

Statement of
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Chief Counsel
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Committee on Banking, Housing, and Urban Affairs
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Chairman Dodd, Ranking Member Shelby, and members of the Committee, my name is Julie Williams and I am Chief Counsel and First Senior Deputy Comptroller of the Office of the Comptroller of the Currency (OCC). The OCC appreciates the opportunity to testify today regarding the potential of covered bonds as a new funding mechanism for financial institutions, and the issues presented in designing a covered bond legislative framework.

Covered bonds are a promising funding option for financial institutions. They could serve as an alternative to securitization and other current funding techniques, and could be a new source of funds for lending and an alternative source of liquidity.

For the banking system, covered bonds could provide a funding source that is longer-term and more stable, and potentially less expensive than currently available alternatives. The structure of covered bonds might require less collateral, and may also accommodate a broader range of types of collateral than current options.

Covered bonds also may attract types of investors that would not otherwise invest in bank debt. Institutions also have a strong incentive to maintain prudent underwriting standards for loans in a covered bond collateral pool because those loans remain on the institution's books.

That said, a complex combination of factors will determine the relative attraction of covered bonds, compared to alternative funding sources. Because covered bonds remain on an institution's balance sheet, the institution must hold more capital than typically required if the same assets were securitized. Thus, capital requirements could constrain the growth of covered bonds.

And, new accounting rules, upcoming changes in capital requirements, and the "skin-in-the-game" provisions in the Dodd-Frank Act, are all factors that could affect the relative advantages and disadvantages of covered bonds versus other funding alternatives.

The legal framework for covered bonds in the U.S. also will be a key factor in whether covered bonds flourish. Various legislative efforts have emerged recently to provide enhanced legal certainty regarding the elements of a covered bond regime in the U.S.

My written testimony provides detail on the issues that we suggest Congress consider in designing a legislative framework for covered bonds. We also offer some suggestions on how those issues could be addressed.

I will summarize those points.

First: What type of entity is eligible to issue covered bonds? We believe that limiting eligible issuers to entities already subject to federal supervision will ensure that dedicated financial supervisors can monitor and control the growth of covered bond programs, react to emerging issues, and promote safe and sound programs in the institutions they oversee.

Second: What agency or agencies are appropriate to regulate U.S. issuers and programs? We support a framework where federal financial regulators, operating under a single uniform set of standards, are designated as the covered bond regulators for their respective regulated entities.

Third: What types of assets should be eligible to collateralize the covered bonds? We suggest that a new covered bond program start with a relatively conservative scope, with regulators authorized to expand the eligible asset classes as more experience is gained with covered bond programs.

Fourth: What specific standards should be applicable to covered bonds and covered bond issuers? These could include, for instance, minimum eligibility criteria by asset class, limits on the size of issuances, and overcollateralization standards.

Here, legislation could provide direction on key issue areas and charge regulators with adopting the detailed standards to implement those directions.

Fifth: What are the consequences of a default of a covered bond issuance or the failure of a covered bond issuer? How a U.S. legal framework resolves how a cover pool is treated in the event of a default or insolvency of a covered bond issuer, and the role of the FDIC, will critically affect the appeal of covered bonds to investors.

And lastly: What reporting and securities disclosure standards should apply to covered bonds? We support transparency and availability of information to investors as important components of a comprehensive covered bond regime.

I appreciate the opportunity to appear today to discuss these issues, and I would be happy to answer any questions.

Thank you.