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Covered Bond Bill Gains the Attention of the Senate

A companion bill to the "U.S. Covered Bonds Act of 2011" (the "Act"),[1] which was introduced earlier this year in the U.S. House of Representatives, was recently introduced in the U.S. Senate.[2] While the Senate bill largely mirrors the House bill as approved by the House Financial Services Committee, there are several key differences. This *DechertOnPoint* summarizes those differences.

Covered Bond Act Definitions

The Senate bill incorporates the following revisions into the definitions section of the Act:

- Two additional types of entities have been added to the definition of "Eligible Issuers," namely (i) any broker or dealer registered under Section 15 of the Securities Exchange Act of 1934, as amended (the "1934 Act"), that is a member of the Securities Investor Protection Corporation and (ii) any insurer that is supervised by a state insurance regulator.[3]

1 For a description of the amended Act that was introduced into the House, see our two *DechetOnPoints* entitled "Reform for the Covered Bond Industry on the Horizon" and "Update Regarding United States Covered Bond Act."

2 United States Covered Bond Act of 2011 (S. 1835), *available at* http://www.hagan.senate.gov/files/111109_CoveredBond_BillText.pdf.

3 This addition was likely made to acknowledge that these two types of entities have become increasingly significant intermediaries in the commercial and multifamily mortgage markets.

- The definition of "Covered Bond" has been modified to eliminate programs that would have previously qualified solely on the basis of issuing several tranches of securities based on a single cover pool.

- Overnight investments in federal funds have been eliminated as qualifying substitute assets.

- The "Covered Bond Regulator" for issuers not subject to the jurisdiction of an appropriate federal banking authority has been changed from the U.S. Department of the Treasury to the Board of Governors of the Federal Reserve System.[4]

Independent Asset Monitor Removal and Replacement

The Senate bill also incorporates a provision permitting the independent asset monitor for a cover pool, which is appointed by the issuer pursuant to the Act, to be removed and replaced by the covered bond regulator for the issuer or by the owners of a majority of the outstanding principal amount of the covered bonds secured by the applicable cover pool.

4 This revision was likely made to address Federal Deposit Insurance Corporation ("FDIC") concerns regarding the assignment of this role to an entity that is not a prudential regulator.

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Securities Laws Provisions

The Senate bill further revises the House bill by adding a provision that no covered bond that has been issued or guaranteed by a bank or issued by an entity that has been sponsored by one or more banks for the sole purpose of issuing covered bonds shall be treated as a structured finance product (as defined in section 939F of the Dodd-Frank Wall Street Reform and Consumer Protection Act) and thereby exempts such covered bonds from the regulatory provision relating to structured finance products. Additionally, securities law provisions have been modified to make clear that exemptions from state and federal securities laws for estates created under the Act shall not extend to the anti-fraud provisions of such securities laws.

Miscellaneous Provisions

The Senate bill also eliminates the provisions of the House version of the Act that addressed certain tax implications[5] by amending the Secondary Mortgage Market Enhancement Act of 1984, as amended. There have been reports that these provisions were deleted in order to avoid review of the bill by the Senate Committee on Finance.[6]

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5 The tax provisions of the House bill permit disregarded entity treatment for a separate bankruptcy estate created as a result of (i) a default under a covered bond program prior to the appointment of the FDIC as conservator or receiver of an issuer in a covered bond program, (ii) the appointment of someone other than the FDIC as conservator, liquidating agent, trustee in bankruptcy or receiver of an issuer in a covered bond program or (iii) the incomplete transfer of the applicable covered bond program within one year of the appointment of the FDIC as conservator or receiver. Additionally, the tax provisions of the House bill allow for (i) covered bonds to be treated as real estate assets in the same manner as a regular interest in a REMIC for purposes of Section 856(c)(5)(E) of the Internal Revenue Code of 1986, as amended (the "Code"); (ii) nonrecognition of gain or loss upon transfers in relation to bankruptcy estates created as a result of default but prior to conservatorship or receivership and bankruptcy estates created as a result of default upon conservatorship or receivership and (iii) acquisitions of covered bonds to be treated as the acquisition of an investment security (instead of the acquisition of an interest in a loan) for the purposes of determining the character of any related trade or business activity of the acquirer or any asset held by the acquirer under the Code.

6 A final vote on the House bill has been delayed by the requirement in the House that the Ways and Means Committee review the tax implications of the proposed amendments.

Conclusion

The introduction of the companion bill indicates the continued interest of legislators to regulate the covered bond market in an effort to revive private residential mortgage lending and to strengthen the U.S. economy generally. Senator Kay Hagan (D-NC), one of the sponsors of the Senate bill, stated that "[w]ith a legislative framework in place, U.S. financial institutions will have a powerful tool that can be used to fund loans to small businesses and households. This bill would level the playing field for U.S. financial institutions and help strengthen our U.S. economy." Similarly, Senator Charles Schumer (D-NY), another Senate sponsor, said that "[w]ith the housing market still struggling to recover, covered bonds are a common sense solution that can help bring private capital back into the housing market. Developing a U.S. covered bond market will also allow more U.S. investors to put their money to work supporting the American economy, rather than investing in covered bonds elsewhere, which they are doing now."[7]

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7 *Senators Introduce Bipartisan Bill to Support U.S. Covered Bond Market, available at* http://corker.senate.gov/public/index.cfm?p=News&ContentRecord_id=badf0565-8e33-4896-ba36-b126d4cd667a.

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