STANDARD & POOR'S

Criteria Report

FDIC TLGP Debt May Be Included As Defeasance Collateral In Rated U.S. CMBS Transactions

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This article addresses the principles of "credit quality," "operational and administrative risks," and "payment structure and cash flow mechanics" discussed in "Principles-Based Rating Methodology For Global Structured Finance Securities," published May 29, 2007. It also supplements the criteria described in "Standard & Poor's Defeasance Criteria for U.S. CMBS Transactions," published April 4, 2003. Both articles are available on RatingsDirect.

We have recently received a number of inquiries regarding the inclusion of debt guaranteed by the Federal Deposit Insurance Corp.'s (FDIC's) Temporary Liquidity Guarantee Program (TLGP) as defeasance collateral in U.S. commercial mortgage-backed securities (CMBS) transactions rated by Standard & Poor's Ratings Services.

Under the TLGP, the FDIC will guarantee senior unsecured debt (including noninterest-bearing deposits, commercial paper and promissory notes, federal funds, certificates of deposit, and other interbank deposits) issued by participating institutions between Oct. 14, 2008, and June 30, 2009. Under the TLGP, the FDIC guarantee will expire upon the earlier of the term of the debt or June 30, 2012.

Since the debt guaranteed under the TLGP is not a direct obligation of the FDIC, there could be obstacles regarding its inclusion as defeasance collateral in rated U.S. CMBS. If the institution issuing the TLGP debt defaults on its obligation to pay either interest or principal (including any balloon payments), the servicer, on behalf of the substitute borrower, must demand payment from the FDIC under the TLGP within 60 days. Delays associated with the demand process could interrupt timely payments of interest to certificateholders in CMBS transactions that have TLGP debt as defeasance collateral. Standard & Poor's will generally look to servicers of CMBS transactions with TLGP debt as defeasance collateral to mitigate this timing risk by advancing principal and interest payments on the substitute borrower's behalf if payments on the TLGP debt are delayed.

Standard & Poor's has determined that obligations covered by the TLGP may be included as defeasance collateral in U.S. CMBS transactions with 'AAA' tranches, provided that the following items are addressed:

- The debt is eligible under the TLGP;
- The servicer (and the trustee, if it serves as the backup advancing agent for the transaction) should waive its right to (i) collect interest on servicer advances made on behalf of substitute borrowers holding TLGP debt, and (ii) collect for trust expenses incurred in making demand on the FDIC;
- If the TLGP debt is to be used to satisfy a balloon payment, a reserve conforming to Standard & Poor's criteria for eligible accounts should be funded with a minimum of 90 days interest on the defeasance collateral to cover potential delays in receipt of the balloon payment;
- The TLGP debt should mature before June 30, 2012;
- The servicer's error and omissions insurance policy should cover losses to the CMBS trust caused by the servicer's failure to make timely demand on the FDIC's guarantee; and
- All other defeasance criteria are satisfied.

These criteria represent the specific application of fundamental principles that define credit risk and ratings opinions. Their use is determined by the issuer-specific or issue-specific facts, as well as Standard & Poor's assessment of the credit and, if applicable, structural risks for a given issuer or issue rating. Methodology and assumptions change from time to time as a result of market and economic conditions, issue specific or issuer-specific factors, or new empirical evidence that would affect our credit judgment.

Related Articles

- "Standard & Poor's Defeasance Criteria for U.S. CMBS Transactions," published April 4, 2003.
- "U.S. CMBS Legal And Structured Finance Criteria," published May 1, 2003.
- "U.S. Guarantees of Bank Debt Under Interim Rules Do Not Promise Timely Payment," published Nov. 10, 2008.
- "The Impact of FDIC TLGP Securities On Rated Money-Market Funds," published Dec. 5, 2008.