrs. Maloney	X		
Mr. Royce	X			Mr. Gutierrez			
Mr. Lucas	X			Ms. Velázquez			X
Mr. Paul				Mr. Watt	X		
Mr. Manzullo	X			Mr. Ackerman	X		
Mr. Jones	X			Mr. Sherman	X		
Mrs. Biggert	X			Mr. Meeks	X		
Mr. Gary G. Miller (CA)	X			Mr. Capuano		X	
Mrs. Capito	X			Mr. Hinojosa	X		
Mr. Garrett	X			Mr. Clay		X	
Mr. Neugebauer	X			Mrs. McCarthy (NY)	X		
Mr. McHenry	X			Mr. Baca			
Mr. Campbell	X			Mr. Lynch		X	
Mrs. Bachmann	X			Mr. Miller (NC)		X	
Mr. McCotter	X			Mr. David Scott (GA)	X		
Mr. McCarthy (CA)				Mr. Al Green (TX)	X		
Mr. Pearce	X			Mr. Cleaver	X		
Mr. Posey	X			Ms. Moore		X	
Mr. Fitzpatrick	X			Mr. Ellison		X	
Mr. Westmoreland				Mr. Perlmutter	X		
Mr. Luetkemeyer	X			Mr. Donnelly	X		
Mr. Huizenga	X			Mr. Carson		X	
Mr. Duffy	X			Mr. Himes	X		
Ms. Hayworth	X			Mr. Peters	X		
Mr. Renacci	X			Mr. Carney	X		
Mr. Hurt	X						
Mr. Dold	X						
Mr. Schweikert	X						
Mr. Grimm	X						
Mr. Canseco	X						
Mr. Stivers							
Mr. Fincher	X						

During consideration of H.R. 940, the following amendments were considered:

1. An amendment offered by Mr. Frank, no. 3, to allow the FDIC to repudiate the contractual rights of covered bond investors, was not agreed to by a record vote of 26 yeas and 28 nays (Record vote no. FC-47).

RECORD VOTE NO. FC-47

Representative	Aye	Nay	Present	Representative	Aye	Nay	Present
Mr. Bachus		X		Mr. Frank (MA)	X		
Mr. Hensarling		X		Ms. Waters	X		
Mr. King (NY)				Mrs. Maloney	X		
Mr. Royce		X		Mr. Gutierrez			
Mr. Lucas		X		Ms. Velázquez	X		
Mr. Paul				Mr. Watt	X		
Mr. Manzullo		X		Mr. Ackerman	X		
Mr. Jones		X		Mr. Sherman	X		
Mrs. Biggert		X		Mr. Meeks	X		
Mr. Gary G. Miller (CA)		X		Mr. Capuano	X		
Mrs. Capito		X		Mr. Hinojosa	X		
Mr. Garrett		X		Mr. Clay	X		
Mr. Neugebauer		X		Mrs. McCarthy (NY)	X		
Mr. McHenry		X		Mr. Baca			
Mr. Campbell	X			Mr. Lynch	X		
Mrs. Bachmann		X		Mr. Miller (NC)	X		
Mr. McCotter		X		Mr. David Scott (GA)	X		
Mr. McCarthy (CA)				Mr. Al Green (TX)	X		



## RECORD VOTE NO. FC-47—Continued

Representative	Aye	Nay	Present	Representative	Aye	Nay	Present
Mr. Pearce .....		X	.....	Mr. Cleaver .....	X	.....	.....
Mr. Posey .....		X	.....	Ms. Moore .....	X	.....	.....
Mr. Fitzpatrick .....		X	.....	Mr. Ellison .....	X	.....	.....
Mr. Westmoreland .....			.....	Mr. Perlmutter .....	X	.....	.....
Mr. Luetkemeyer .....		X	.....	Mr. Donnelly .....	X	.....	.....
Mr. Huizenga .....		X	.....	Mr. Carson .....	X	.....	.....
Mr. Duffy .....		X	.....	Mr. Himes .....	X	.....	.....
Ms. Hayworth .....		X	.....	Mr. Peters .....	X	.....	.....
Mr. Renacci .....		X	.....	Mr. Carney .....	X	.....	.....
Mr. Hurt .....		X	.....				
Mr. Dold .....		X	.....				
Mr. Schweikert .....		X	.....				
Mr. Grimm .....		X	.....				
Mr. Canseco .....		X	.....				
Mr. Stivers .....			.....				
Mr. Fincher .....		X	.....				

2. An amendment offered by Mr. Frank, no. 4, to give the FDIC concurrent authority with an issuer's covered bond regulator to approve a covered bond program, was not agreed to by a record vote of 26 yeas and 28 nays (Record vote no. FC-48).

## RECORD VOTE NO. FC-48

Representative	Aye	Nay	Present	Representative	Aye	Nay	Present
Mr. Bachus .....		X	.....	Mr. Frank (MA) .....	X	.....	.....
Mr. Hensarling .....		X	.....	Ms. Waters .....	X	.....	.....
Mr. King (NY) .....			.....	Mrs. Maloney .....	X	.....	.....
Mr. Royce .....		X	.....	Mr. Gutierrez .....		.....	.....
Mr. Lucas .....		X	.....	Ms. Velázquez .....	X	.....	.....
Mr. Paul .....			.....	Mr. Watt .....	X	.....	.....
Mr. Manullo .....		X	.....	Mr. Ackerman .....	X	.....	.....
Mr. Jones .....		X	.....	Mr. Sherman .....	X	.....	.....
Mrs. Biggert .....		X	.....	Mr. Meeks .....	X	.....	.....
Mr. Gary G. Miller (CA) .....		X	.....	Mr. Capuano .....	X	.....	.....
Mrs. Capito .....		X	.....	Mr. Hinojosa .....	X	.....	.....
Mr. Garrett .....		X	.....	Mr. Clay .....	X	.....	.....
Mr. Neugebauer .....		X	.....	Mrs. McCarthy (NY) .....	X	.....	.....
Mr. McHenry .....		X	.....	Mr. Baca .....		.....	.....
Mr. Campbell .....	X		.....	Mr. Lynch .....	X	.....	.....
Mrs. Bachmann .....		X	.....	Mr. Miller (NC) .....	X	.....	.....
Mr. McCotter .....		X	.....	Mr. David Scott (GA) .....	X	.....	.....
Mr. McCarthy (CA) .....			.....	Mr. Al Green (TX) .....	X	.....	.....
Mr. Pearce .....		X	.....	Mr. Cleaver .....	X	.....	.....
Mr. Posey .....		X	.....	Ms. Moore .....	X	.....	.....
Mr. Fitzpatrick .....		X	.....	Mr. Ellison .....	X	.....	.....
Mr. Westmoreland .....			.....	Mr. Perlmutter .....	X	.....	.....
Mr. Luetkemeyer .....		X	.....	Mr. Donnelly .....	X	.....	.....
Mr. Huizenga .....		X	.....	Mr. Carson .....	X	.....	.....
Mr. Duffy .....		X	.....	Mr. Himes .....	X	.....	.....
Ms. Hayworth .....		X	.....	Mr. Peters .....	X	.....	.....
Mr. Renacci .....		X	.....	Mr. Carney .....	X	.....	.....
Mr. Hurt .....		X	.....				
Mr. Dold .....		X	.....				
Mr. Schweikert .....		X	.....				
Mr. Grimm .....		X	.....				
Mr. Canseco .....		X	.....				
Mr. Stivers .....			.....				
Mr. Fincher .....		X	.....				

The following amendments and motion were also considered by the Committee:

1. An amendment offered by Mrs. Maloney, no. 1, to increase the time the FDIC has to market a covered bond in order to sell it to another issuer before creating a separate estate, was agreed to by voice vote.

2. An amendment offered by Mr. Campbell, no. 2, to direct the appropriate covered bond regulator to set an asset encumbrance cap for covered bond issuers, was agreed to by voice vote.

3. An amendment offered by Mr. Garrett, no. 5, to remove the ability of the covered bond regulator to serve as trustee; to amend what type of non-bank financial company issuer can qualify as an eligible issuer under the bill; to require covered bond issuers to make certain disclosures to investors about the quality of loans that are eligible for the pool; to clarify the legal rights of lienholders to assets within the issuing institutions; and to ensure that no collateral may be double pledged to different creditors, was agreed to by voice vote.

4. A motion offered by Mr. Garrett to move the previous question on H.R. 940 was agreed to by voice vote.

#### COMMITTEE OVERSIGHT FINDINGS

Pursuant to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the Committee has held hearings and made findings that are reflected in this report.

#### PERFORMANCE GOALS AND OBJECTIVES

Pursuant to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee establishes the following performance related goals and objectives for this legislation:

The purpose of H.R. 940 is to establish a comprehensive regulatory framework for a U.S. covered bond market, which in turn would help credit flow more readily from capital markets to households, small businesses, and state and local governments to enhance economic growth and the stability of the financial system. H.R. 940 provides a legislative framework to address the legal and regulatory uncertainty that has thus far prevented the establishment of a covered bond market in the United States.

#### NEW BUDGET AUTHORITY, ENTITLEMENT AUTHORITY, AND TAX EXPENDITURES

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee adopts as its own the estimate of new budget authority, entitlement authority, or tax expenditures or revenues contained in the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974.

#### COMMITTEE COST ESTIMATE

The Committee adopts as its own the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974.

## CONGRESSIONAL BUDGET OFFICE ESTIMATES

Pursuant to clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, the following is the cost estimate provided by the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974:

FEBRUARY 21, 2012.

Hon. SPENCER BACHUS,  
*Chairman, Committee on Financial Services,  
House of Representatives, Washington, DC.*

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 940, the United States Covered Bond Act of 2011.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Daniel Hoople.

Sincerely,

DOUGLAS W. ELMENDORF.

Enclosure.

*H.R. 940—United States Covered Bond Act of 2011*

Summary: H.R. 940 would establish a framework for regulating financial instruments known as covered bonds. Covered bonds are full-recourse debt obligations, secured by a pool of performing assets. Under the bill, investors in covered bonds would receive greater compensation in some cases if the issuer were placed into the receivership or conservatorship of the Federal Deposit Insurance Corporation (FDIC). CBO expects that implementing the bill would lead to an increase in the use of covered bonds in the United States. CBO estimates that this increase would add to the cost of financial resolution programs, although any gross additional costs to the FDIC over the next 10 years would be offset by amounts assessed on depository institutions and other large financial institutions over many years.

CBO reviewed the nontax provisions of H.R. 940. Enacting those provisions of the legislation would increase net direct spending by \$50 million, and would increase net revenues by \$15 million over the 2012–2022 period, resulting in a net increase in the deficit of \$35 million over the next 10 years, CBO estimates. The Joint Committee on Taxation (JCT) reviewed the tax provisions of H.R. 940 and expects that enacting those provisions would probably decrease revenues to the federal government; however, the legislative language requires further specification before the revenue effect can be estimated. Pay-as-you-go procedures apply because enacting the legislation would affect direct spending and revenues.

In addition, CBO estimates that implementing the bill would cost \$10 million over the 2012–2017 period for activities of the Securities and Exchange Commission (SEC), assuming appropriation of the necessary amounts.

H.R. 940 contains no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would not affect the budgets of state, local, or tribal governments.

H.R. 940 contains a private-sector mandate, as defined in UMRA, on financial institutions because they would be required to pay additional fees or deposit insurance premiums to offset the costs to the FDIC associated with the covered bond program under the bill.

Based on the expected use of covered bonds under the bill, CBO estimates that the cost of the mandate would fall well below the annual threshold for private-sector mandates (\$146 million in 2012, adjusted annually for inflation).

**Estimated cost to the Federal Government:** The estimated budgetary impact of H.R. 940 is shown in the following table. The costs of this legislation fall within budget function 370 (commerce and housing credit).

	By fiscal year, in millions of dollars—													
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2012– 2017	2012– 2022	
CHANGES IN DIRECT SPENDING														
Estimated Budget Authority .....	0	*	1	3	4	6	6	7	7	8	8	14	50	
Estimated Outlays .....	0	*	1	3	4	6	6	7	7	8	8	14	50	
CHANGES IN REVENUES <sup>a</sup>														
Estimated Revenues .....	0	0	0	*	1	2	2	2	2	3	3	3	15	
NET INCREASE IN THE DEFICIT FROM CHANGES IN DIRECT SPENDING AND RECEIPTS														
Impact on Deficit .....	0	*	1	3	3	4	4	5	5	5	5	11	35	
CHANGES IN SPENDING SUBJECT TO APPROPRIATION														
Estimated Authorization Level .....	*	2	2	2	2	2	2	2	2	2	2	10	20	
Estimated Outlays .....	*	2	2	2	2	2	2	2	2	2	2	10	20	

Note: \* = between \$0 and \$500,000.

<sup>a</sup>Amounts included under this heading only include changes in revenues associated with the nontax provisions of H.R. 940. The staff of the Joint Committee on Taxation expects that the tax provisions of H.R. 940 would probably decrease revenues; however, the legislative language requires further specification before the revenue effect can be estimated.

**Basis of estimate:** CBO estimates that enacting H.R. 940 would increase federal deficits by \$35 million over the 2012–2022 period. Most of those estimated net costs would result from the legislation's effect on the Orderly Liquidation Fund (OLF) of the FDIC, which was established by the Congress in 2010 to liquidate certain large financial institutions. CBO also estimates that the SEC would spend an additional \$10 million over the 2012–2017 period and \$20 million over the 2012–2022 period, assuming appropriation of the necessary amounts.

For this estimate, CBO assumes that H.R. 940 will be enacted during fiscal year 2012, that fees will be levied on issuers of covered bonds to cover the administrative expenses of federal regulatory agencies and to pay for establishing a covered bond registry (as authorized by the bill), and that amounts estimated to be necessary for discretionary expenses of the SEC will be provided for each year.

### *Background*

Covered bonds share some similarities with other means of financing, such as unsecured debt and asset-backed securities. Each allow the issuer to raise funds for lending or other purposes and to repay investors from general cash flows. However, covered bonds have some unique features:

- The securing collateral (that is, the asset pool) must be continually refreshed if an asset becomes delinquent or does not otherwise meet qualifying criteria (unlike other asset-backed securities that are secured by a fixed group of assets that does not change); and,
- If the issuer of a covered bond were to default, investors would have dual recourse against both a fixed pool of assets

that would be unavailable to other creditors and other assets of the issuer. (This is unlike unsecured debt and asset-backed securities where investors have recourse against the general assets of the issuer or a fixed pool of assets, respectively, but not both.)

*Effect of H.R. 940 on the issuance of covered bonds*

CBO expects that enacting H.R. 940 would lead to an increase in the issuance of covered bonds because the bill would mitigate investor uncertainty in the case of default. Under current law, if a covered bond issuer is placed into receivership or conservatorship of the FDIC, the agency has the option to terminate future payments and instead pay investors up to the par value of the bond plus accrued interest. This option is available even if cash flows of the underlying collateral are sufficient to sustain continued payments to investors. Even in cases where full par value plus accrued interest is paid, this treatment increases the risk to investors that future returns may not be as great as if bond payments were continued. H.R. 940 would mitigate this reinvestment risk by requiring that the entire collateral pool of a covered bond be transferred to a separate estate in the event that an issuer is placed into receivership or conservatorship. This would prevent the FDIC from terminating bond payments early, thus making covered bonds more attractive to investors.

While CBO expects that enacting H.R. 940 would increase the use of covered bonds by financial institutions, the additional volume over the next 10 years would probably be small for several reasons. First, increases in deposits, slow economic growth, and low demand for lending have reduced the need for bank borrowing in the near term. Second, given the higher level of risk retained by issuers of covered bonds compared to other forms of financing (for example, securitization), additional regulatory capital would need to be maintained. Third, alternative sources of secured financing (most notably, advances from Federal Home Loan Banks) would continue to have advantages over covered bonds, particularly for small banks. Fourth, banks and investors in the United States would likely take a cautious approach until they have become more familiar with the product. Finally, H.R. 940 would allow the federal regulatory agencies to place a cap on outstanding issuances (which CBO assumes would be at or near 4 percent of an institution's liabilities based on current policy).

Considering those factors as well as historical data on the funding sources used by banks, CBO estimates that issuances of covered bonds would increase to between 1 percent to 2 percent of the projected liabilities of insured depository institutions. However, given the variety of factors that influence the financing decisions of institutions, the precise impact of this legislation on the use of covered bonds is uncertain.

*Direct spending and revenues*

H.R. 940 would lead to an increase in the net costs of the FDIC by reducing the value of assets the agency could sell as receiver or conservator of a financial institution. Under current law, the FDIC may sell or transfer the assets of a failed or insolvent institution to offset agency costs (including payments made to insured depositors if necessary). In some cases, the asset pool securing a covered

bond would carry a higher value than the par value of the bond plus accrued interest. By requiring that the entire collateral pool of a covered bond (including its excess value) be transferred to a separate estate in the event of a receivership or conservatorship, the legislation would prevent the FDIC from exercising the option of terminating future bond payments (and paying investors par value plus accrued interest) and retaining the excess value. The loss of this excess value would represent an additional cost to the FDIC (mostly in the OLF—although the Deposit Insurance Fund or DIF would also suffer additional losses). CBO estimates that loss at about \$50 million over the 2012–2022 period. By comparison, CBO estimates that spending from the OLF, net of recoveries, will total roughly \$30 billion over the same period under current law.

Under current law, the FDIC has the authority to recoup losses by increasing premiums on insured depository institutions and levying assessments on large financial institutions. In the case of the DIF, once empirical data became available, the FDIC would probably adjust premiums paid by insured institutions to offset any additional losses attributable to covered bonds, similar to current policy for brokered deposits. Thus, by the end of the 10-year period, the net effect of this legislation on the DIF would probably be minimal or zero on an annualized basis. In the case of the OLF, however, assessments would occur for multiple years beyond any additional spending and, in some cases, would not be collected until well outside of the 10-year period covered by this estimate. Because of this timing lag, CBO estimates that enacting H.R.940 would increase federal deficits over the next 10 years.

In addition to timing effects, assessments that would be levied to offset additional losses to the OLF under the bill would become an additional business expense for companies required to pay them. Those additional expenses would result in decreases in taxable income elsewhere in the economy, which would produce a loss of government revenue from payroll and income taxes (estimated to be about 25 percent) that would partially offset the revenues collected from the assessment itself.

Relative to CBO's baseline projections for the FDIC, H.R. 940 would increase federal deficits by \$35 million over the 2012–2022 period. This estimate of additional outlays and revenues stemming from the bill was done on a probabilistic basis. Following the default of some covered bonds, additional outlays and revenues probably would be much higher under the bill (particularly, if the issuer was a systemically important financial institution); however, in other periods where such an event does not occur, the effect on the federal deficit would be zero. We estimate that provisions affecting other banking agencies, such as the Office of the Comptroller of the Currency and the Federal Reserve, would have a negligible effect on net direct spending and revenues.

#### *Spending subject to appropriation*

Based on information from the SEC, CBO estimates that implementing this legislation would increase SEC costs by about \$2 million a year, adjusted annually for inflation. Thus, we estimate that implementing H.R. 940 would increase discretionary spending by about \$10 million over the 2012–2017 period, assuming appropriation of the necessary amounts.

Pay-As-You-Go considerations: The Statutory Pay-As-You-Go Act of 2010 establishes budget-reporting and enforcement procedures for legislation affecting direct spending or revenues. The net changes in outlays and revenues that are subject to those pay-as-you-go procedures are shown in the following table.

CBO ESTIMATE OF PAY-AS-YOU-GO EFFECTS FOR H.R. 940 AS ORDERED REPORTED BY THE HOUSE COMMITTEE ON FINANCIAL SERVICES ON JUNE 22, 2011

	By fiscal year, in millions of dollars—												
	2012	2013	2014	2015	2016	017	2018	2019	2020	2021	2022	2012–2017	2012–2022
NET INCREASE IN THE DEFICIT													
Statutory Pay-As-You-Go Impact .....	0	0	1	3	3	4	4	5	5	5	5	11	35

Estimated impact on state, local, and tribal governments: H.R. 940 contains no intergovernmental mandates as defined UMRA and would not affect the budgets of state, local, or tribal governments.

Estimated impact on the private sector: The bill contains a private-sector mandate, as defined in UMRA, on financial institutions because they would be required to pay additional fees or deposit insurance premiums to offset the costs to the FDIC associated with the covered bond program under the bill. The incremental increase in fees or insurance premiums would depend on the number and value of covered bonds issued. CBO estimates that, under this bill, the use of covered bonds would cause the FDIC to increase fees or insurance premiums by a total of about \$5 million over the first five years that the mandate would be in effect. Thus, the cost of the mandate would fall well below the annual threshold for private-sector mandates (\$146 million in 2012, adjusted annually for inflation).

Estimate prepared by: Federal costs: Daniel Hoople (banking agencies), Barbara Edwards (Federal Reserve), and Susan Willie (Securities and Exchange Commission); Impact on state, local, and tribal governments: Elizabeth Cove Delisle; Impact on the private sector: Paige Piper/Bach.

Estimate approved by: Theresa Gullo, Deputy Assistant Director for Budget Analysis.

#### FEDERAL MANDATES STATEMENT

The Committee adopts as its own the estimate of Federal mandates prepared by the Director of the Congressional Budget Office pursuant to section 423 of the Unfunded Mandates Reform Act.

#### ADVISORY COMMITTEE STATEMENT

No advisory committees within the meaning of section 5(b) of the Federal Advisory Committee Act were created by this legislation.

#### APPLICABILITY TO LEGISLATIVE BRANCH

The Committee finds that the legislation does not relate to the terms and conditions of employment or access to public services or accommodations within the meaning of the section 102(b)(3) of the Congressional Accountability Act.

## EARMARK IDENTIFICATION

H.R. 940 does not contain any congressional earmarks, limited tax benefits, or limited tariff benefits as defined in clause 9 of rule XXI.

## SECTION-BY-SECTION ANALYSIS OF THE LEGISLATION

*Section 1. Short title*

This section provides a short title which may be cited as the “United States Covered Bond Act of 2011.”

*Section 2. Definitions*

This section contains various definitions used in the Act, including those for “covered bonds,” “eligible issuers,” “eligible assets,” and “covered bond regulators.”

*Section 3. Regulatory oversight of covered bond programs established*

This section directs the Secretary of the Treasury, in consultation with the covered bond regulators, to issue regulations establishing a covered bond regulatory oversight program and to establish minimum over-collateralization requirements for covered bonds backed by each of the different eligible asset classes. The Secretary of the Treasury is also required to maintain a public registry of approved covered bond programs.

This section authorizes each covered bond regulator to (1) approve the covered bond programs of eligible issuers under its primary supervision; (2) prohibit the additional issuance of covered bonds by an issuer if the issuer is not complying with the requirements of the Act or the directives of the covered bond regulator; (3) set a cap on covered bond issuance, consistent with safety and soundness considerations, for each issuer as a percentage of the issuer’s total assets; and (4) levy fees on covered bond issuers under the covered bond regulator’s primary supervision in order to cover the costs of administering the oversight program.

This section also requires each cover pool securing covered bonds to satisfy an asset coverage test that assesses whether the minimum over-collateralization requirements are met, and obligates the issuer and an independent asset monitor to confirm on a periodic basis whether the asset coverage test is satisfied. This section also establishes eligibility criteria for cover pools and recordkeeping obligations of eligible issuers.

*Section 4. Resolution upon default or insolvency*

This section establishes that—if a covered bond issuer defaults before the issuer enters conservatorship, receivership, liquidation, or bankruptcy—a separate estate is to be created that comprises the applicable cover pool, and the separate estate assumes liability for the covered bonds and any related obligations secured by that cover pool. The issuer is required to transfer applicable books, records, files, and other documents to the trustee of the estate or a designee of the trustee and, at the election of the trustee, to continue servicing the cover pool for 120 days.

This section also provides that if the FDIC is appointed as conservator or receiver for an issuer before a default on the issuer’s covered bonds results in the creation of a separate estate, the FDIC



has an exclusive right for one year to transfer the issuer's covered bond program to another eligible issuer. The FDIC must perform all monetary and nonmonetary obligations of the issuer until the FDIC completes the transfer of the covered bond program; the FDIC affirmatively elects to cease further performance; or the FDIC fails to perform or cure any default (other than the issuer's conservatorship or receivership).

This section creates a separate estate if another conservator, receiver, liquidator, or bankruptcy trustee is appointed for an issuer before a default on its covered bonds results in the creation of an estate. This section also creates a separate estate if the FDIC as conservator or receiver does not timely effect a transfer of the covered bond program to another eligible issuer; affirmatively elects to cease further performance; or fails to perform or cure any default. The separate estate comprises the applicable cover pool and assumes liability for the covered bonds and any related obligations secured by that cover pool. The conservator, receiver, liquidating agent, or bankruptcy court is required to estimate and allow any contingent deficiency claim against the issuer. The conservator, receiver, liquidating agent, or bankruptcy trustee is required to transfer applicable books, records, files, and other documents to the trustee of the estate or a designee of the trustee and, at the election of the trustee, to continue servicing the cover pool for 120 days.

This section also preserves the investors' deficiency claims against the issuer, and provides the issuer, conservator, receiver, liquidating agent, or bankruptcy trustee with a residual interest that represents the right to any surplus from the cover pool.

This section requires the applicable covered bond regulator to appoint the trustee of the estate and to appoint and supervise a servicer or administrator for the cover pool held by the estate. The covered bond regulator is also given the authority to remove and replace any trustee, servicer, or administrator. The trustee is required to administer the estate and the servicer or administrator is required to collect, realize on, and manage the cover pool and to invest the proceeds. The servicer or administrator is authorized to borrow funds or otherwise obtain credit for the benefit of the estate on a secured or unsecured basis and on a priority, *pari passu*, or subordinated basis. The estate is required to make distributions in order to make required payments on the covered bonds and to satisfy other liabilities of the estate. Once the estate is fully administered, the trustee is required to close the estate.

This section also limits judicial, administrative, and other actions that may be brought against the estate or that would affect its resolution; requires a study by the Government Accountability Office on whether estates should be authorized to borrow from a Federal Reserve Bank to manage liquidity (though not credit) risks and, if so, on what conditions; and makes clear that taxpayers will not bear any loss from the resolution of an estate.

#### *Section 5. Securities law provisions*

This section clarifies that covered bonds are securities but not asset-backed securities. This section also creates exemptions for the separate estates and residual interests.

*Section 6. Miscellaneous provisions*

This section expands the Secondary Mortgage Market Enhancement Act of 1984 to encompass covered bonds.

This section also provides that an estate is not a taxable entity and that a transfer of assets or liabilities to an estate is not a taxable event under the Internal Revenue Code and, to the extent provided by the Secretary, under state and local income-tax laws. The acquisition of a covered bond is treated as the acquisition of an investment security, and not as a lending transaction, under the Internal Revenue Code.

This section also provides that covered bonds backed by the residential mortgage asset class or the commercial mortgage asset class are to be considered qualified mortgages for Real Estate Mortgage Investment Conduits (REMICs) and, to the extent provided by the Secretary of the Treasury, to be treated as real estate assets in the same manner as REMIC regular interests.

This section provides that other bankruptcy or insolvency laws may not be construed or applied to interfere with the operation of the Act.

This section also requires the covered bond regulators to report to and testify before Congress annually on the state of the U.S. covered bond market.

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

**SECTION 106 OF THE SECONDARY MORTGAGE MARKET ENHANCEMENT ACT OF 1984**

PREEMPTION OF STATE LAW

SEC. 106. (a)(1) Any person, trust, corporation, partnership, association, business trust, or business entity created pursuant to or existing under the laws of the United States or any State shall be authorized to purchase, hold, and invest in securities that are—

(A) \* \* \*

\* \* \* \* \*

(C) small business related securities (as defined in section 3(a)(53) of the Securities Exchange Act of 1934), **[or]**

(D) securities issued or guaranteed by the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association, *or*

(E) *covered bonds (as defined in section 2 of the United States Covered Bond Act of 2011),*

\* \* \* \* \*

---

**INTERNAL REVENUE CODE OF 1986**

\* \* \* \* \*

**Subtitle A—Income Taxes**

\* \* \* \* \*

**CHAPTER 1—NORMAL TAXES AND SURTAXES**

\* \* \* \* \*

**Subchapter M—Regulated Investment Companies  
and Real Estate Investment Trusts**

\* \* \* \* \*

**PART IV—REAL ESTATE MORTGAGE INVESTMENT  
CONDUITS**

\* \* \* \* \*

**SEC. 860G. OTHER DEFINITIONS AND SPECIAL RULES.**

(a) **DEFINITIONS.**—For purposes of this part—

(1) \* \* \*

\* \* \* \* \*

(3) **QUALIFIED MORTGAGE.**—The term “qualified mortgage” means—

(A) \* \* \*

(B) any qualified replacement mortgage, **[and]**

(C) any regular interest in another REMIC transferred to the REMIC on the startup day in exchange for regular or residual interests in the REMIC~~[.]~~, *and*

(D) *covered bonds that are secured by eligible assets from the residential mortgage asset class or the commercial mortgage asset class, as such terms are defined in section 2 of the United States Covered Bond Act of 2011.*

For purposes of subparagraph (A), any obligation secured by stock held by a person as a tenant-stockholder (as defined in section 216) in a cooperative housing corporation (as so defined) shall be treated as secured by an interest in real property. For purposes of subparagraph (A), any obligation originated by the United States or any State (or any political subdivision, agency, or instrumentality of the United States or any State) shall be treated as principally secured by an interest in real property if more than 50 percent of such obligations which are transferred to, or purchased by, the REMIC are principally secured by an interest in real property (determined without regard to this sentence).

\* \* \* \* \*

## MINORITY VIEWS

There is a bipartisan consensus that covered bonds represent a potentially useful component of a reformed housing finance market. Experience has shown us, however, that this is an area in which great care must be exercised in establishing such a market. Our view is that, before this bill comes to the House, we should add amendments supported by the FDIC that would provide the authority it needs both before and after a bank fails.

Before a bank fails, the FDIC is not empowered to prevent covered bond programs from destabilizing the institutions that use them or to reduce excessive risk to the FDIC Deposit Insurance Fund. As the FDIC learned in connection with the failure of Washington Mutual, a covered bond program with no limits on size or amount of overcollateralization can quickly become a liquidity drain on the sponsoring institution at a time that it can least afford it.

After a bank fails, the FDIC under H.R. 940 would have no authority to re-capture any of a covered bond program's overcollateralization, no matter how large. Unlike the treatment of other secured lending, the FDIC would not be permitted to repudiate a program and pay off the bonds, even with interest to the date of payment. This would subject the FDIC to a waiting period of many years before the value of any overcollateralization could be re-captured. No other secured creditor has this right. H.R. 940 effectively shields covered bond investors from the risk of loss by giving them superior rights in a receivership ahead of the FDIC.

We believe additional work is needed to create a sound regulatory scheme and provide adequate resolution authority to ensure that a new covered bond market is on solid footing.

BARNEY FRANK.  
EMANUEL CLEAVER.  
GARY L. ACKERMAN.  
ANDRÉ CARSON.  
LUIS V. GUTIERREZ.  
WM. LACY CLAY.  
BRAD MILLER.  
MICHAEL E. CAPUANO.  
MAXINE WATERS.  
STEPHEN F. LYNCH.  
CAROLYN B. MALONEY.  
RUBÉN HINOJOSA.  
MELVIN L. WATT.  
GWEN MOORE.