October 30, 2013

SUBMITTED ELECTRONICALLY

Department of the Treasury
Office of the Comptroller of the Currency
Legislative and Regulatory Activities Division
400 7th Street, SW, Suite 3E-218
Mail Stop 9W-11
Washington, DC 20219
Docket Number OCC-2013-0010
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Securities and Exchange Commission
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Washington, DC 20549-1090
Attn.: Elizabeth M. Murphy, Secretary
File Number S7-14-11
RIN 3235-AK96

Board of Governors of the Federal Reserve System
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Washington, DC 20551
Attn: Robert deV. Frierson, Secretary
Docket No. R-1411
RIN 7100-AD70

Federal Housing Finance Agency
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Attn.: Alfred M. Pollard, General Counsel
RIN 2590-AA43

Federal Deposit Insurance Corporation
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Attn.: Comments, Robert E. Feldman, Executive Secretary
RIN 3064-AD74

Department of Housing and Urban Development
Regulations Division
Office of General Counsel
451 7th Street, SW, Room 10276
Washington, DC 20410-0500
RIN 2501-AD53

Re: <u>Credit Risk Retention; Re-Proposed Rule</u>

Ladies and Gentlemen:

The Securities Industry and Financial Markets Association ("SIFMA"),[1] the Financial Services Roundtable ("FSR"),[2] the American Bankers Association ("ABA")[3] and the ABA

[1] The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in

Securities Association ("ABASA")[4] are pleased to respond to the request for comment by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation (the "Banking Agencies"); the Securities and Exchange Commission (the "SEC" or the "Commission"); and the Federal Housing Finance Agency and the Department of Housing and Urban Development (collectively, the "Agencies")[5] on the Agencies' jointly re-proposed rules (together with the accompanying supplementary information, "Re-Proposing Release")[6] to implement the requirements of section 941(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"), as codified at Section 15G of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The Re-Proposing Release revises and re-proposes certain rules that originally were proposed in April 2011 (together with the accompanying supplementary information, the "Original Proposing Release").[7] SIFMA, FSR, ABA and ABASA provided extensive comments to the Agencies on the Proposing Release (the "Prior SIFMA Comment Letter," the "Prior FSR Comment Letter" and the "Prior ABA/ABASA Comment Letter," respectively, and together, the "Prior Comment Letters").

SIFMA is a diverse organization whose membership includes many of the largest and most significant participants in the United States capital markets. SIFMA's members and their affiliates include financial institutions that originate consumer and commercial loans of various types; financial institutions that sponsor securitization transactions; special-purpose companies that issue asset-backed securities ("ABS") and other structured finance products; broker-dealers that act as underwriters, placement agents or initial purchasers in offerings of structured finance products; and asset managers that include experienced investors in ABS. This letter reflects the considered views of SIFMA's member financial institutions that act as originators, as securitization sponsors or issuers, or as underwriters, placement agents or initial purchasers in securitization transactions (which we refer to for purposes of this letter as SIFMA's "originator,

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the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, please visit www.sifma.org.

[2] The mission of The Financial Services Roundtable is to protect and promote the economic vitality and integrity of its members and the United States financial system. For more information and a statement of our core values, please visit http://www.fsround.org/.

[3] The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $14 trillion banking industry and its 2 million employees. Learn more at www.aba.com.

[4] The ABA Securities Association is a separately chartered affiliate of ABA, representing those holding company members of ABA that are actively engaged in capital markets, investment banking and broker-dealer activities.

[5] When we refer to the "Agencies" in this letter, we refer to the appropriate Agencies having rulemaking authority with respect to any particular aspect of the proposed rules.

[6] Credit Risk Retention, 78 Fed. Reg. 78928 (Sept. 20, 2013).

[7] Credit Risk Retention, 76 Fed. Reg. 24090 (April 29, 2011).

sponsor and dealer members"). The views of SIFMA's asset manager and investor members are reflected in a letter that will be submitted separately.

As *advocates for a strong financial future*™, FSR represents 100 integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. FSR member companies provide fuel for America's economic engine, accounting directly for $98.4 trillion in managed assets, $1.1 trillion in revenue, and 2.4 million jobs.

ABA is the exclusive national representative of the collective interests of the almost 7,000 institutions in the FDIC-insured banking industry, and has strong member participation in every asset class. ABA advocates for banks of all sizes and charters, and for their customers and communities.

Throughout this letter, references to "we" and to "our" views are to the views of FSR, of ABA, of ABASA and of SIFMA's originator, sponsor and dealer members, and to their collective views regarding the re-proposed rules.

You were indeed assigned a daunting task under Section 941(b) of the Dodd-Frank Act, and we extend our appreciation to each of the Agencies for their diligent efforts to achieve the correct balance in these important new regulations. We also commend the Agencies for the care involved in responding to the mandates of the Dodd-Frank Act and for your consideration of comments submitted on the Proposing Release.

Although we continue to believe that in important ways the re-proposed rules should be revised to address the positions we set forth in this letter, we appreciate and support many aspects of the re-proposed rules. In particular, we strongly support the following features of the re-proposed rules: (1) the ability of sponsors to customize risk retention through any combination of vertical and horizontal interests; (2) differing rules for differing types of asset-backed securities; (3) removing the premium capture cash reserve account requirement; (4) harmonizing the definition of "qualified residential mortgage" in the re-proposed rules with the definition of "qualified mortgage" from Section 129C of the Truth in Lending Act; and (5) setting the maximum required retained risk at five percent (5%). In light of this, our letter focuses on recommendations that we believe would improve the re-proposed rules, while allowing asset securitization markets to continue to provide access to cost-effective credit to individuals and companies, and important capital markets investment alternatives for investors.

We appreciate your consideration of our views, and we are most eager to make the respective staffs of SIFMA, FSR, ABA and ABASA, as well as representatives of our respective members, available to discuss any of the issues raised in this letter at a time and place that would be convenient for you.

Introduction and Executive Summary

We greatly appreciate the changes that the Agencies have made in response to all of the comments received on the original proposals. In many respects, the re-proposed rules are dramatically clearer and more workable than the originally proposed rules were. Many of our comments represent our collective efforts to continue this process, by providing specific suggestions that will further clarify and enhance the real-world functioning of the credit risk retention process.

As we have noted in our Prior Comment Letters, there remain areas where the re-proposed rules would, in our view, fundamentally reshape portions of the securitization markets and impose significant economic costs on securitizers, consumers, and the credit markets as a whole. We remain concerned that, in some cases, the impact would be detrimental to the broader economy. Therefore, the wide-ranging effects of this rulemaking continue to demand extremely careful economic and public policy analysis and consideration. It is important that the costs of compliance with the re-proposed risk retention rules be compared to and balanced with the expected benefits. The potential benefit to borrowers (both individual and commercial) from improvements to lending standards is clear, but this benefit should be balanced against the cost. In this light, some of our comments also focus on the significant impacts we expect if certain portions of the rules are adopted as re-proposed. In our view, if the final rules are to serve their intended purpose and not cause undue harm, it is crucial that the Agencies take these concerns into account.

Our comments begin with a variety of *general topics* that apply across asset classes and transaction types:

- <u>The proposed restrictions on payment for an eligible horizontal interest should be eliminated, or at least revised to accommodate economic reality and common securitization structures</u>. The proposed payment limitations do not work for many structures, and upend the normal economics of the residual structure. We recommend that these limitations be eliminated. Alternatively, we believe that sponsors should be able to choose either the proposed projected method or the alternatively proposed actual method, and also should be able to choose whether to limit principal payments on the residual in comparison to principal payments on the more senior ABS interests, or to

limit all payments on the residual in comparison to all payments on the more senior ABS interests.

- We support fair value for horizontal risk retention, but the related disclosure should not be required to be provided to investors, and the timing of calculation presents several irreconcilable conflicts. We do not believe that the proposed detailed disclosures are material to an investor, and they could allow the reverse-engineering of proprietary models. They should not be required to be disclosed to investors, though we do not object to a requirement that they be provided to a sponsor's primary regulator. The proposed timing of the calculation creates several significant technical problems that need to be addressed in the final rules.

- It is not necessary to use fair value for vertical risk retention. Basing the sponsor's required retention of each class of ABS interests on fair value adds a needless complication. The same result can be obtained by simply providing that the sponsor must retain 5 percent of each class of ABS interests.

- The amount of vertical risk retention should not be required to exceed the amount that would be required under the horizontal option.

- There should be a streamlined and consistent procedure for obtaining interpretation and guidance. We remain concerned that the re-proposed approach will create significant uncertainty and difficulty.

- Participation interests and representative sampling should be permitted methods of risk retention. It is unclear to us why the Agencies did not include some version of several commenters' proposals for a participation interests approach, and we disagree with the deletion of the representative sample option, particularly for automobile loan securitizations. These options would perfectly align the incentives of sponsors and investors.

- There should be no minimum risk retention requirement for blended pools.

- Legacy assets should be exempt from risk retention. If not, large pools of legacy assets will no longer be able to be securitized economically.

- Unfunded forms of credit risk retention should be permitted. Unfunded forms of retention by the sponsor such as letters of credit, surety bonds and guarantees are no less real than funded forms, and expose the sponsor to genuine credit risk.

- Asset-level and pool-level insurance should be exempted from the restrictions on transfer and hedging. A sponsor should not have to carve its retained interests out of asset-level and pool-level insurance policies. These long-standing techniques, which benefit all holders of securitization interests equally, do not change the relative distribution of risk.

- Multiple sponsors should be permitted to allocate risk retention among themselves. We believe that this change would enhance liquidity without in any way harming the goals of risk retention.

- Sponsors should be permitted to allocate risk retention to originators without any minimum permitted restriction, where appropriate. Allocation of credit risk to originators is the most direct way to influence the credit quality of financial assets, so the use of this option should be encouraged more strongly.

- Non-economic REMIC residual interests should be excluded from the definition of "ABS interest". Inclusion of these specialized interests, which are required in many RMBS and CMBS transactions, would create undesirable complications, including reducing the calculated fair value of all ABS interests in a transaction.

With regard to *residential mortgages* and the definition of "*qualified residential mortgage*":

- QM should be adopted as the standard for QRM, rather than QM-plus. QM is a meaningful standard for high quality loans. The characteristics of QM-plus, particularly the 70 percent LTV ratio, would exclude most borrowers from these loans. We believe the adoption of QM-plus would reduce the competitiveness of private mortgage originators and delay the transition of the housing finance system away from the GSEs.

- The requirement for a depositor certification regarding effectiveness of its internal controls is unnecessary and misleading. QRM status is a strict requirement of the exemption, and noncompliant loans must be promptly repurchased. The certification may be misleading to investors because compliance with internal controls 60 days before the cut-off date does not mean that there was compliance on the cut-off date. If the requirement must be retained, then the certificate should be provided only to regulators and not to investors.

- The seasoned loan criteria for residential mortgages should be revised to better reflect market consensus on loan quality. We support a flat 5 year standard, so long as the loan

has been outstanding and performing that entire time. Up to two 30-day delinquencies should be permitted, so long as the loan has been outstanding and performing for at least 5 years since the most recent such delinquency.

- The sunset period for RMBS transfer and hedging restrictions should be shortened. We support a flat 5 years after closing.

- The definition of "originator" should be broadened to address correspondent lending relationships. We believe that this is consistent with both industry practice and the language and intent of the Dodd-Frank Act.

- There should be a blended pool option for QRMs. The same policy arguments in favor of a blended pool option for other qualifying asset classes apply equally to QRMs. Adoption of this option is within the Agencies' broad exemptive powers under the Dodd-Frank Act.

- Where a credit investor acquires and finances mortgage assets through a securitization sponsored by a broker-dealer at its request, the credit investor should be permitted to retain the required risk. These securitizations are a tool to provide financing to the credit investor, who selects the collateral underlying the securitization and bears the economic risk in the assets. Therefore, the credit investor should be permitted to retain the required risk, so long as this choice is disclosed in the offering documents.

With regard to *commercial mortgage-backed securities* and the definition of "*qualifying commercial real estate loans*":

- We support CREFC's comment letter. The Commercial Real Estate Finance Council has submitted a comment letter addressing the concerns of the CMBS market in great detail. We support all of their recommendations.

- Multiple B-pieces should not need to be *pari passu*. Each eligible buyer would still retain meaningful risk and its incentives would be aligned with other investors. The holder of the most subordinated interest would still have the same strong incentive to perform complete and effective due diligence.

- Single creditor/single borrower CMBS transactions should be exempt from risk retention. These high-quality, simple and transparent transactions are more like direct loans, so there is no need for risk retention.

With regard to *resecuritization and repackaging transactions*:

- The resecuritization exemption should permit credit tranching and the issuance of multiple classes of ABS interests. Requiring credit risk retention for these investor-driven transactions would likely eviscerate the market, as banks would not be willing to take credit risk that belongs to their customers. If necessary, exempt resecuritizations could be subject to conditions that clearly distinguish them from managed-pool transactions such as CDOs – or failing that, limited to a single class of underlying ABS.

- The resecuritization exemption should permit resecuritization of legacy ABS where risk was not retained. If the vast pool of legacy assets cannot be resecuritized without credit risk retention, this important risk-mitigating tool for investors would become uneconomical.

- Resecuritizations of multiple classes of underlying ABS should be permitted, so long as the cash flows support different classes of new ABS. Regardless of whether multiple classes of ABS are permitted for credit tranching purposes, for cost and convenience purposes sponsors should be able to separately resecuritize multiple underlying classes of ABS in a single transaction.

- The Agencies should adopt an exemption for repackaging transactions. These very simple transactions are analogous to the single class pass-through resecuritizations that would already be permitted by the re-proposed rules.

With regard to *collateralized loan obligations* and the definition of "*qualifying commercial loan*":

- CLOs are different from, and do not present the same risks as, other types of ABS, and already contain elements of risk retention by their managers in their fee arrangements. CLOs are more like debt mutual funds with widely traded and market-priced assets. The fees structures for CLO managers already subject them to substantial risk, but many managers are not financially capable of funding a full 5 percent risk retention. If risk retention is to be required for CLOs, it should be in a manner that does not disrupt the markets.

- We support the LSTA's request for the rules to be modified to provide a workable, realistic exemption for CLOs and appropriate exemptions for qualified assets and structures. Because lenders have indicated that they will not be willing to originate and retain the "CLO eligible tranches" that would be required for the proposed open-market

CLO exemption, the re-proposal leaves CLOs without a workable option for risk retention. We urge the Agencies to consider the alternatives submitted by the Loan Syndications & Trading Association.

With regard to *asset-backed commercial paper conduits*:

- Current market practices for liquidity coverage and credit enhancement provide more than sufficient "skin in the game" in ABCP conduits. The ABCP method of risk retention should recognize partially-supported liquidity facilities as well as fully-supported liquidity facilities, so long as there is 100 percent liquidity coverage. The rules should permit liquidity coverage to be syndicated, so long as all lenders qualify as regulated liquidity providers.

- The types of assets that are permitted to collateralize ABCP conduits should be expanded to reflect market practices. ABCP conduits, like direct bank loans, finance many types of assets other than ABS. There is no reason to prohibit these ordinary course transactions.

- The proposed monitoring and disclosure requirements for ABCP conduit sponsors are burdensome and unnecessary. Because of the ever-changing asset base of ABCP conduits, providing all of the proposed information on a monthly basis would be extremely difficult, if not impossible. Current reporting practices are already robust.

- The tenor of ABCP should not be limited to 270 days. Other regulatory considerations are pushing average tenor out further. If an outside limit is needed, we suggest 397 days, consistent with Rule 2a-7 under the Investment Company Act of 1940.

- Legacy ABCP conduit assets should be grandfathered. Conduits have long term financing agreements with customers, many of which are revolving, and some financed assets themselves are very long term. It will not be possible to renegotiate all of these arrangements until they expire by their terms or are otherwise amended or extended.

With regard to securitizations of *automobile loans* and the definition of "*qualifying automobile loan*":

- Risk retention of a representative sample should remain an option. Adoption of a representative sample is key for the automobile industry, especially since the definition of "qualifying automobile loan" does not sufficiently reflect industry practice. The use of a representative sample, which is recognized by and consistent with the FDIC's

securitization safe harbor, preserves the ability to achieve sale accounting for transferred assets and is ideal for asset pools that are large and granular.

- We recommend several specific requirements for a representative sample option. For pools of 6,000 assets or greater, the statistical validity of the randomness of the representative sample is assured. Pools of fewer assets would require additional disclosure demonstrating the randomness of the sample.

- Risk retention options should include existing structures common in automobile ABS. Automobile ABS historically have performed well because of existing sound underwriting and risk retention practices, even during the economic downturn. Risk retention practices that are currently utilized for this asset class should be recognized by the risk retention rules, including significant overcollateralization, which creates a first-loss position.

- The criteria proposed for the definition of "qualifying automobile loan" are impractical and inconsistent with industry practice. This exemption would be useless, as virtually no loans made today would qualify. The proposed standards, which are more suited to unsecured installment loans, rely on information not available to prime and super prime automobile lenders. The cash down payment requirement is particularly out of step with the market, as is the lack of permitted reliance on credit scoring. The criteria should be expanded to include leases on the structural side, and motorcycles on the asset side.

With regard to securitizations of *credit card receivables* and *revolving master trusts*:

- The definition of "seller's interest" should be refined to reflect market practice. The allocation of distributions of principal is not done *pro rata* after the revolving period ends. Rather, there is a disproportionate allocation of principal collections to ABS interests that will be repaid from the distribution of principal collections. The Agencies' proposal for the definition of "seller's interest" is less protective of investors than current market practice, and should be revised to only be required to be *pari passu* during the revolving period. The Agencies also should consider permitting a seller's interest to be subordinated.

- The proposed pre-closing disclosure requirements should be modified to take account of the fluctuating nature of a seller's interest, and measurement dates thereafter should be at least monthly and should incorporate a reasonable cure period. It would be impossible to comply with the requirement to disclose the dollar amount of the seller's interest and the percentage of the ABS interests that it will represent on the closing. Sponsors should

disclose the dollar amount and percentage of ABS interests represented by the seller's interest within a reasonable time prior to the closing date, such as the immediately preceding measurement date specified in the transaction documents.

- Changes are required to the provisions permitting combined retention at trust and series levels in order to conform with existing structures. Neither the standard eligible horizontal risk retention option nor the specialized horizontal risk retention option, as proposed, presents a workable option for revolving master trusts. We make several specific suggestions that would transform these provisions into a more workable option. For example, the subordinated certificates utilized in legacy trusts should be considered a valid form of horizontal risk retention.

- We also request several other specific clarifications and adjustments. These requests are more technical in nature. For example, we propose revisions to the definition of "revolving master trust" and to the reference to "wholly-owned affiliates," in order to reflect more accurately reflect market practice.

- Because the re-proposed rules are inconsistent with existing revolving master trusts, a broad grandfathering provision is required. If the master trust option is not revised to take account of existing structures, there will be no viable option for compliance by existing revolving master trusts.

With regard to securitizations of *equipment loan*s and a proposed new definition of "*qualifying equipment loan*":

- A new qualifying asset category of "qualifying equipment loan" should be added. Equipment loan ABS are a distinct asset class that should not be confused with other types of commercial lending. Historically, equipment loan ABS have performed very well, due to the high quality of equipment loan underwriting. However, the re-proposed definition of "qualifying commercial loan" does not adequately reflect underwriting practices in this important market segment.

With regard to *securitizations of federally guaranteed student loans*:

- All FFELP student loans should be completely exempted from the risk retention requirements. FFELP loans are guaranteed at least 97 percent, and an asset pool that bears a federal guarantee at this level is far more protective of investors than even a 5 percent risk retention by the sponsor. These loans are no longer being originated, so risk

retention cannot affect asset quality. Other government guaranteed programs providing less credit protection are completely exempted.

And finally, with regard to *cross-border issues*:

- We support AFME's comment letter regarding cross-border issues. The letter of the Association for Financial Markets in Europe raises many important points, and we concur with AFME's views.

- A mutual recognition process is necessary to avoid irreconcilable jurisdictional conflicts. The EU regime is in many instances completely inconsistent with the Agencies' proposal, making cross-border offerings impossible. Without mutual recognition, the ability of European banks to participate in the U.S. securitization markets could be eliminated, impairing an important source of capital and liquidity. Mutual recognition, while difficult, is crucial to the proper functioning of cross-border markets.

- In the proposed safe harbor, the U.S. person limitation on investors should be eliminated in favor of mutual recognition – or substantially raised. The "U.S. person" limitation will be very difficult to enforce. While we believe mutual recognition is the proper solution, if some limit is required, we believe that 20 percent would provide a more appropriate margin for error.

- There should be a safe harbor for sales by U.S. entities modeled on Regulation S under the Securities Act. U.S. entities should be able to make overseas offerings without triggering U.S. risk retention, based on principles of comity and reasonable expectations in the global market. An exemption based on Regulation S would provide a flexible and workable boundary for when compliance with U.S. regulations is required.

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I. Comments That Apply to All Asset Classes and Transaction Types

Before we set forth our views on the applicability of the re-proposed rules to specific asset and transaction types, we will first address a variety of concerns that span these areas. Among the topics we address below are:

- The restrictions on payment for eligible horizontal residual interests, fair value calculations and disclosures;
- The procedures for obtaining regulatory guidance;
- Alternative forms of risk retention that we believe should be acceptable;
- A proposal for the exemption of legacy assets; and
- Allocation of risk retention among sponsors and between sponsors and originators.

A. The Restrictions on Payment for an Eligible Horizontal Residual Interest Should Be Eliminated, or at Least Revised to Accommodate Economic Reality and Common Securitization Structures

For risk retention held in the form of an eligible horizontal residual interest, the re-proposal would require any shortfall in funds available to pay principal or interest on a payment date be used to reduce amounts paid to the horizontal interest before reducing amounts paid to any other ABS interest (whether through loss allocation, priority of payments, or any other contractual provision) until the amount of all other ABS interests is reduced to zero. The re-proposal also would require that the residual have the most subordinated claim to payments of both principal and interest by the issuing entity. Further, the sponsor must, as of the closing date and using the same assumptions and discount rate used in its fair value calculation with respect to the horizontal interest:

- Determine the "closing date projected cash flow rate" by dividing the fair value of all projected cash flows to the horizontal interest on each payment date by the fair value of all projected cash flows to the horizontal interest through maturity;
- Determine the "closing date projected principal repayment rate" by dividing the amount of all projected principal cash flows to be paid to all ABS interests on each payment date by the aggregate principal amount of all ABS interests issued in the transaction; and

- Certify to investors that the closing date projected cash flow rate for each payment date does not exceed the closing date projected principal repayment rate for that payment date.

The Agencies also request comment on an alternative method of implementing payment restrictions on an eligible horizontal residual interest. Under this alternative, on any payment date, "the cumulative amount paid to an eligible horizontal residual interest [could] not exceed a proportionate share of the cumulative amount paid to all holders of ABS interests in the transaction."[8]

In assessing the feasibility of payment limitations on an eligible horizontal residual interest, we believe it is important to compare it to the economics of the residual interests[9] that exist in current securitization structures.

The Agencies' proposed approach simply does not work for securitization structures where the investors' entitlements to principal and interest are treated separately. For example, in some cases the holders of the ABS interests sold to investors are entitled to receive no, or limited, principal payments for a period of time. This might include, for example, a pass-through transaction where the asset pool contains primarily interest-only loans, so that investors may not receive principal until the refinancing or final due date of the pool loans. Another example is a transaction that accounts for principal collections differently than a straight pass-through, such as by diverting principal collections during a reinvestment period during which such collections are used to acquire additional pool assets rather than being passed through to investors.

In these structures, investors would continue to receive their coupon rates of interest, but because the closing date projected cash flow rate effectively could not exceed the closing date projected *principal* repayment rate for each payment date, the holder of the residual could receive nothing at all, possibly for a very long time. The purpose of this restriction is unclear. The cash flow belongs to the residual holder and ultimately will be paid to the residual holder. This provision will merely delay payment for no reason since the senior classes of ABS interests will have no claim or entitlement to the withheld amounts.

In any event, these payment restrictions upend the normal economics of the residual structure. The value of a residual interest is determined by the expectation that it will receive payments over time, whether in the form of interest or principal collections on the pool assets.

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[8] *Id.*, 78 Fed. Reg. at 57941.
[9] We refer to residual interests broadly here, rather than non-economic REMIC residual interests, which we do not believe should be considered ABS interests at all, as further discussed below in section I.M.

The more deeply subordinated (and therefore, riskier) an ABS interest is, the higher the effective interest rate generally would need to be to compensate the holder for taking that risk. As a result, interest payments to the residual holder would not only be expected not to be proportional to interest received by the more senior interests, but significantly inversely proportional. As proposed, they would get nothing for this risk until the more senior tranches are all paid off.

According to the Agencies, the proposed payment limitations are intended "to allow for sponsors to receive the upside from a transaction performing above expectations in a timely fashion."[10] In these transactions, the proposed payment limitations frustrate, rather than further, that goal.

Another unintended result of the proposed payment limitations would be to artificially increase the size of the required horizontal residual interest. If the holder of an eligible horizontal residual interest is not entitled to receive a return commensurate with the risk of the interest, that will decrease the fair value of the interest, requiring that it represent a significantly greater portion of the capital structure of the securitization in order to reach 5 percent of the fair value of all ABS interests issued.

For all of these reasons, we urge the Agencies to eliminate the proposed limitations on payments to the holder of an eligible horizontal residual interest. We recognize that allowing the holder of the residual to receive unlimited interest cash flows might result in the residual being paid faster than the investors' interests, but the economic and practical impediments generated by Agencies' proposal are almost insurmountable. We do not object to requiring the disclosure document to detail the expected cash flows on the residual interest, so investors will be able to make an informed investment decision as to whether to accept it in the context of their individual investment decisions.

If, notwithstanding all of the problems associated with the proposed payment limitations, the Agencies remain of the view that some limitation is necessary, we recommend that the Agencies modify the proposed payment limitation to address our concerns.

First, we suggest that the Agencies permit sponsors to use, at their option, either the proposed projected method of calculating the payment limitations on the eligible horizontal residual interest, or the alternative actual payment method on which the Agencies request comment.

[10] Re-Proposing Release, 78 Fed. Reg. at 57939.

Second, regardless of whether the sponsor uses the projected or actual payment, it should be permitted to calculate the payment limitation in one of two separate ways. The first optional way we recommend would be based on the Agencies' primary proposal, but instead of requiring a comparison of *all* cash flows cumulatively paid or to be paid on the residual as of any payment date to all *principal* cash flows cumulatively paid or to be paid on the other ABS interests, we would compare all *principal* cash flows cumulatively paid or to be paid on the residual as of any payment date to *principal* cash flows paid or to be paid on the other ABS interests. This would prohibit the eligible horizontal residual interest from being de-leveraged by means of principal payments proportionately faster than the investors are paid their principal. However, interest payments to the holder of the eligible horizontal residual interest would not be restricted, consistent with the notion that the more subordinated an interest is, the riskier it is, and the higher the effective interest rate should be to compensate the holder for that risk. Our second optional way should be consistent with the proposed alternative actual payment method, and would compare *all* amounts paid (or, in the projected method, to be paid) to the holder of the residual as of any payment date with *all* amounts paid (or, in the projected method, to be paid) to the holder of the holders of the other ABS interests.

In our view, the combination of these alternatives would work for more deal structures than any other approach we considered. We believe our suggested approach makes more economic sense than the Agencies' proposal, would not artificially inflate the size of the residual, and sufficiently addresses the Agencies' underlying concerns.

B. We Support Fair Value for Horizontal Risk Retention, but Related Disclosures Should Not Be Required to Be Provided to Investors, and the Timing of Calculation Presents Several Irreconcilable Conflicts

As re-proposed, the standard method of risk retention would be based on "fair value" under generally accepted accounting principles ("GAAP"). A sponsor retaining risk under this option would be required to provide a variety of disclosures, including a description of the methodology used to calculate fair value, the key inputs and assumptions used in measuring fair value, and the reference data set or other historical information used to develop those inputs and assumptions.

While we generally support the fair value approach – at least for eligible horizontal residual interests[11] – we would like to point out several problems and inconsistencies with the calculation and disclosure requirements that need to be addressed in the final rules.

[11] *See* our comments below regarding the lack of need for fair value calculations in the vertical risk retention method, in section I.C.

First, we do not believe that all of these disclosures should be required to be provided to investors. In general, we question the usefulness of these disclosures to investors. Fair value for an asset under GAAP is measured using the assumptions that a market participant would use in pricing the asset, and therefore could result in a range of values depending on the particular asset. As acknowledged by the Agencies, the result will depend on the assumptions and data used to generate the number. Investors likely will have their own ideas of fair value, and all of these specifics are unlikely to change those views or even substantially inform them. In our opinion, all that a reasonable investor should care about is that the sponsor used the appropriate accounting framework to develop its fair value standards, so that the amount of the sponsor's risk retention is consistent with the sponsor's view of fair value. We do not believe that details of the fair value calculations are material to a reasonable investor's decision whether to purchase the ABS being offered.

Also, requiring this level of detail in the disclosures – particularly, the reference data set – could allow the reverse-engineering of proprietary models. We are not completely clear on whether the Agencies intend for the reference data set to simply be identified in some way, or for all of the values in that set to be disclosed. In any event, the more detailed the disclosure that is required, the more of a risk to the proprietary nature of the sponsor's models.

We do not object to disclosure of these items to the sponsor's primary regulatory Agency, which we believe is better situated to address any compliance issues in this regard.

Second, there are irreconcilable issues with the proposed timing of the calculation of fair value. As proposed, fair value calculations – as well as the sizing of the retained interest, which depends on the fair value calculations – would be required to be made as of the closing date. The interest rates on and purchase prices of all of the ABS interests in the deal, which are dependent on pricing, need to be taken into account in determining fair value. Conversely, the timing of determination of fair value and the size of the residual must allow issuers sufficient time for issuers to prepare and make all required disclosures to investors, both as specifically required by the proposed risk retention rules and as may be otherwise required by Commission regulations or anti-fraud concerns. This implies that the determination needs to be made much earlier in the offering process. As a practical matter, it is not clear to us how these conflicts would be managed. For example, would the Agencies expect for a preliminary fair value and residual size to be calculated early in the offering process, and then for these numbers to be "trued up" at closing based on actual pricing data? In order to address liability concerns and the Commission's guidance surrounding Rule 159 under the Securities Act of 1933, as amended (the "Securities Act"), any resulting changes in the disclosed offering information that are material would require updated disclosure documents to be prepared, and for each investor agree to terminate its old contract of sale and agree to enter into a new one based on the new information,

including "a meaningful ability to elect to terminate or not terminate the prior contract and to elect to enter into or not enter into the new contract."[12] Requiring this process in every offering of ABS would be cumbersome at best and would introduce significant uncertainties and inefficiencies into the offering process. We request that the Agencies resolve these conflicts in the final rule release in a manner which does not introduce unneeded speed bumps into the offering process.

This conclusion reinforces our concerns about requiring any fair value disclosures to be made to investors. As we understand GAAP, market pricing is the best evidence of fair value. Once the transaction has priced, the fair value calculus may differ substantially from that which would apply before that evidence is available. Therefore, the calculation of fair value performed to size the retained interest may differ substantially from a similar calculation undertaken immediately post-closing. In these circumstances, detailed disclosures surrounding the calculation of fair value not only are immaterial, but they may well be inaccurate. If the Agencies determine to disregard our request that the proposed fair value disclosures not be required to be made to investors, it is crucial that the final rules provide for a safe harbor from liability with respect to any private action brought in reliance on any forward-looking information contained in those disclosures, similar to the safe harbors for certain forward-looking statements provided by Section 27A of the Securities Act and Section 21E of the Exchange Act.

C. It Is Not Necessary to Use Fair Value for Vertical Risk Retention

In the original rule proposal, the Agencies suggested that the risk retention be calculated based on the par value of the ABS interests. The re-proposal changed this approach to a calculation based solely on fair value, as that term is defined under GAAP.

As we all noted in our Prior Comment Letters, the vertical risk retention option generally strikes a useful and appropriate balance. Nevertheless, the Agencies have in the re-proposal sought to standardize the basis for calculating both the vertical and horizontal risk retention options by proposing a fair value methodology. As discussed elsewhere in this letter, the fair value approach generally seems reasonable with respect to the eligible horizontal residual interest option, subject to certain important refinements. However, we are concerned that mandating a fair value approach for the vertical option adds needless complexity, because retention of 5% of the par value of each class of ABS interests issued will always equal 5% of the fair value of the same class.

[12] Securities Offering Reform, SEC Release No. 33-8591, 70 Fed. Reg. 44772, 44768 (Aug. 3, 2005).

Examples for securitizations where multiple classes of ABS interests are issued illustrates this concept:

ABS Interest	**Par Value**	**Px**	**FV**	**5% of FV**	**5% Par Retention**	**FV of 5% of Par Retention**
Example 1						
A	80	1.25	100	5	4	5
B	20	.50	10	.5	1	.5
Total	100		110	**5.5**	5	**5.5**
Example 2						
C	80	1.00	80	**4**	4	**4**
D	10	.90	9	**.45**	.5	**.45**
E	10	.40	4	**.20**	.5	**.2**
Total	100		93	**4.65**	5	**4.65**

There appears to be no reason why the percentage must be of the fair value of each class of ABS interests, as opposed to the simpler option of a specified percentage of the par value (to the extent a class of interests has a par value) or of the class itself. In our view, the "fair value" of each class at the time of issuance is simply not necessary to the risk retention calculation, because the key to achieving risk retention with respect to the eligible vertical interest is simply a standardized percentage of each class of ABS interests.

Our comments apply equally to the proposed option for satisfying vertical risk retention by retaining a single vertical security, rather than an interest in each class of ABS interests issued. Under either option, the key is that the retained interest or interests must constitute a specified percentage of each class of ABS interests, regardless of the form the retention takes.

Simplified disclosure is the most obvious benefit from dispensing with the fair value calculation where it is not necessary. Also, the sponsor will not have to make difficult and unnecessary determinations about which assumptions and inputs it will use to calculate fair value, such as the methodology and key inputs and assumptions, or the reference data. The sponsor could simply disclose the percentage of the ABS interests it has retained, either *via* a single vertical security or of each class of ABS interests, as compared with the required minimum. The sponsor also would disclose that this retention entitles it to the specified percentage of the payments (principal, interest or otherwise) of each class of ABS interests. We do not believe there is any need for further disclosure. For example, the sponsor could satisfy its risk retention obligation by retaining 5 percent of each class of ABS interests, regardless of the

fair value. Then, as payments are made with respect to any class, it would receive a corresponding 5 percent of those payments.

As noted in our Prior Comment Letters, one of the great benefits of the eligible vertical interest option is the simplicity, because it helps all participants understand the exact allocation of the risk retention for each class of ABS interests issued. Introducing a fair value calculation into the process reduces this straightforward nature. Estimating the fair value of each class of ABS interests not only is unnecessary in the context of the vertical option, but it may result in investor confusion that the calculation of fair value had some impact upon the amount of each class of ABS interests that the sponsor would be required to retain. Additionally, our proposed methodology will make it easier for the Agencies to perform their oversight and supervisory functions for ABS where the risk retention requirements are accomplished in whole or in part by the eligible vertical interest, because there would be no complex calculations, key assumptions and inputs or other variables to scrutinize.

In sum, we think that this more straightforward methodology accomplishes the Agencies' (and Congress') goals, while simplifying the disclosures sponsors must make.

Finally, we note that eliminating the fair value calculation from the vertical method should not impact the ability of a sponsor to use any combination of vertical and horizontal retention. So long as the sum of the percentage of each class of ABS interests retained for the vertical portion, and the percentage of the fair value of all ABS interests represented by the eligible horizontal residual interest, equals at least 5 percent, then the aggregate credit risk retention for the deal will be at least 5 percent.

D. The Amount of Vertical Risk Retention Should Not Be Required to Exceed the Amount That Would Be Required Under the Horizontal Option

In request for comment 2.A., the Agencies ask whether a sponsor should be required to hold a higher percentage of risk retention if the sponsor retains only an eligible vertical interest or only a small amount of horizontal risk retention. We do not believe so. In our view, the purpose of the risk retention requirements is to align the interests of sponsors and investors, and a blanket 5 percent risk retention requirement is sufficient to maintain that alignment, regardless of whether the risk is held horizontally or vertically. In fact, as we have noted above, there are aspects of the re-proposal that could inflate the fair value of an eligible horizontal residual interest well beyond 5 percent (*i.e.*, the restrictions on payment to the holders of the residual), and we have asked that these distorting factors be eliminated.

E. There Should Be a Streamlined Procedure for Obtaining Interpretation and Guidance

The Original Proposing Release stated that the Agencies intended to jointly approve any interpretations, no-action letters, opinions and other written interpretive guidance concerning the risk retention rules, as well as to jointly approve any exemptions, exceptions, or adjustments to the final rules. We were among the many commenters who expressed concern that the cumbersome nature of this process would be at best quite lengthy, and could at worst place market participants in the position of being unable to obtain necessary guidance and relief.

In the Re-Proposing Release, the Agencies acknowledge the comments received on this topic, noting that market participants can seek guidance concerning the rules from their primary regulator. However, because of the joint nature of the Agencies' rule writing authority, the Agencies continue to view consistency as a benefit and intend to consult with one another when adopting public staff interpretations or other guidance, and are considering whether to require that such staff interpretations and guidance be jointly issued by the relevant Agencies.

We agree that consistency in interpretation is very important; in fact, we believe that all Agency interpretations of the proposed rules should be required to be consistent, even where not required to be jointly promulgated.[13] However, we remain concerned about the cumbersome nature of the Agencies' proposed approach. Agency staff understandably wish to carefully analyze an applicant's request and consider alternative interpretations before expressing a view on any request. A request for clarification or a "no-action" position from a single Agency can take weeks or months to resolve, even when the rules in question are far more straightforward than the credit risk retention rules. Joint rulemaking requirements could well make this process even more unwieldy. We do not believe the re-proposed joint rulemaking requirements necessitate that the Agencies make each interpretation jointly, and we believe that a joint approach may create significant uncertainty and difficulty for sponsors, investors, and other market participants.

We urge the Agencies to adopt a more streamlined approach that would allow a single regulator to provide interpretative guidance, no-action relief or legal opinions with respect to the inquiries of a particular sponsor or any of its affiliates, subject to limited consultation with other Agencies to ensure consistency. In our view, the appropriate regulator would be the primary regulator of the sponsor, or (if the sponsor has one or more corporate parents that also are regulated) the primary regulator of the highest level regulated corporate parent of the sponsor, or (if neither the sponsor nor any corporate parent has a primary regulator) the Commission. This

[13] *Cf*. Re-Proposing Release, 78 Fed. Reg. at 57933 n. 26.

approach would allow the regulator with the most expertise with a sponsor and all of its affiliates to deal with issues uniquely within its jurisdiction, such as broker-dealer or bank capital treatment questions regarding the retained interests. On the other hand, it might not always be clear which regulator is the primary regulator of the sponsor or its parent. For that reason, the Agencies might wish to consider other alternatives, such as forming small coordinating committee with authority to grant relief and an obligation to act within a specified time frame, or delegating interpretative authority for particular provisions to a designated agency or subset of agencies. However these concerns are addressed, it remains vital that a process be established that will provide a meaningful way for sponsors and their affiliates to obtain interpretations and guidance that are both timely and consistent.

F. Participation Interests and Representative Sampling Should Be Permitted Methods of Risk Retention

As noted in our respective Prior Comment Letters, we recommend that the Agencies adopt a "participation interest" option as an alternative means of holding the required credit risk retention. Loan participation structures have been used for many years by commercial lenders. Although perhaps not practical for all asset classes, we believe participation interests could be a useful risk retention mechanism for many sponsors, which would perfectly align the interests of sponsors and investors. In addition, we believe that resurrecting the similar "representative sample" option is of particular importance for automobile loan securitizations.[14]

Under the participation interests approach, the sponsor or an affiliate would enter into a participation agreement pursuant to which each individual asset identified for the securitized pool (a "designated asset") would be divided into two interests – a 95 percent interest that would be securitized, and a 5 percent interest that would be retained by the sponsor (or its majority-owned affiliate). Each participation interest would share proportionately in all payments of interest and principal and in any expenses attributed to it (*e.g.*, servicing fees and expenses). Payment shortfalls or losses realized on the underlying asset would be borne proportionately by the holders of the participation interests. Because the servicer would administer each designated asset in its entirety, not just the participation interests in that asset, the administration of each interest in each asset would be identical.

It is our understanding that during the course of considering the re-proposed rules, the Agencies held a number of discussions with industry participants concerning the possibility of a participation option. As a follow-up to some of those discussions, on September 10, 2012, the Federal Regulation of Securities Committee and the Securitization and Structured Finance

[14] Our views on the representative sample option are set forth below in section VII.A.in the context of our comments regarding automobile loans and the definition of "qualifying automobile loan."

Committee of the Business Law Section of the American Bar Association (the "ABA Committees") submitted a supplemental comment letter suggesting specific rule text that could be used to permit the use of participation interests.

In the Re-Proposing Release, the Agencies stated their belief that the costs and benefits of the participation interest option would not be an improvement over the "standard" risk retention option. Based on our members' experiences in the market, we disagree. Where appropriate, a participation interest structure is much simpler than the "standard" approach, and results in a complete alignment of interest of sponsors and investors. We also believe that providing flexibility to sponsors is itself an important goal, and that a participation option would provide that additional flexibility. Therefore, we support the mechanisms proposed by the ABA Committees and ask the Agencies to adopt a participation interest option.

Rule 190 under the Securities Act provides that, subject to certain conditions, qualifications and exceptions, in an offering of ABS pursuant to a registration statement where the asset pool includes securities of another issuer, unless the underlying securities are themselves exempt from registration under Section 3 of the Securities Act, the "offering" of the underlying securities must itself be registered as a primary offering of those securities. The Commission has stated its view that "if a loan participation were securitized, that would be viewed as a public distribution of the loan participation and the loan participation would therefore be a security, the offer and sale of which, unless exempt, would be subject to the registration requirements of the Securities Act."[15] Before the Commission articulated this view, it had been common practice in commercial mortgage-backed securitizations to participate high balance loans and include a *pro rata* participation interest in the loan in each of two or three securitized pools. However, this structure was largely abandoned in public offerings of commercial mortgage-backed securities ("CMBS") because registration of each loan participation offering was viewed as unduly burdensome.

If the Agencies determine to permit sponsors of securitization transactions to satisfy their credit risk retention requirements by retaining a 5 percent *pro rata* participation interest in each designated asset, we ask that the Commission clarify that the related 95 percent participation in each designated asset that is securitized would not, under these circumstances, constitute a separate security requiring registration under the Securities Act.

[15] Asset-Backed Securities, SEC Release No. 33-8518, 70 Fed. Reg. 1506, 1529 n. 173 (Jan. 7, 2005).

G. There Should Be No Minimum Risk Retention Requirement for Blended Pools

We appreciate the Agencies' proposal to allow blended pools of qualifying and non-qualifying assets, which we believe is appropriate and consistent with the purpose of the Dodd-Frank Act. As recognized by the Agencies, it might be useful for sponsors acting on a transparent basis to allay investor reservations about some assets in a pool by including other high-quality assets.

However, we disagree with the Agencies' intention to impose a limit on the amount of qualifying assets a sponsor could include in any one securitization involving blended pools through a risk retention minimum of 2.5 percent (subject to decrease or increase by 1 percent in the final rules). It is unclear why the Agencies believe that allowing sponsors of blended pools to include a risk retention requirement based precisely on the percentage of non-qualified assets in the pool is "inconsistent" with the principle that sponsors should "hold a meaningful exposure to all assets they securitize that are subject to the full risk retention requirement."[16] A fully proportional approach would maintain 5 percent risk retention with respect to each and every non-qualifying asset, which is by definition a meaningful exposure.

For this reason, we urge the Agencies not to adopt a risk retention minimum for blended pools of qualifying and non-qualifying assets. Instead, we ask the Agencies to require that the risk retention be required to be fully proportional to the percentage of non-qualifying assets in the securitized pool.

H. Legacy Assets Should Be Exempt from Risk Retention[17]

Under Section 941(b) of the Dodd-Frank Act, the risk retention rules will become effective one year after the date on which the final rules are published in the FEDERAL REGISTER, with respect to securitizers and originators of asset-backed securities backed by residential mortgage loans, and two years after the date of such publication, with respect to securitizers and originators of all other classes of asset-backed securities.

We continue to believe that it is appropriate to exempt from the risk retention rules securitizations of assets that were originated or issued prior to the date on which the final rules are published in the FEDERAL REGISTER. We refer to such assets as "legacy assets."

As reiterated by the Agencies in the Re-Proposing Release, the purpose of the risk retention rules is to align the interests of parties to a securitization transaction with those of

[16] Re-Proposing Release, 78 Fed. Reg. at 57986.
[17] We also discuss the treatment of legacy assets in the context of resecuritizations below in section IV.B.

investors. "[W]hen incentives are not properly aligned and there is a lack of discipline in the origination process, securitization can result in harm to investors, consumers, financial institutions, and the financial system."[18] Credit risk retention "provide[s] securitizers an incentive to monitor and ensure the quality of the assets underlying a securitization transaction, and, thus, help align the interests of the securitizer with the interests of investors."[19] The Agencies note that "in circumstances where the assets collateralizing the ABS meet underwriting and other standards that should ensure the assets pose low credit risk, the statute provides or permits an exemption."[20]

In the case of loans or other assets that are originated prior to adoption and publication of the final risk retention rules, or asset-backed securities that are issued prior to such time, it will of course not have been possible to create those assets in compliance with a regulatory scheme whose precise terms have yet to be promulgated. Further, it will in most cases not be possible to retroactively comply with the risk retention régime with respect to legacy assets. In the case of consumer and commercial loans and other receivables, the extension of credit will already have been made and obtaining borrower consent to modifications may not be feasible. In the case of asset-backed securities, their terms generally cannot be materially changed after issuance without affecting the interests of third-party investors, nor in many cases will it be feasible for a sponsor to repurchase the requisite portions of the applicable ABS interests. Accordingly, imposing mandatory risk retention in securitizations of legacy assets would not further the purposes of Section 941(b) of the Dodd-Frank Act because it would not be possible to influence the credit quality of the legacy assets.

In our view, an exemption for legacy assets is of even greater importance for many of the asset classes that are expected to rely primarily on the qualified asset exemptions and options that permit retention by originators. Assuming that the various qualifying asset definitions are revised to better reflect the realities of their markets,[21] we anticipate that originators will quickly begin to originate qualifying assets after the adoption of final rules. However, large pools of non-qualifying assets originated before that time will no longer be able to be securitized economically, in the absence of alternative risk retention methods that work well for those asset classes. We do not believe that an exemption for legacy assets would encourage sponsors to make an end-run around risk retention, by pumping up origination before the effective date of the rules.

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[18] *Id.*, 78 Fed. Reg. at 57931.
[19] *Id.*, 78 Fed. Reg. at 57932.
[20] *Id.*
[21] We discuss qualifying residential mortgages below in section II.A., qualifying commercial loans below in section V.B., qualifying commercial real estate loans below in section III.D., and qualifying automobile loans below in section VII.D.

We believe that the accommodation that we request here is narrow and reasonable, and is intended only to ask that the Agencies draw a bright line, at a practical point in time, between assets that are subject to the new rules and those that are not. Otherwise, we anticipate that the markets for legacy assets may be seriously disrupted, with a resulting negative impact on both the investors who hold those assets and on the broader market.

Should the Agencies be concerned that our proposed blanket legacy asset exemption might be a back door for inappropriate expansion of the resecuritization exemptions, however they are finally adopted,[22] the legacy asset exemption could be limited to financial assets that are not themselves ABS interests.

I. Unfunded Forms of Credit Risk Retention Should Be Permitted

Under the re-proposed rules, only fully funded forms of risk retention would satisfy a sponsor's credit risk retention obligations. As noted in the Re-Proposing Release, "[g]enerally, the agencies have declined to recognize unfunded forms of risk retention for purposes of the proposal (such as fees or guarantees) . . . ."[23] While other jurisdictions' risk retention rules recognize "unfunded forms of risk retention, such as standby letters of credit, . . . the agencies do not believe [that these mechanisms] provide sufficient alignment of incentives and have rejected as eligible forms of risk retention under the U.S. framework."[24]

We do not agree with this assessment. As we noted in various Prior Comment Letters, we find the Agencies' position to be unnecessarily restrictive. Alternative methods of risk retention, such as guarantees, letters of credit, liquidity facilities and overcollateralization, are already common in some types of ABS and are as effective as fully funded retention at aligning the interests of a securitization sponsor with those of investors.

As one example, ABCP conduits have a long history of providing liquidity and credit enhancement in unfunded form. The high levels of liquidity and credit support inherent in all types of conduit structures are, in our view, the key reasons behind the special form of risk retention that would be permitted for ABCP conduits.[25] Similarly, significant over-collateralization, which effectively creates a first-loss position, has been instrumental in the historically strong performance of automobile ABS.[26]

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[22] Our comments on the proposed resecuritization exemptions appear below in section IV.
[23] Re-Proposing Release, 78 Fed. Reg. at 57963.
[24] *Id.*, 78 Fed. Reg. at 57977.
[25] We refer you to our discussion below on ABCP conduits below in section VI for more detail.
[26] We refer you to our discussion on auto ABS below in section VII.C. for more detail.

There is no reason why similar unfunded forms of credit risk retention should not be permitted in other types of ABS. Whether support is provided in the form of an irrevocable bank letter of credit, a surety bond or a guarantee, or in some other form, unfunded credit enhancement is no less real than funded risk retention, and exposes the enhancement provider to genuine credit risk.

We concede that some sponsors may be more creditworthy than others, and that unfunded risk retention carries the risk that a sponsor may be unable, when called upon, to fulfill its payment obligations. But considerations of creditworthiness, while of interest to investors, should be irrelevant to the risk retention rules. The purpose of the risk retention mandate is to help to align the interests of securitization sponsors with those of investors. Investors should of course receive adequate disclosure regarding the form of risk retention and the financial condition of an enhancement provider. But from the perspective of alignment of interests, a sponsor that writes a guarantee or a letter of credit to an issuing entity is every bit as exposed to risk of loss as a sponsor that holds an eligible horizontal residual interest. Unfunded forms of risk retention by the sponsor provide all the same incentives for the sponsor to ensure that the securitized assets are of the highest quality.

The Committee of European Banking Supervisors has correctly recognized the value of alternative forms of risk retention by "synthetic, contingent or derivative means," expressly including the provision of a letter of credit.[27] We ask that the Agencies reconsider the merits of permitting a sponsor or its majority-owned affiliate to satisfy the sponsor's risk retention obligations by retaining unfunded risk exposure through letters of credit, guarantees and other forms.

J. Asset-Level and Pool-Level Insurance Should Be Exempted from the Restrictions on Transfer and Hedging

As re-proposed, the credit risk retention rules generally would prohibit a sponsor from transferring or hedging an interest that it is required to retain, or financing the retained interest on other than a full recourse basis. We appreciate the careful consideration given by the Agencies to many comments, including ours, that advocated for a reasonable sunset on the transfer and hedging restrictions applicable to the sponsor's required risk retention.[28] However, as noted in

[27] *See* Committee on European Banking Supervisors, Guidelines to Article 122a of the Capital Requirements Directive, clause 45 (Dec. 31, 2010), available at http://www.eba.europa.eu/documents/10180/106202/Guidelines.pdf.

[28] Our views on the length of these restrictions for RMBS and automobile ABS are addressed in sections II.B. and VII.E., respectively.

the Prior SIFMA Comment Letter, we continue to believe that these restrictions would unnecessarily prohibit certain features of ABS that have operated successfully for decades, primarily the ability of transaction to include pool-level insurance, such as bulk private mortgage insurance or residual value insurance.

The Agencies reiterate in the Re-Proposing Release that "the proposed rule would not prohibit an issuing entity from engaging in hedging activities when such activities would be for the benefit of all investors in the [ABS]" but that such products "could not cover any ABS interest or asset that the sponsor is required to retain . . . ."[29] We acknowledge the Agencies' legitimate concern that sponsors not use credit risk hedging techniques available to issuing entities to avoid the risk retention requirements. However, asset-level and pool-level insurance are legitimate credit enhancement tools of long standing, which we do not believe have contributed in any way to any weakening of credit standards. Therefore, we ask that these tools be permitted to be used in all cases, without the need to carve out the sponsor's retained piece. Credit enhancement that covers a portion of losses on one, some or all of the pool assets is a benefit to *all* holders of ABS issued by the issuing entity, not only those ABS interests retained by the sponsor, and would not eliminate the retaining sponsor's exposure to credit risk. The reduction in credit risk achieved through the enhancement would accrue to holders of all classes of ABS interests in the securitization, and would not change the relative distribution of risk among interest holders. Therefore, we continue to urge the Agencies to include a blanket exception for pool-level and asset-level credit enhancement.

K. Multiple Sponsors Should Be Permitted to Allocate Risk Retention Among Themselves

Under § __.3(b) of the re-proposed rules, in a securitization transaction having two or more sponsors it will continue to "be the responsibility of each sponsor to ensure that at least one of the sponsors" retains the amount of credit risk required under the rules. This language has not changed from the original proposal. As explained in the Original Proposing Release, "[i]n circumstances where two or more entities each meet the definition of sponsor for a single securitization transaction, the proposed rules would require that one of the sponsors retain a portion of the credit risk of the underlying assets in accordance with the requirements" of the rules.[30] It remains unclear to us why it should not be possible for multiple sponsors to agree to allocate the required amount of retained credit risk among themselves, so long as the aggregate amount retained satisfies the requirements of the risk retention rules. Transactions with multiple sponsors are most common in CMBS transactions, because of the unusually large scale of those deals. Thus, although the interests may be small based on the percentage of the entire deal that

[29] Re-Proposing Release, 78 Fed. Reg. at 57969.
[30] Original Proposing Release, 76 Fed. Reg. at 24098.

each sponsor holds, each of these interests will involve a significant investment, and together they would equal or exceed the aggregate proposed credit risk retention requirement of 5 percent. We believe that the rationale for permitting sponsors to allocate risk retention among themselves is the same as the Agencies have elucidated for blended pools, in that it would "promote liquidity in the relevant securitization markets without harming the goals of [the] risk retention requirement."[31] For all of these reasons, we reiterate the request made in both Prior Comment Letters that proposed § __.3(b) be revised to accommodate such an allocation.

Securitization transactions with multiple sponsors are not uncommon, particularly for CMBS. Forcing one sponsor to retain all of the required risk exposure would unnecessarily complicate the economics of these transactions, and could unfairly disadvantage one sponsor versus another. Presumably some financial accommodation would need to be negotiated between the sponsors to minimize the disproportionate economic impact on the retaining sponsor. However, absent changes to § __.12 of the re-proposed rules, it is not entirely clear that this could be accomplished without violating the anti-hedging provisions.[32] In a securitization with two or more sponsors, the retaining and non-retaining sponsors might need to negotiate compensation not just for the amount of the purchase price of the retained interests but also for the retaining sponsor's ongoing unhedged risk exposure in an amount disproportionate to the retaining sponsor's economic interest in the securitization.

As noted in the Prior SIFMA Comment Letter, this seems to us to be a simple change to the proposed rules that could be easily accommodated and could be clearly disclosed to investors and regulators.

L. Sponsors Should Be Permitted to Allocate Risk Retention to Originators Without Any Minimum Permitted Restriction, Where Appropriate

As re-proposed, § __.11 would continue to require as conditions to the ability of a sponsor to allocate a portion of its required credit risk retention to an originator that, among other things, that (1) the originator acquire and retain at least 20 percent of the aggregate risk retention amount otherwise required to be retained by the sponsor and (2) the proportion of credit risk retained by the originator for this purpose not exceed the proportion of the securitized pool assets originated by that originator. The proposed 20 percent threshold remains too high. This requirement would place added pressure on smaller originators, reducing their ability to sell their

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[31] Re-Proposing Release, 78 Fed. Reg. at 57986.

[32] Proposed §__.12(b) provides that "[a] retaining sponsor . . . may not enter into an agreement . . . with any other person if . . . [p]ayments . . . under the agreement . . . are materially related to the credit risk of one or more particular ABS interests . . . that the retaining sponsor is required to retain with respect to a securitization transaction."

originations to securitizers. It is predictable that a securitizer that has otherwise been successful in reaching agreement with originators to retain a portion of the credit risk in its securitization transactions would be less eager to do business with a smaller originator that may not be able to produce enough loans between planned securitizations to satisfy the 20 percent threshold. Smaller originators could find their portfolios less liquid and/or their sales prices less favorable.

In our view, the allocation of credit risk retention to originators is the most direct and effective way to positively influence the credit quality of the assets they originate, without regard to any minimum percentage of assets that a particular originator may have contributed to a deal. Therefore, the Agencies should encourage the use of this option, rather than restricting as substantially as they have in the re-proposed rules.

Also, as discussed in the Prior SIFMA Comment Letter, we believe that it would not materially increase the complexity of compliance if a sponsor is permitted to allocate credit risk proportionately to originators without any minimum percentage restriction. The allocation of credit risk would be just as easy to disclose clearly to investors and to regulators, whether there are five or ten or more originators involved in a transaction. As a practical matter some securitizers may choose to limit such allocations for their own administrative convenience, but we do not believe that this should be a regulatory concern.

M. Non-Economic REMIC Residual Interests Should Be Excluded from the Definition of "ABS Interest"

Both residential mortgage-backed securities ("RMBS") and CMBS transactions often are structured to rely on the Real Estate Mortgage Investment Conduit ("REMIC") rules adopted by the Internal Revenue Service (the "Service").[33] As proposed to be defined, the term "ABS interest" generally would include all types of interests or obligations issued by an issuing entity, whether or not in certificated form, including a security, obligation, beneficial interest, or residual interest. This definition would include a REMIC residual interest, which is an interest required by the REMIC rules and which may occupy the most subordinate position in the cash flow waterfall, even though in many cases such a residual interest will be structured so that it has no entitlement to cash other than any cash that remains after all other interests are paid in full. Thus, the likelihood that holders of the REMIC residual will receive any cash flow is remote.

We again ask that the Agencies modify the definition of "ABS interest" to exclude "non-economic residual interests" within the meaning of the REMIC rules. Inclusion of these interests would create a variety of undesirable complications. Because securitizers often must pay third

[33] 26 C.F.R. § 1.860E-1(c)(2) (2013), as it may be amended from time to time.

parties to take them, they will likely be deemed to have negative fair value. The inclusion of non-economic residual interests as ABS interests could partially offset, and thereby reduce, the overall fair value calculations with regard to all ABS interests issued in the securitization.

In addition, we repeat the request from the Prior SIFMA Letter that clause (3) of the definition of "eligible horizontal residual interest" be revised to make clear that an eligible horizontal residual interest must have the most subordinated claim to payments of both principal and interest by the issuing entity (except to the extent that this requirement is modified as discussed above), other than any *de minimis* amounts that may be payable on a non-economic REMIC residual interest. We view this as a technical clarification, and do not believe that such an exclusion would create an opportunity for avoidance of the risk retention requirements. Each REMIC must file a federal income tax return with the Service every year; it will be readily apparent if a sponsor has sought to avoid the risk retention requirements by inappropriately characterizing as noneconomic a REMIC residual interest that is in fact receiving material cash flow.

II. Residential Mortgage-Backed Securities and Qualified Residential Mortgages

We greatly appreciate the Agencies' thoughtful responses to industry comments on issues related to residential mortgage-backed securities ("RMBS") in the re-proposal, including many of the comments we made in our respective Prior Comment Letters. In particular, we appreciate the proposed equivalence of the definition of "qualified residential mortgage" ("QRM") for purposes of risk retention, with the definition of "qualified mortgage" ("QM") within the meaning of Section 129C of the Truth in Lending Act and its implementing regulations, as may be amended from time to time by the Bureau of Consumer Financial Protection (the "CFPB"). We believe that this approach will result in the alignment of the interests of RMBS sponsors and investors, and will not impede the recovery of the still-fragile private label RMBS markets. We do not support the so-called "QM-plus" approach, which would add a variety of additional requirements to those imposed by the definition of QM. We believe that this alternative approach is not necessary for investor protection and would greatly restrict the availability of credit for private label borrowers.

In addition, we request that the proposed internal supervisory controls certification for the QM option be eliminated, that a broader seasoned loan exemption be adopted for residential mortgages, that a shorter period be adopted for the sunset of the transfer and hedging restrictions for risk retention on RMBS transactions, that the definition of "originator" be modified to recognize the economic reality of correspondent lending relationships, and that blended pools be permitted for QMs.

A. QM Should Be Adopted as the Standard for QRM, Rather than QM-Plus

For all of the reasons expressed by the Agencies in the Re-Proposing Release, we, along with many other industry groups representing many different constituencies,[34] strongly support the Agencies' proposal to broaden and simplify the scope of the QRM exemption from the credit risk retention requirements by defining "qualified residential mortgage" as a "qualified mortgage" within the meaning of Section 129C of the Truth in Lending Act and its implementing regulations, as may be amended from time to time by the CFPB. We fully agree with the Agencies that "a QRM definition that aligns with the definition of a QM meets the statutory goals and directive of section 15G of the Exchange Act to limit credit risk, preserves access to affordable credit, and facilitates compliance."[35]

The Agencies also requested comment on an alternative approach to the QRM definition, referred to a "QM-plus." Under this approach, a loan would be required to meet the CFPB's core criteria for the general definition of QM, including the requirements for product type, loan term, points and fees, underwriting, income and debt verification, and debt-to-income ("DTI") ratio. In addition to the core criteria, loans would be required to meet four other requirements:

- QRM treatment would only be available for loans secured by one-to-four family real properties that constitute the principal dwelling of the borrower;

- Junior liens would be prohibited for purchase loans, and permitted for refinancings (subject to the loan-to-value ("LTV") calculations described below);

- The originator would be required to determine the borrower was not currently 30 or more days past due on any debt, and had not been 60 or more days past due on any debt within the preceding 24 months; and the borrower must not have, within the preceding 36 months, been a debtor in a bankruptcy proceeding or been subject to a judgment for collection of an unpaid debt, had personal property repossessed, had any one-to-four family property foreclosed upon, or engaged in a short sale or deed in lieu of foreclosure; and

[34] *See*, *e.g.*, Coalition for Sensible Housing Policy, Updated QRM Proposal Strikes Balance: Preserves Access While Safeguarding Consumers and Market, available at http://sensiblehousingpolicy.org/uploads/White_Paper.pdf. The Coalition for Sensible Housing Policy is a diverse coalition of 51 consumer organizations, civil rights groups, lenders, real estate professionals, housing organizations, mortgage insurers and local governments that share the goal of attracting private capital to the mortgage market while ensuring that creditworthy families, including those unable to afford a large down payment, are not unnecessarily excluded from homeownership opportunities.

[35] Re-Proposing Release, 78 Fed. Reg. at 57989.

- The LTV at closing could not exceed 70 percent, with (for refinancings) junior liens included in the calculation if known to the originator at closing and (if they secure an open-end credit) calculated as if fully drawn, and property values determined by an appraisal or (for purchase loans with a lower contract price) the contract price.

We do not support the adoption of the QM-plus approach, for several important reasons.[36]

Loans that meet the QM standard are very high-quality loans, significantly higher than were common in the last years before the credit crisis. While many loans originated today would qualify under the QM standard, this would not have been true in earlier years when lending standards were looser. According to one analysis, only 16 percent of loans securitized in non-agency transactions from 2006 through 2008 would have met the QM standard. This shows that the QM standard is not overly broad, but is a meaningful standard that reflects high-quality mortgage originations.[37]

Because of the benefits derived from the resulting safe harbor from the CFPB's ability-to-repay requirement, and due to the broad applicability of the QM criteria, we anticipate that QMs will constitute a majority of all residential mortgages made. The adoption of QM as the *de facto* standard for high quality QRMs would facilitate the recovery of the private RMBS markets, which remain depressed long after the recovery of most other sectors of the ABS markets. This recovery will serve an even greater goal – hastening the ability of the mortgage finance system to transition away from dependence on the government-supported programs offered by the Federal Housing Administration (the "FHA") and the government-sponsored enterprises (the "GSEs"). On the other hand, we believe that QM-plus loans will never constitute a significant percentage of the market. Adopting QM-plus as the standard for the QRM exemption would significantly impede the recovery of the private RMBS market, would reduce the availability of credit to consumers, and would increase the costs of the types of loans most sought by consumers.

The 70 percent LTV ratio is perhaps the most troubling characteristic of QM-plus. Most consumers simply cannot afford a 30 percent down payment, particularly in purchase transactions. The proposed 70 percent LTV ratio would mean that QM-plus loans would consist primarily of refinancings, although even for refinancings that requirement still would pose

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[36] We also refer you to the comment letters of FSR's Housing Policy Council and of the ABA, which further address this topic.

[37] *See* Laurie Goodman, Ellen Seidman and Jun Zhu, "QRM vs. Alternative QRM: Quantifying the Comparison, available at http://blog.metrotrends.org/2013/10/qrm-vs-alternative-qrm-quantifying-comparison/.

difficulties in a market where property values remain depressed.[38] Because the costs of securitizing non-QRMs will be higher, the adoption of QM-plus would mean that mortgage financing will cost more for the majority of consumers. In sum, QM-plus would adversely affect consumers by requiring them to amass a historically disproportionate (and for many unattainable) down payment, or suffer a much higher cost of obtaining mortgage credit.

The unstated underlying premise of the QM-plus proposal seems to be that restricting QRMs to a narrow slice of the mortgage market would encourage the development of a robust non-QRM private securitization market. We believe that this premise is based on a number of unsupportable assumptions. Because QRMs will the "gold standard" for mortgage loans, many private mortgage lenders will be unwilling to originate non-QRMs because of their more limited liquidity on the secondary market. If QM-plus is adopted, the origination of non-QRMs will be mostly limited to large institutions that can afford to retain those loans on their balance sheet. This would give Fannie Mae and Freddie Mac, which would retain their own absolute exemption from credit risk retention, an almost impenetrable competitive advantage in the non-QRM market. Therefore, the adoption of QM-plus would increase the GSEs' current dominance in the RMBS markets, further reducing the competitiveness of private mortgage originators and delaying the transition of the housing finance system away from dependence upon the GSEs.

According to the Agencies, "academic research and the agencies' own analyses show that credit history and loan-to-value ratio are key determinants of mortgage default, along with the product type factors that are included in the QM definition." Therefore, the Agencies have requested comment on whether "securitizers packaging QRM-eligible mortgages into RMBS [would] have any financial incentive to be concerned with these factors" if QRM criteria do not address credit history and LTV, asking whether "the incentive that would be provided by risk retention [is] unnecessary in light of the securitizer incentives and investor disclosures under an approach that aligns QRM with QM."[39]

In response, we note first the Agencies' own conclusion that "historical data indicate that mortgages that meet the QM criteria have a lower probability of default than mortgages that do not meet the criteria."[40] While credit history and the LTV ratio may be relevant to the risk of default, as further described above, we also agree that "these additional credit overlays may have ramifications for the availability" – and cost – "of credit that [are] not outweighed by the corresponding reductions in likelihood of default."[41]

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[38] According to recent data, average purchase loan LTVs are in the range of 85-90 percent. *See*, *e.g.*, Mark Zandi and Jim Parrot, "Opening the Credit Box" (Sept. 30, 2013).
[39] Re-Proposing Release, 78 Fed. Reg. at 57994.
[40] *Id.*, 78 Fed. Reg. at 57989.
[41] *Id.*

Perhaps more importantly, we believe that making the definition of QRM fully consistent with the definition of QM simply will not result in the origination and securitization of low quality mortgages. A QM is certain enough of repayment to be entitled to a presumption of compliance with federal laws regarding determination of the borrower's ability to repay the loan. Also, the adoption of the definition of QRM also should not be viewed out of context. In addition to risk retention and the QRM rules, and the ability-to-repay rules and the definition of QM, there are a variety of other recent and pending rulemakings and market trends that provide significant incentives to securitize higher-quality assets as to which all material information has been fully disclosed to investors.

- Rule 15Ga-1, adopted pursuant to Section 943 of the Dodd-Frank Act, requires securitizers of both public and private Exchange Act ABS for which the underlying transaction agreements contain a covenant to repurchase underlying assets for breach of a representation or warranty to make quarterly disclosures of all fulfilled and unfulfilled asset repurchase requests for all of the securitizer's Exchange Act ABS trusts.

- Rule 193, adopted pursuant to Section 945 of the Dodd-Frank Act, requires public Exchange Act ABS issuers to perform a review of the pool assets underlying the ABS, designed to provide "reasonable assurance" that the disclosure in the prospectus regarding the assets is accurate in all material respects.

- Rule 17g-7, adopted pursuant to Section 943 of the Dodd-Frank Act, requires nationally-recognized statistical ratings organizations ("NRSROs") to make certain disclosures in any report accompanying a credit rating relating to both public and private Exchange Act ABS, including a description of the representations and warranties and enforcement mechanisms and how they differ from those that the NRSRO believes are applicable to issuances of similar securities. This rule has resulted in a much higher level of standardization of representations and warranties with respect to the pool assets in securitizations, a trend which was already underway as a result of both market pressures and industry efforts.

- The Commission's proposed comprehensive regulations to Regulation AB, commonly known as "Reg. AB II," would impose a variety of new disclosure requirements. Among the most important would be the requirement to disclose a long list of specific loan-level data points regarding the individual pool assets. In addition, disclosure would be required regarding the amount and characteristics of pool assets that were originated under exceptions to credit underwriting standards, the amount of assets in the pool not meeting those compensating factors, and steps taken by originators to verify information

used in underwriting of pool assets. These rules would reinforce the current trend towards much more specific disclosure in RMBS transactions, which already is being driven by market forces.

B. The Requirement for a Depositor Certification Regarding Effectiveness of Its Internal Controls Is Unnecessary and Misleading, and Should Be Eliminated

In order to rely on the exemption from credit risk retention for QRMs, the depositor would be required to certify that it has evaluated the effectiveness of its internal supervisory controls with respect to the process for ensuring that all assets that collateralize the asset-backed security are qualified residential mortgages and has concluded that its internal supervisory controls are effective. These "internal supervisory controls" must be evaluated within 60 days prior to the related cut-off date, and a copy of the depositor's certification would have to be delivered to prospective investors and, upon request, to the Commission and any other applicable Agency.

We acknowledge that Section 941 of the Dodd-Frank Act requires each issuer to certify, for each issuance of an ABS that are backed exclusively by QRMs, that the issuer has evaluated the effectiveness of its internal supervisory controls for ensuring that all assets that collateralize the ABS are QRMs. Were it not for the statute, we would argue that the certification is unnecessary. As proposed, it is a strict condition of the exemption that all pool assets actually be QRMs. Any loans that turn out not to be QRMs must be repurchased within 90 days of discovery of noncompliance, so investors already have a built-in remedy for the inclusion of noncompliant assets. The certification adds no additional assurance. At least for public offerings of Exchange Act ABS, the already-effective requirements of the Rule 193 under the Securities Act appear to be much more aptly targeted, by requiring the issuer to perform a review of the pool assets designed to provide "reasonable assurance" that the disclosure in the prospectus regarding the assets (which would include their QRM status) is accurate in all material respects.

If a certification requirement must be adopted, we believe that the proposal should be modified to address several important issues. It is not clear what standards would apply to the certification, and because the offering document certainly will disclose whether all pool assets are QRMs, investors will already have the basis to bring a disclosure claim if that assertion turns out to be wrong (and the other requirements of the relevant antifraud provision are satisfied). Requiring that the certification be delivered to investors would seem only to add a layer of potential liability to the certifying depositor if it is subsequently determined to be incorrect, even if all loans in the pool actually are QRMs (or if not, are repurchased as required) and if the relevant supervisory controls are operating effectively as of the cut-off date. The certification

could also be misleading to investors – it is possible for these internal supervisory controls to be operating effectively 60 days prior to the cut-off date, but then fail to identify a non-QRM loan in the pool at that later time.

Therefore, we ask that the proposed certification be required to be provided confidentially to the Commission and any other appropriate Agency, but not to investors. As discussed above, investors will certainly have other remedies more directly related to any inappropriate inclusion of non-QRM loans in the pool. A certification addressing internal controls is much more suitably directed to the sponsor's prudential regulator. Also, should the Agencies adopt a blended pool option for QRMs as we request, we also ask for clarification that the certification would apply only to QRMs in the blended pool.

C. The Seasoned Loan Criteria for Residential Mortgages Should Be Revised to Better Reflect Market Consensus on Loan Quality

For a residential mortgage loan to qualify for the credit risk retention exemption for any securitization transaction collateralized solely by servicing assets and seasoned loans, it would be required to have been outstanding and performing (*i.e.*, not 30 days delinquent) for the longer of five years, or until its outstanding principal balance has been reduced to 25 percent of the original principal balance, but no longer than 7 years.

We agree with the Agencies that that "risk retention as a regulatory tool to promote sound underwriting is less relevant after loans have been performing for an extended period of time."[42] However, we believe that the seasoning requirements proposed by the Agencies are unduly restrictive, are out of step with the level of seasoning generally agreed by the market to be appropriate, and would inappropriately discourage securitizations of seasoned mortgage loans. As a practical matter, because of the long term of most residential mortgages, the re-proposal would result in almost all mortgage loans becoming seasoned after 7 years, which we believe is longer than is necessary to demonstrate the quality of the loan. We also believe that permitting a limited number of 30 day delinquencies is appropriate – such minor nonconformance is not generally viewed by the market as indicating a lack of asset quality, if the loan has been performing for a substantial period after the last delinquency.[43] The data referenced in the

[42] Re-Proposing Release, 78 Fed. Reg. at 57975.
[43] The standards recently adopted by Fannie Mae and Freddie Mac for relief from repurchase obligations for breaches of certain origination representations and warranties for loans that meet specific payment requirements support the notion that 5 years and a limited number of permissible 30-day delinquencies should be acceptable, so long as the loan has been performing for a significant period of time. *See* the FHFA's news release dated September 11, 2012, available at
http://www.fhfa.gov/webfiles/24366/Reps%20and%20Warrants%20Release%20and%20FAQ%20091112.pdf;

separate comment letter submitted by Bank of America supports the appropriateness of a 5 year performance period after the last permitted delinquency.

Therefore, we propose that a residential mortgage loan should be considered sufficiently seasoned to qualify for an exemption from the credit risk retention requirements if it has been outstanding and performing for 5 years, subject to a permitted exception of no more than three 30 day delinquencies (and no 60 day delinquencies) during that time, so long as the loan is current (*i.e.*, not 30 days delinquent) at the time of securitization. We ask the Agencies to eliminate the alternate 25 percent test, because the typical amortization schedule for a mortgage loan, which generally pays interest first, would make this of doubtful utility.

In the future, we expect that most residential mortgages will be QMs, so that the practical usefulness of this exemption will decline over time. However, many large portfolios of quality, seasoned residential mortgages remain unsecuritized. We believe it is important to craft a seasoned loan exemption that is not so restrictive that it inappropriately discourages the securitization of those loans, so long as it facilitates the securitization only of mortgage loans whose past payment history demonstrates a very low probability of default.

D. The Sunset Period for RMBS Transfer and Hedging Restrictions Should Be Shortened

We appreciate the Agencies' recognition that "sound underwriting . . . is less likely to be effectively promoted by risk retention requirements after a certain period of time has passed and a peak number of delinquencies for an asset class has occurred."[44] Given that this expressed rationale for sunsets on required risk retention is quite similar to the rationale expressed by the Agencies for the proposed seasoned loan exemption,[45] it is not surprising that the Agencies have proposed a sunset period for credit risk retention on RMBS transactions that is very similar to the standard proposed for seasoned residential mortgage loans. As re-proposed, the restrictions on transfer and hedging for RMBS would expire on the date that is the later of five years after closing, or the date on which the total unpaid balance of the pool assets is reduced to 25 percent of the original unpaid principal balance of the pool as of the closing date, but no longer than seven years.

Because of the long term of most residential mortgages, almost all RMBS mortgage pools would become eligible for this sunset only after the full 7 years has elapsed. We believe that this

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Fannie Mae's Selling Guide Announcement SEL-2012-08 dated September 11, 2012; and Freddie Mac's Guide Bulletin No. 2012-18 dated September 11, 2012.

[44] Re-Proposing Release, 78 Fed. Reg. at 57978.

[45] As quoted above in our discussion of seasoned residential mortgages.

is longer than is necessary to incentivize the inclusion of high quality mortgage loans in the underlying asset pool. For the same reasons discussed above with respect to seasoned mortgage loans, we believe that five years is the more appropriate standard. As noted above, because of the long term of most residential mortgages, the option based on amortization of the asset pool is unlikely to be of much usefulness, so we ask that it be eliminated. In sum, we ask the Agencies to adopt a flat five-year rule for the sunset of the transfer and hedging restrictions on credit risk retention in RMBS transactions.[46]

E. The Definition of "Originator" Should Be Broadened to Address Correspondent Lending Relationships

As re-proposed, § __.11 would continue to allow a sponsor to allocate risk retention to an originator of securitized assets, but only under very limited circumstances. Among other things, the Agencies continue to believe that an "originator" that agrees to share retention of credit risk would be required to have been the original creditor, and "not a subsequent purchaser or transferee."[47]

As noted in the Prior Comment Letters, we believe that the Agencies' interpretation of "originator" would have the effect of eliminating many of the parties that might in fact transfer assets to a securitizer and be willing, potentially, to share in the retention of credit risk. In some cases, the party from which a securitization sponsor acquires pool assets, though not itself the original creditor, may be a party that could appropriately be viewed as the originator for purposes of allocation of risk retention. We refer to such a party that transfers assets to a sponsor as a "transferor." Under some types of lending arrangements, which have been commonplace in the market for many years, a correspondent lender applies the underwriting criteria of a transferor in originating assets pursuant to an agreement whereby the transferor had committed to purchase from the correspondent lender assets that satisfy the transferor's criteria. Regulation AB does not contain a definition of "originator." However, if there was such a pre-existing relationship between a correspondent lender and a transferor that purchased the assets, many securitizers conclude that, for purposes of satisfying the prospectus disclosure requirements of Regulation AB under the Securities Act, a transferor that had committed to and did purchase assets

[46] The 30 day delinquency provisions which we support with respect to the seasoned mortgage loan exemption – which operates at the loan level – is not applicable at the pool level, where the determination of eligibility for risk retention sunset is made. Also, the purpose of these requirements in the sunset context is slightly different than in the seasoned loan context. For seasoned loans, the purpose of the requirements is to demonstrate that credit risk retention is not needed to incentivize the origination and securitization of quality older loans, both because they were originated long ago and because their payment history shows that they bear a low risk of default. For sunset purposes, the rationale focuses solely on how long risk retention needs to be held to incentivize the origination and securitization of quality loans generally.

[47] Re-Proposing Release, 78 Fed. Reg. at 57935.

originated in accordance with its specified criteria, and not the correspondent lender, is the true "originator."[48]

We understand that the Agencies are not starting with a blank slate when determining who may be considered an originator for purposes of risk retention. Section 15G(a)(4) of the Exchange Act defines "originator" to mean a person who, "*through the extension of credit or otherwise*, creates a financial asset that collateralizes an asset-backed security" and "sells an asset directly or indirectly to a securitizer" (emphasis added). It is not required that the originator be the person who initially extends credit, or the phrase "or otherwise" would be mere surplusage. Therefore, we disagree with the Agencies' statement that "only the original creditor under a loan or receivable"[49] can be the originator. Where (1) a correspondent lender applies the underwriting criteria of a transferor in originating assets (2) pursuant to an agreement whereby the transferor had committed to purchase from the correspondent lender assets that satisfy the transferor's criteria, and (3) the transferor transfers the assets directly or indirectly to a securitizer, the transferor – not the correspondent lender – is the party that created the assets. In this circumstance, the transferor is the "originator" under Section 15G(a)(4).

We urge the Agencies to agree with our reasoning and conclusions with respect to correspondent lending relationships. If the Agencies will not do so, then at the very least we request acknowledgement of the statutory mandate that a financial asset can be created otherwise than through the extension of credit and withdrawal of the Agencies' inconsistent statement that "only the original creditor" can be an originator, thus permitting sponsors and their counsel to draw the appropriate conclusion directly from the language of the statute.

F. <u>There Should Be a Blended Pool Option for QRMs</u>

In the Prior Comment Letters, we commented that the qualifying asset risk retention exemptions – whether for QRMs or qualifying commercial real estate loans, commercial loans or auto loans – should not be all or nothing, and that credit risk should be required to be retained on a proportional basis to the extent that a securitized pool includes non-qualified assets. The Agencies have partially responded to this request with respect to qualifying commercial real estate loans, commercial loans or auto loans with the so-called "blended pool" option, but have not proposed to allow QRMs to benefit from this approach.

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[48] This arrangement should be distinguished from secondary market purchases of assets, where a transferor may review assets post-origination for conformity with its guidelines, but there was no pre-existing relationship between the parties and no prior commitment to purchase.
[49] Re-Proposing Release, 78 Fed. Reg. at 57935.

We continue to believe that the blended pool option, modified as per our comments,[50] should apply to QRMs, so that QRMs could be securitized with, for example, seasoned loans (with no resulting risk retention requirement), or other types of mortgage loans (resulting in a requirement for partial risk retention). We do not believe there is any policy reason to distinguish QRMs from other classes of qualified assets in this regard.[51]

In the Re-Proposing Release, the Agencies requested comment on whether a blended pool option for QRMs could be constructed, "given the provisions of paragraph (c)(1)(B)(i)(II) and the exemption authority in paragraph (c)(2)(B), (e)(1) and (e)(2) of Section 15G."[52]

Paragraph (c)(1)(B)(i)(II) states that the rules must require the retention of "not less than 5 percent of the credit risk for any asset . . . that is a [QRM] that is transferred, sold, or conveyed through the issuance of an [ABS] by the securitizer, if 1 or more of the assets that collateralize the [ABS] are not [QRMs]." However, the Agencies also have extremely broad exemptive authority. Pursuant to paragraph (c)(1)(G), the rules "shall . . . provide for . . . a total or partial exemption of any securitization, as may be appropriate in the public interest and for the protection of investors." Paragraph (e)(1) allows the Agencies to "adopt or issue exemptions, exceptions, or adjustments for classes of institutions or assets," subject to the requirement of paragraph (e)(2) that such an exemption, exception or adjustment must "help ensure high quality underwriting standards for securitized assets, encourage appropriate risk management practices, improve the access of consumers and businesses to credit on reasonable terms, or otherwise be in the public interest and for the protection of investors."

According to the Re-Proposing Release, "allowing both qualifying and nonqualifying assets to secure [ABS] should promote liquidity in the relevant securitization markets without harming the goals of risk retention requirement. . . . The . . . proposal to apply a 0 percent risk retention requirement to qualifying assets would likely enhance the liquidity of loans underwritten to the qualifying asset underwriting standards, thereby encouraging originators to underwrite more qualifying assets of high credit quality."[53] In addition, "allowing blended pools with a reduced risk retention requirement will improve efficiency, competition and capital formation by allowing sponsors to securitize more loans when it is difficult to obtain a large enough pool of qualifying assets to issue an ABS consisting entirely of exempted assets."[54]

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[50] We refer you to our comments on the blended pool option generally, which would apply equally to any blended pool option for QRMs.
[51] We also refer you to the Housing Policy Council Letter for further discussion of this topic.
[52] Re-Proposing Release, 78 Fed. Reg. at 57987.
[53] *Id.*, 78 Fed. Reg. at 57986.
[54] *Id.*, 78 Fed. Reg. at 58011.

Nothing distinguishes the applicability of these conclusions to QRMs. A blended pool option for QRMs would satisfy the statutory requirements for a partial exemption from the risk retention requirements, because it would help ensure high quality underwriting standards for residential mortgages and improve the access of consumers and businesses to credit on reasonable terms – all without harming the goals of the risk retention requirement. We urge the Agencies to adopt a QRM blended pool option, because it would be in the public interest and for the protection of investors.

The blended pool option will be even more important if, despite our serious reservations, the Agencies adopt QM-plus rather than QM as the standard for QRMs. In that event, the resulting standard would be very high, so the origination of enough QRMs to securitize could take a considerable amount of time. As noted in the Prior Comment Letters, if a securitizer must wait until it has assembled a critical mass of qualified assets sufficient to support an ABS offering by itself, the liquidity of these loans could be significantly impaired, the originator would bear the cost of holding and financing those loans, and the origination of qualified assets would therefore be discouraged. We believe that the risk retention rules should be designed to encourage, rather than discourage, origination of higher quality loans, and the change we recommend would be a step in that direction.

G. Where a Credit Investor Acquires and Finances Mortgage Assets Through a Securitization Sponsored By a Broker-Dealer at Its Request, the Credit Investor Should Be Permitted to Retain the Required Risk

Many securitizations of mortgage assets are intended to provide financing to a credit investor who is not otherwise able to invest directly in mortgage assets (such as whole mortgage loans). In these transactions, the investor never takes direct possession of the assets prior to the closing of the securitization. Rather, the investor contracts with a broker-dealer to purchase specified mortgage assets. The broker-dealer sells the assets to the securitization trust, sells senior securities on behalf of the credit investor, and delivers the subordinate securities to the credit investor.

These securitizations improve efficiency and liquidity in the financial markets, for the benefit of asset investors and consumers, by enabling a wider universe of credit investors than would be possible if risk retention were limited to securitization sponsors and the other parties contemplated by the proposed rules. These securitizations are not undertaken at the behest of the sponsor. Rather, they are a tool to provide financing to the credit investor, who selects the collateral underlying the securitization and bears the economic risk in the assets. Therefore, in these circumstances, the credit investor should be permitted to retain the required risk, so long as this choice is disclosed in the offering documents.

III. Commercial Mortgage-Backed Securities and the Definition of "Qualifying Commercial Real Estate Loan"

According to the Dodd-Frank Act, the Agencies are authorized to include in the risk retention rules a risk retention option for CMBS transactions that provides for retention of the first loss position (commonly known as the "B-piece") by a third-party purchaser that specifically negotiates for its purchase, holds adequate financial resources to back losses, provides due diligence on all individual assets in the pool before the issuance of the CMBS, and meets the same standards for risk retention that would be required of a sponsor. We appreciate the attention paid by the Agencies to their proposal of this risk retention for CMBS, which recognizes the benefits of the special structural safeguards that already are built into the CMBS structure as a result of market forces. These safeguards have resulted in a vibrant market for CMBS and low levels of defaults, delinquencies and losses, even in the immediate aftermath of the financial crisis.

Also of great importance to the CMBS industry is the definition of "qualifying commercial real estate loans" ("QCREs"), which if appropriately tailored will be another viable option for many CMBS sponsors, particularly since the Agencies have proposed to allow blended pools of QCREs and non-QCREs.

In addition to the specific issues noted below regarding the proposed CMBS risk retention option and the definition of QCRE, CMBS market participants also are focused on our general comments above regarding allocation among multiple sponsors and allocation to originators, and we urge you to consider them in that light.

A. We Support CREFC's Comment Letter

In general, we support the comment letter submitted by the Commercial Real Estate Finance Council ("CREFC") with regard to the proposed CMBS option and the definition of QCRE, which addresses these matters in great detail. Among other things, we support CREFC's positions regarding modification of the cash flow limitations on an eligible horizontal residual interest, a senior/subordinate structure for B piece retention, a complete exemption from risk retention for single borrower/single credit transactions, a significantly broader definition of QCRE, an appraisal reduction amount calculation for operating advisor consultation rights, an increase in the voting quorum to replace the special servicer, broadened permissible B-piece buyer affiliations, and a variety of technical recommendations. While we support all of CREFC's positions, we urge the Agencies to pay particular attention to the following issues.

B. Multiple B-Pieces Should Not Need to Be *Pari Passu*

We appreciate the Agencies' positive response to comments requesting additional flexibility in satisfying the CMBS risk retention option. In particular, we appreciate that the re-proposal would permit up to 2 third-party purchasers to satisfy the CMBS option by purchasing an eligible horizontal residual interest. However, as re-proposed, each purchaser's interest would be required to be *pari passu* with the other's interest, so that neither purchaser's losses are subordinate to the other's losses. The Re-Proposing Release does not contain any explanation for this requirement, which we believe to be inappropriate. Traditional B-piece buyers often lack the capital to take on exposure to a full 5 percent of the credit risk in a transaction, but if the B-piece were permitted to be split into a senior piece and a subordinated piece, they could find investment partners to take on the senior piece. We believe that this B-piece structure should be permitted by the CMBS option.

In our view, the subordination of one CMBS purchaser's eligible horizontal residual interest to another's should be permissible, so long as both purchasers meet the eligibility requirements set forth in the rules (including the requisite independent review of the pool assets and lack of prohibited affiliations), and so long as both interests are in consecutive order based on subordination level and together represent the most subordinated interests in the capital structure. One might be concerned that a senior/subordinate B-piece structure could result in the purchaser of the senior interest being less concerned about, and not performing as effectively, the required due diligence. However, the holder of the subordinate interest – the traditional B-piece buyer – would continue to have the same strong interest in performing complete and effective due diligence. CMBS structures would continue to be subjected to a strong, meaningful due diligence effort at the instigation of the traditional B-piece buyer, as they are today.

In sum, we believe that our proposed requirements for a senior/subordinate B-piece structure would still ensure that each buyer bears meaningful risk. We do not believe that permitting the B-piece to be tranched in this manner would have any adverse impact on the goals of credit risk retention.

C. Single Borrower/Single Credit CMBS Transactions Should Be Exempt from Risk Retention

We join CREFC in urging the Agencies to provide a full exemption from the credit risk retention requirements for single borrower/single credit CMBS transactions. These transactions involve only one loan (or a pool of cross-collateralized loans that essentially functions as one loan).

These transactions are already of extremely high quality and present very low default rates, for obvious reasons. Deal structures are simple and transparent. With only a single borrower to cover, diligence generally is extremely thorough. Historically, there has been no role for B-piece buyers in this space, and the imposition of credit risk retention requirement would significantly increase the cost of credit for potential borrowers – which may result in borrowers exiting this market altogether. There simply is no need for credit risk retention in these deals, as there is already more than sufficient incentive to align the interests of investors and sponsors and produce high-quality ABS.

D. The Definition of "Qualifying Commercial Real Estate Loan" Should Be Broader

Even as re-proposed, the definition of QCRE continues to be too restrictive. Our analysis suggests that as few as 7 percent (by principal balance) of all commercial real estate loans originated today would qualify for the QCRE exemption from risk retention, a number that we consider significantly too low. In order to be useful for originators and securitizers, the definition of QCRE should be broad enough to encompass more than a *de minimis* portion of the market.

First, there should be no minimum loan term requirements. The Agencies present no support for their assertion that loans with shorter terms may create improper underwriting incentives. As CREFC notes, the data suggests that shorter-term loans historically have been safer.

Second, the amortization period should be permitted to be as long as 30 years for all assets. Thirty years is the standard market term for all asset classes, not just multifamily residential loans. A shorter maximum amortization period will result in the loss of many high quality loans to other markets.

Third, interest-only loans should be permitted, so long as the LTV ratio is 50 percent or less. Again, the Agencies provide no data to support their claim that long-term interest-only loans are associated with higher credit risk.

Fourth, the Agencies should eliminate the lower LTV/CLTV ratio caps for loans documented with appraisals that use lower capitalization rates. The Agencies assert that a low cap rate will inflate the appraised value of the property and increase the amount that can be borrowed with a fixed LTV or CELT. As noted by CREFC, market experience is to the contrary, in that the safest loans on the most mature properties in premier markets generally are appraised with lower capitalization rates because of their very stability.

IV. Resecuritizations and Repackagings

In a resecuritization transaction, the sponsor typically takes one or more existing ABS and transfers them to a depositor, which then creates a new securitization transaction where the pool of assets consists solely of the previously issued ABS. The payments on the new ABS depend primarily on the cash flows from the underlying ABS. Resecuritizations commonly use very simple structures involving a single class of underlying ABS or at most a small number of classes of underlying ABS (often including most or all of the securities comprising the class or classes of underlying ABS). By credit tranching the underlying securities, resecuritizations can be valuable "de-risking" transactions for institutional holders of the underlying ABS whose ratings have been downgraded or which have otherwise become impaired. Indeed, credit tranching generally is the primary purpose for a resecuritization – a holder of the ABS that are deposited into a resecuritization desires to create a security representing exposure to only part of the risk of the underlying security.

We appreciate the Agencies' proposal of an exemption from the credit risk retention requirements for certain single class pass-through resecuritizations, even though we believe that this exemption would benefit from several important modifications. This exemption would require compliance with two conditions:

- The transaction must be collateralized solely by existing ABS issued in a securitization for which credit risk was retained as required under the rule or which was exempted from the credit risk retention requirements of the rule ("15G-compliant"), and servicing assets; and

- The transaction must involve the issuance of only a single class of ABS interests and provide for the pass-through of all principal and interest payments received on the underlying ABS (net of the issuing entity's expenses).

A resecuritization that involves the issuance of more than one class of securities would not have the benefit of this exemption, so retranching for credit risk would be prohibited. Also, legacy ABS issued before the effective date of the risk retention rules and for which risk was not retained would not be eligible for this exemption.[55]

[55] The Agencies also have proposed an additional exemption for certain multiple class securitizations of first-pay classes of RMBS. A "first-pay class" would be defined as a class of ABS interests which are all entitled to the same priority of payment and are entitled to payments of principal and interest prior to or pro rata with all other classes (except for principal-only or interest-only tranches that are prior in payment). There would be several conditions to the first-pay RMBS exemption, which would permit retranching but only for prepayment risk. As far as we are aware, the only resecuritizations where retranching prepayment risk is common are in the Agency CMO market, but

For the reasons discussed above, we remain concerned about the narrow scope of the proposed resecuritization exemption. While we recognize that the Agencies carefully considered this exemption, we believe it is important for the Agencies to expand it in three key ways:

- Credit tranching should be permitted, subject to appropriate conditions;
- The exemption should permit the resecuritization of legacy ABS issued before the effectiveness of the credit risk retention rules, regardless of whether risk was retained in the underlying transaction; and
- Resecuritizations of multiple classes of underlying ABS should be permitted, so long as the cash flows from each class of underlying ABS support their own classes of new ABS.

A. The Resecuritization Exemption Should Permit Credit Tranching and the Issuance of Multiple Classes of ABS Interests

A holder of one or more ABS bonds – particularly ones that have not performed as well as was expected, or have been downgraded – may prefer to have bonds with greater protection from losses, or with a higher credit rating. For example, a holder may be forced to sell because the downgraded security does not meet its investment guidelines, even though it would otherwise wish to keep the exposure. Such a holder may request that a financial institution resecuritize them into two or more new securities. The new junior bonds will represent a more subordinated claim on the cash flows of the underlying ABS, serving as credit support for the new senior bond. The junior bonds may be sold into the market, or retained by the original owner of the underlying ABS and disposed of at a later time. Alternatively, the holder may desire exposure only to the riskier aspects of the security, and retain the subordinated bond but sell the more highly rated senior bonds.

In each case, there is no new credit risk created; the amount of risk in the system is the same before and after a bond has been resecuritized. All of the credit risk that existed on the previous transaction still exists – it has neither been increased nor decreased. Risk is merely reallocated from the underlying ABS into the new securities. Furthermore, resecuritizations often are done at the request of the holder of the underlying ABS, or as a condition of purchase

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because securities issued by Fannie Mae and Freddie Mac will have the benefit of their own separate exemption from risk retention, the usefulness of this exemption is likely to be minimal. While we do not object in any way to the inclusion of the first-pay RMBS exemption in the final rules, our members do not believe they are likely to make use of it. Therefore, we do not direct any of our comments toward this proposed additional exemption.

of those bonds by a potential investor. Resecuritizations are not "originate-to-distribute" transactions – the underlying ABS (and the associated credit risk) already exist. For that reason, credit risk retention in a resecuritization will not (and cannot) impact the quality of the origination of the underlying pool assets. Also, because of the investor-driven nature of many of these transactions, we do not believe that requiring credit risk retention would have any material influence on the selection of ABS to be resecuritized.

Unfortunately, the proposed exemption for pass-through resecuritizations would not permit credit tranching, as it would allow the issuance of only a single class of ABS interests. Therefore, resecuritizations where credit is retranched – by far the most common type of resecuritization – generally would require the retention of credit risk by the sponsor.

In our view, the market impact of requiring credit risk retention for every resecuritization in which credit risk is tranched will eviscerate the market for plain vanilla resecuritization transactions. This would be quite unfortunate, as resecuritization has proven to be a valuable risk mitigation tool for investors and an important mitigating force for some of the consequences of the financial crisis. The capital and other costs required to retain the risk in every resecuritization in which credit risk is tranched would likely exceed the revenue from the transaction, or at least decrease returns sufficiently that it will be more economical to deploy capital elsewhere. Our member firms that commonly resecuritize ABS at the request of their clients have reported that they would be much less likely to do so if they were required to retain 5 percent of the credit risk of each resecuritization. Investor choice would be decreased, and holders of ABS positions would need to resort to other measures to manage their credit risk exposure, such as purchasing credit protection or other less efficient means which may introduce additional forms of risk to the holder.

We believe it is important to distinguish collateralized debt obligation ("CDO") transactions from resecuritizations. CDOs are commonly acknowledged as having contributed substantially to the credit crisis and are, at this point, dormant in the U.S. market. Resecuritizations, to the contrary, have been a valuable tool used by *investors* to *mitigate* the impact of the credit crisis. CDOs had actively managed asset pools, where the intent was to profit from changes in the market value of the underlying assets by means of acquisitions and dispositions. The asset pools for resecuritizations are not actively managed and, in most cases, are completely static. Therefore, there is no ability to significantly alter the credit risk profile over time by changing the nature of the asset pool. Resecuritizations simply do not present any of the same risks that were common with CDOs. It would be unfortunate in the extreme if a valuable investor tool that imposes no systemic risk were to be completely foreclosed by overly broad rulemaking.

Should the Agencies have any remaining concerns about whether a broadened resecuritization exemption would inadvertently facilitate the resurrection of the CDO market, we suggest that the Agencies consider adopting three additional conditions to credit retranching and the issuance of multiple ABS interests, which are specifically directed towards excluding CDOs and other actively managed structures:

- The resecuritization vehicle will only passively own or hold the pool of underlying ABS, without any active management of the pool;
- All payments on the newly issued tranches will be attributable only to the cash flows of the underlying ABS and other permitted assets, and not based upon changes in the value of the underlying assets; and
- The vehicle will not acquire new assets or dispose of assets in order to realize gain or minimize loss due to changes in market value of the underlying assets.[56]

We strongly believe that imposition of these additional conditions would eliminate the types of risks and dangers associated with CDOs and other actively managed structures, even when the resecuritization involves credit tranches of the cash flows of multiple underlying assets, and we urge the Agencies to adopt them if they have any concerns in that regard.

In the unlikely event that the Agencies do not believe that our proposed additional conditions are sufficient to address these risks, we believe that the retranching for credit risk could be safely accommodated if it were only permitted when the underlying assets consist of a single class of ABS issued by the same issuer. While such a stringent limitation is not, in our view, necessary, it would still preserve a substantial part of the current market for resecuritizations. Therefore, if the Agencies determine that they cannot accede to our request to amend the proposed resecuritization exemption to permit credit retranching even with our proposed additional conditions, we ask the Agencies to amend the proposed resecuritization exemption to permit credit retranching and the issuance or multiple classes of ABS interests if the underlying assets consist of a single class of ABS issued by the same issuer.

[56] These conditions are drawn from an interpretive letter issued by the Commodity Futures Trading Commission (the "CFTC"), which concluded that certain securitization vehicles would not be included within the definition of "commodity pool" so that an operator of one of those vehicles would not be a "commodity pool operator" that is required to register. See Request for Exclusion from Commodity Pool Regulation for Securitization Vehicles, CFTC Interpretation Letter No. 12-14 (Oct. 11, 2012), available at http://cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/12-14.pdf.

In sum, we urge the Agencies to permit credit tranching and the issuance of multiple classes of ABS interests in exempt resecuritizations, with appropriate conditions.

B. The Resecuritization Exemptions Should Permit Resecuritization of Legacy ABS Where Risk Was Not Retained

At the time that the credit risk retention rules become effective, there will be a large number of ABS already issued and outstanding. Very few, if any, of these legacy ABS will be compliant with the credit risk retention rules, or structured to take advantage of one of the regulatory exemptions from credit risk retention. The proposed resecuritization exemption would not apply to these legacy assets, so any resecuritization with legacy assets as the underlying generally would require credit risk retention by the sponsor. However, as described above, without appropriate exemptions from risk retention for resecuritizations, we believe that the vast majority of these transactions will become uneconomical. That would be quite unfortunate, as resecuritization is an important risk-mitigating tool for investors.

As discussed in more detail above and in the prior SIFMA letter, resecuritization does not create new credit risk in the underlying ABS securities, nor does it alter the payment of principal and interest by the underlying assets, both of which would still be subject to pass-through, net of issuer fees. Rather, the payment streams are reallocated to create the resecurization bonds. And because the underlying legacy ABS already exist, requiring credit risk to be retained in the resecuritization will have no effect on the origination of the pool assets supporting the legacy ABS. Investors resecuritize their portfolio ABS for a variety of reasons, but requiring the sponsor to retain credit risk will have no effect on those decisions – the alignment of interests between those of the sponsor and investors is an irrelevant consideration when the investor requests and dictates the structural outcome, or where the investor is the sponsor. For these reasons, requiring risk retention will only make this important tool more expensive for, or completely unavailable to, investors.

C. Resecuritizations Of Multiple Classes of Underlying ABS Should Be Permitted, So Long as the Cash Flows Support Different Classes of New ABS

As noted, the proposed exemption for resecuritizations would permit only the issuance of a single class of ABS interests. We have requested that the resecuritization exemption permit the issuance of multiple classes of ABS interests for purposes of credit tranching, as described above, but there is another common structure involving the issuance of multiple classes of ABS that we believe should be expressly permitted by the final credit risk retention rules, regardless of whether they permit credit tranching.

Sometimes, for convenience and cost savings, holders of ABS will resecuritize several classes of its portfolio ABS at once in a single transaction. In this structure, each different class of ABS interests issued by the resecuritization trust is linked to specific class of underlying ABS, and the cash flows for each class of resecuritization ABS rely exclusively on the cash flows from the linked underlying class of ABS. In effect, for investor convenience and cost savings, several resecuritizations are effectively accomplished by means of a single transaction. Essentially, this type of multi-tranche resecuritization is really just the combining of multiple resecuritizations in a single vehicle. We do not believe that permitting the issuance of multiple classes of ABS interests for these purposes will have any effect at all on the credit risk profile (or payment streams) of the transaction.

Therefore, whether or not the Agencies determine to permit multiple classes of ABS interests to be issued for credit tranching purposes, we request that the final resecuritization exemption expressly permit multiple classes of ABS interests to be issued in a resecuritization, where each class is linked to (and its cash flows depend on the cash flows from) a separate class of underlying ABS.

D. The Agencies Should Adopt an Exemption for Repackaging Transactions[57]

We reiterate our prior comments urging the Agencies to provide an exemption for corporate debt repackaging transactions, because they do not involve the creation, modification or tranching of credit risk. In essence, corporate debt repackagings are very similar to single class pass-through resecuritizations of an underlying asset that is subject to or exempt from the credit risk retention requirements, and the Agencies have already proposed an exemption for those transactions. For the reasons discussed below, it seems incongruous that the Agencies would allow such an exemption for resecuritizations, but not for repackaging transactions, which historically have, for the most part, followed a very similar structural model.

A repackaging transaction (which the industry refers to generically as a "repack" or "corporate debt repack") does not involve either underlying ABS or municipal bonds. Rather, a repack is created by depositing a single-issuer fixed income security, typically a corporate bond[58] or other fixed-income security, in a trust or other special purpose issuance vehicle. The typical transaction is designed to alter the interest rate, denomination or term of the underlying fixed

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[57] Please note that SIFMA will submit separate comments on the application of the re-proposal to municipal tender option bond transactions. See letter from Ashurst on behalf of Citibank, N.A., Deutsche Bank AG, New York Branch, J.P. Morgan Securities LLC, Societe Generale, New York Branch, Wells Fargo Bank, N.A., and Securities Industry and Financial Markets Association dated October 30, 2013.

[58] Corporate bonds are the most common underlying asset, but repacks may also involve certain other fixed income securities issued in the capital markets, including sovereign debt securities and trust preferred securities. .

income security.[59] The repackaging issuer ultimately issues one or more securities representing the right to receive cash flows based on the single underlying security, but with certain other characteristics that differ from the underlying security. Payments on the securities issued by the repackaging issuer are not prioritized or tranched in a way that creates a new credit exposure, but instead are based on the payment of principal and/or interest payments from the underlying security's cash flows.

In the current market, corporate debt repackaging transactions are most often created by a sponsor at the request of a customer. These customers are typically institutional investors who want credit exposure to a particular bond or bond issuer, and could buy the underlying bonds – and 100 percent of the related credit exposure – directly in the secondary market. However, the investors may prefer features that are not readily available on bonds in the secondary market. For example, the investor may want a different maturity or series of maturities or a floating coupon rather than fixed coupon. Repackaging structures address these investor desires and needs by changing the payment or other characteristics of the underlying corporate debt, and without altering the credit risk (*i.e.*, the risk of nonpayment by the issuer of the underlying corporate debt).

We believe the Agencies should not subject this form of repackaging transaction to the risk retention requirement for several reasons. First, repacks differ from traditional securitizations in material ways. In a repack, the underlying asset is a single fixed income security, not ABS or any other form of pooled financial assets that support traditional securitizations. A single security goes in to the repack issuer, and one or more securities comes out, but because there is no credit tranching the underlying fixed income security and the securities issued by the repack trust both have the same credit risk. In other words, investors can directly acquire either the underlying bonds or the repack certificates, and because the repack does not involve tranching of credit risk, the credit exposure acquired by the investor in either case is exactly the same.

Second, because the underlying security in most cases is a pre-existing, fixed income security of an unrelated issuer acquired in the secondary market, the sponsor can have no meaningful impact on the underwriting standards of that underlying security.

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[59] The alteration of rates, terms or denominations are accomplished through the structural features of the issuance entity, or by other contractual arrangements which may include a swap. For example, to shorten the term and alter the denomination of the underlying assets, a repack trust issuer may issue a single class of pass-through securities representing the right to receive principal and interest on the bonds, but with a smaller minimum denomination that the underlying bonds, together with a call warrant representing the right to acquire the underlying securities at par. This structure creates the economic equivalent of a callable bond. Callable bonds are available in the marketplace and are not themselves subject to risk retention.

Third, and perhaps more importantly, it would not further the legislative purposes behind the credit risk retention rules to require sponsors to retain credit risk on repack securities where there is no credit tranching, and the underlying securities are fixed income securities (which are not subject to credit risk retention) that the sponsor's institutional customers have requested and could directly acquire in the primary or secondary market, or which they may already own. Sponsors would be unwilling to create these structures for their institutional customers if the sponsors were forced to, in effect, co-invest with them by retaining risk.[60] The result would be the loss of a valuable portfolio management tool to institutional investors. We do not believe that Congress intended this result, as there simply is no "moral hazard" that might justify a risk retention requirement. For all of these reasons, we ask the Agencies to exempt repackaging transactions from any risk retention obligation.

V. Collateralized Loan Obligations and the Definition of "Qualifying Commercial Loan"

Managed collateralized loan obligations ("CLOs") involve the issuance of securities representing a pool of syndicated loans (primarily ordinary corporate, senior secured loans) selected and actively managed by an independent third party manager.

CLOs serve as a valuable source of financing for lenders to middle-market and larger companies, as they help to ensure the availability of less expensive financing sources for such lenders as well as an active secondary market for loans. In providing a market for such loans, CLOs provide an important means for bank lenders to manage their risk and comply with capital rules, as well as enabling further lending by such lenders. CLOs are likely to be an especially important source of financing going forward given the implementation of new capital rules that are likely to discourage banks from lending to smaller, non-investment grade companies.

While we appreciate the Agencies' consideration of the comment letters submitted in respect of the Original Proposal and their attempts to provide an additional risk retention option for CLOs by including the arranger option, we believe that the proposed rules (including the arranger option) remain largely unworkable for CLOs and will, if adopted as written, have a widely detrimental effect on the CLO market and on the businesses who rely on it as a source of financing. In order to avoid these disastrous results, we urge the Agencies to adopt the recommendations of the Loan Syndication and Trading Association (the "LSTA") in its comment letter on the re-proposal.

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[60] The situation could be just as troublesome from the institutional customer's side. The institutional customer, even if it already owns the underlying security, would effectively be forced to sell the sponsor 5 percent of its position, even if it wants to retain 100 percent of the exposure.

A. CLOs Are Different from and Do Not Present the Same Risks as, Other Types of ABS, and Already Contain Elements of Risk Retention by Managers in Their Fee Arrangements

As noted in our Prior Comment Letters, CLOs are very different from most ABS transactions in several crucial respects. In their selection and management of assets, for instance, they are much more similar to a debt mutual fund than they are to a securitization of mortgage loans. The relationship of the independent third-party asset manager to the investors is much more akin to the relationship between the fund manager and investors in a private equity fund than it is to the relationship between investors and either the sponsor or the depositor in a traditional securitization. In addition, the activities of CLO managers may be constrained by their fiduciary duties under the Investment Advisers Act of 1940, as amended.

The market classifies CLOs as a type of securitization, rather than as a private fund, largely because of some of the structuring techniques they use and the fact that they issue rated debt. They generally have no depositor, nor do they have a sponsor that is in the chain of title for the assets. Many of the assets acquired by managed CLOs are acquired in secondary-market transactions and thus are not part of the "originate-to-distribute model" that some view as one of the drivers of the credit crisis.

Additionally, many of the syndicated corporate loans held by CLOs are priced daily by third-party pricing services, and interests in those loans are widely traded by financial institutions, so there is a much greater degree of transparency than for most financial assets underlying ABS. These types of loans are made to corporate borrowers by financial institutions, who may then sell the loans to other lenders or to CLOs, or may hold them to maturity. For this reason, only a portion of the loans made to a given corporate borrower under a given loan facility will be owned by CLOs at any time, and only a much smaller portion is likely to be owned by any individual CLO.

CLO managers are compensated with a fee for their investment advisory services rather than through an interest in the proceeds of the sale of the assets. These fee arrangements are structured in a way that strongly ties them to the performance of the loan assets, and closely aligns the interests of the CLO manager with those of the investors. In our view, these existing fee arrangements already contain an element of risk retention that should be taken into account by the Agencies in formulating the final credit risk retention rules. In addition, as further discussed below, most CLO managers simply do not have the balance sheet capacity to fund a 5 percent risk retention in the CLOs they manage.

For these and other reasons, as stated in the Prior Comment Letters, we continue to believe that CLOs are not the types of transactions that were meant to be subject to the risk retention requirements of Section 941.

However, if the Agencies nonetheless determine to require risk retention by CLO managers in the final rules, we strongly believe that the Agencies should take into account all of these considerations, as well as the importance of CLOs as a source of financing to U.S. corporate borrowers (and the low default rate of CLOs, even in the depth of the credit crisis). Based on these factors, the risk retention rules for CLOs should be revised in a manner that will enable CLOs to comply, without completely disrupting well-functioning markets.

B. We Support the LSTA's Request for the Rules To Be Modified To Provide a Workable, Realistic Risk Retention Option for CLOs and Appropriate Exemptions for Qualified Assets and Structures

As highlighted in our Prior Comment Letters, and as discussed in great length in the comment letters submitted by the LSTA both on the Original Proposal and the re-proposal, it would be very difficult (or even impossible) for most CLO managers to make the scale of investment that would be required for any of the sponsor risk retention options proposed by the Agencies. The difference between the capital available to a CLO manager and the capital available to the sponsor of a securitization who is in the chain of title of the assets is substantial, and reflects the difference in roles between an investment adviser and a principal. Risk retention by CLO managers therefore is simply not a realistic option for most CLOs.

Additionally, as the LSTA has also noted in its comment letter (after consulting with a large number of arrangers and other market participants), the arranger risk retention option proposed by the Agencies for "open market CLOs" in the re-proposal is unworkable, and does not present a realistic option for risk retention by CLOs. A long-term requirement to keep loans on their books is not an option for arrangers who are banks, as this flexibility is inconsistent with prudential risk management and compliance with capital rules. The re-proposal therefore creates a direct conflict between the risk retention regulations and the other important regulatory régimes applicable to bank lenders. For these and other reasons explored at length in the LSTA's letter, the institutions surveyed by the LSTA indicated that they would not undertake a meaningful portion of their loan syndications in a manner that would produce CLO-eligible loan tranches as would be required to take advantage of the open-market CLO option, and certain of them indicated that they would not agree to not sell or hedge their resulting loan positions to any degree.

Given the fundamental flaws in both the risk retention by CLO managers and the open-market CLO option for risk retention by arrangers, the re-proposal leaves CLOs without a

workable option for compliance with the risk retention rules. Left unchanged, the proposed rules would likely have a broadly detrimental effect on both the CLO markets and the availability of credit to businesses.

We urge the Agencies to revise the rules by replacing the open-market CLO option with new, workable methods for compliance by CLOs with the risk retention rules. Such methods should provide options and flexibility for risk retention to the greatest extent possible (including *via* existing fee structures and third party involvement). In addition, we recommend that the Agencies adopt a broader definition of "qualifying commercial loan," because the criteria as proposed in the re-proposal would apply to only a very small number of commercial loans.

Toward all of these ends, we encourage the Agencies to consider and adopt the suggested alternatives submitted by the LSTA in its extensive comments on the re-proposal.

VI. Asset-Backed Commercial Paper Conduits

We appreciate the Agencies' good faith attempt to craft a specialized risk retention method for asset-backed commercial paper ("ABCP") conduits[61] based on actual market practices. However, for a variety of reasons, the specifics of the proposal simply would not work for a large portion of the ABCP conduits currently in existence. We urge the Agencies to avoid significant market disruption by revising the proposed ABCP risk retention option to accommodate the methods of risk retention that already are prevalent in the market.

ABCP conduits use securitization technology to access the short-term debt capital markets in order to provide funding to the sponsoring bank's clients. ABCP conduit transactions are underwritten by banks in the same way as and generally are otherwise indistinguishable from loans and other financings directly funded by banks. Like the customers for a bank's loans, the customers for ABCP conduit transactions are predominantly manufacturers, automobile companies, and other industrial companies whose success is critical to the overall U.S. economy.

In our strongly held view, common liquidity and credit enhancement features are more than sufficient to ensure that bank sponsors of ABCP conduits have enough "skin in the game" to align their interests with those of investors, the policy goal of Section 941(b) of the Dodd-Frank Act, so we ask the Agencies to modify the proposal to more closely align with liquidity and credit enhancement features already employed by many conduits. Consistent with current market practices, we also request expansion in the types of assets that ABCP conduits are permitted to acquire, and (in light of already extensive disclosure practices driven by market

[61] When we refer to ABCP conduits, we mean multi-seller ABCP conduits, as opposed to securities arbitrage conduits or other types of vehicles.

pressures) a reduction in the reporting burden that would be imposed by the re-proposed rules. In addition, we ask the Agencies to eliminate the requirement that the tenor of qualifying ABCP be limited to 270 days, and in order to avoid almost insurmountable practical difficulties with changing the long-term contractual arrangements in place for existing ABCP conduits, we request "grandfathering" of legacy assets already in conduit asset pools.

A. Current Market Practices for Liquidity Coverage and Credit Enhancement Provide More than Sufficient "Skin In the Game" in ABCP Conduits

One of the requirements for an ABCP conduit to be eligible for the proposed ABCP conduit credit risk retention option is that the conduit must have 100 percent liquidity coverage (in the form of a lending facility, asset purchase agreement, repurchase agreement or the like) from a regulated liquidity provider (generally, a bank or similar financial institution) with respect to all ABCP issued by the conduit, provided by a single regulated liquidity provider. The term "100 percent liquidity coverage" would be defined by §___.6(a) to mean the entire outstanding balance of all issued ABCP plus accrued but unpaid interest, "without regard to the performance of the ABS interests held by the ABCP conduit and without regard to any credit enhancement." According to the Agencies:

> Amounts due pursuant to the required liquidity coverage may not be subject to credit performance of the ABS interests held by the ABCP conduit or reduced by the amount of credit support provided to the ABCP conduit. Liquidity coverage that only funds performing ABS interests will not meet the requirements of the ABCP option.[62]

An ABCP conduit that meets all of the proposed rules' requirements, including the liquidity coverage requirement, would be able to satisfy its risk retention requirement if each originator-seller to the conduit retains credit risk equal to 5 percent of the fair value of the assets it contributes in the manner required by the rules.

The liquidity coverage requirements that have been proposed would not function effectively for a large part of the ABCP market, and do not give credit to the fact that conduits already have an effective risk retention scheme in place, in the form of liquidity facilities and credit enhancement. While the statutory mandate is for credit risk retention of 5 percent, under the re-proposal a conduit with a partially supported liquidity facility and aggregate structural credit enhancement of 5 percent or more would not be deemed to meet this requirement. Such partially supported conduits currently comprise almost half of the market measured by number, and more than half of the market measured by outstanding ABCP. Only an ABCP conduit with "

[62] Re-Proposing Release, 78 Fed. Reg. at 57971.

fully supported" liquidity facilities (as described below) providing effective credit risk retention of at least 100 percent would qualify. This result would unnecessarily exclude from the ABCP method of risk retention a large percentage of existing ABCP conduits, despite the fact that in the thirty or more years, investors in commercial paper issued by the multi-seller customer conduits now in existence are not known to have suffered any losses whatsoever. Instead, any losses in these conduits have been borne by the parties that already retain risk – the sponsoring bank's customers (the originator-sellers) and the bank sponsor in its role as liquidity provider.

In order to assess the appropriateness of the liquidity requirement (and the other requirements of the proposed ABCP conduit option), it is important to understand the structure of a typical ABCP conduit. A bank sponsors an ABCP conduit to provide the bank's customers with access to the commercial paper market, which eliminates the need for customers to establish their own commercial paper facilities. It is true that all ABCP conduits provide 100 percent backstop liquidity facilities covering outstanding ABCP. However, in a "partially supported" liquidity facility, there typically is a borrowing base that is reduced by any excess of non-performing collateral over the customer's credit enhancement, but the bank sponsor typically also provides an additional unconditional credit enhancement of at least 5 percent of the conduit's ABCP. ABCP investors recognize that the 5 percent credit enhancement is the most important feature providing "skin in the game" – liquidity coverage, while important, serves only to provide the investors assurance in the event that ABCP coming due cannot be "rolled" due to market forces. In more recent times, "fully supported" liquidity facilities have become more common. In these facilities, the ability to draw on the facility is not conditioned on the performance of the underlying collateral, so the same facility provides both liquidity support and credit enhancement. All of these types of ABCP conduits have exhibited the same strong market performance. However, under the re-proposed rules, only a fully supported liquidity facility would meet the requirements of the ABCP method of risk retention. A partially supported facility would not, even though both partially and fully supported conduits provide liquidity coverage for 100 percent of the outstanding ABCP.

A fully supported liquidity facility effectively provides 100 percent credit enhancement in addition to 100 percent liquidity support. By requiring all ABCP conduits to have fully supported liquidity facilities in order to be deemed to meet the statutory 5 percent credit risk retention requirements, the re-proposed rules would effectively require sponsors to retain risk in excess of 100 percent of the amount of ABCP issued – 20 times more than the 5 percent threshold required by the Dodd-Frank Act. An ABCP conduit with a partially supported liquidity facility would be deemed not to meet the statutory 5 percent risk retention requirement, even though the bank sponsor retains 5 percent or more of the credit risk due to the credit enhancement feature.

Several of the requirements of the re-proposed ABCP risk retention method appear to represent an effort by the Agencies to distinguish between an ABCP conduit, a type of high-quality asset-backed vehicle that has consistently performed well over the years, and a structured investment vehicle (or "SIV"), a type of highly leveraged asset-backed vehicle that also issued commercial paper but generally did not perform well during (and some believe contributed significantly to) the financial crisis. SIVs may be distinguished from ABCP conduits in many ways – including their highly tranched capital structure – but most important for these purposes is that SIVs did not have 100 percent liquidity coverage of any kind, whether fully or partially supported. Instead, the liquidity of the commercial paper tranche, which sat at the top of the capital stack, was provided primarily by the assumed ability to sell the pool assets (which were subject to a variety of liquidity coverage tests) in the open market. Unlike ABCP, SIVs presented the risk of a "death spiral" when the markets for their pool assets became illiquid. Also, SIVs' liquidity facilities only addressed shortfalls in projected cashflows required to pay the commercial paper tranche. ABCP conduits simply do not present the same risks as SIVs, primarily because they do not rely on the potential for future sales of the pool assets for liquidity, and they have vastly stronger sources of liquidity support and credit enhancement.

For all of these reasons, we urge the Agencies to eliminate the provision that would require liquidity coverage be "without regard to the performance of the [collateral] and without regard to any credit enhancement," so long as the sponsor provides credit enhancement in an amount of at least 5 percent of the conduit's ABCP.

Also, in our view, there is no reason to mandate that the required liquidity coverage be provided by a single financial institution so long as the bank sponsor provides at least 5 percent credit enhancement. Currently ABCP conduit sponsors often syndicate their liquidity facilities in the same manner as other types of lending facilities. Sometimes this is even done at the request of the originator-seller of the pool assets, who may desire to spread the liquidity business among multiple relationship banks. In our view, multiple sources of liquidity should be acceptable, so long as all providers are "regulated liquidity providers" within the meaning of the proposed rules – and, in a partially supported facility, that the bank sponsor provides at least 5 percent credit enhancement. Therefore, we further request the Agencies to eliminate the requirement that the requisite liquidity coverage be provided by a single regulated liquidity provider.

B. The Types of Assets That Are Permitted to Collateralize ABCP Conduits Should Be Expanded to Reflect Market Practices

As re-proposed, the ABCP method of risk retention would require that the conduit be collateralized solely by other ABS acquired from one or more intermediate SPVs[63] and servicing assets. The underlying ABS would have to be:

- Collateralized solely by assets originated by a single originator-seller or one or more majority-owned affiliates of that originator-seller (and servicing assets);
- Special units of beneficial interest in a titling trust relating to a lease securitization collateralized by leases originated as described above; or
- Interests in a revolving master trust collateralized by assets originated as described above.

The underlying ABS could not be purchased or acquired by the intermediate SPV (or the related originator-seller or one of its majority-owned affiliates); they would have to be acquired by the conduit in an original issuance transaction.

ABCP conduits currently finance many other types of assets, in many different ways. In fact, almost no existing conduits currently are invested solely in ABS. Among other things, ABCP conduits sometimes:

- Enter into loan agreements with a customer secured by financial assets, instead of purchasing ABS collateralized by financial assets;
- Fund the acquisition by a customer of a portfolio of financial assets that it did not originate (*e.g.*, acquired in connection with the acquisition of a business);
- Purchase financial assets directly;
- Acquire syndications of or participations in financial assets from another financial institution or conduit;
- Acquire ABS issued by SPVs that are not owned by the originator-seller; and

[63] An intermediate SPV is defined as a bankruptcy remote special purpose vehicle that is directly or indirectly owned by an originator-seller.

- Utilize SPVs established by the conduit sponsor to address legal or non-U.S. tax considerations in connection with non-U.S. transactions.

None of these quite ordinary course types of transactions would be permitted by the re-proposed ABCP conduit option. We urge the Agencies to accommodate these financings by permitting an eligible ABCP conduit to be collateralized by assets other than original issuance ABS of an intermediate SPV that themselves are collateralized solely by assets originated by an originator-seller and its majority-owned affiliates.

The Agencies mention several times their concern that ABCP conduits not be used to finance receivables acquired in the open market by an "aggregator." Given that ABCP conduits have successfully conducted the foregoing types of ordinary course transactions for decades, it is not clear to us how foreclosing them to a conduit that relies on the ABCP option serves any useful purpose. As described above, we are aware that the Agencies are concerned about SIVs and similar highly-leveraged structures that were popular before the financial crisis. In our view, the primary distinguishing factor between SIVs and ABCP conduits is not the source of the assets. It is the 100 percent liquidity coverage (whether fully or partially supported) and, in the case of partially supported conduits, the 5 percent or more credit enhancement by the sponsoring bank. These features (alone or combined with other forms of permitted risk retention), are sufficient to ensure adequate "skin in the game" for ABCP conduits.

C. The Proposed Monitoring and Disclosure Requirements for ABCP Conduit Sponsors Are Burdensome and Unnecessary

The disclosure requirements of § __.6(e) would impose monitoring and disclosure requirements that are unduly burdensome to conduit sponsors. Given the structure of ABCP conduits, even some of the requirements that may be less controversial for other transaction structures would pose particular difficulty for their sponsors.

The conduit sponsor would remain responsible for the originator-sellers' compliance with its risk retention obligations and would have to maintain policies and procedures to monitor that compliance. If the sponsor determines that an originator-seller is noncompliant, the sponsor would be required to promptly notify investors and would need to identify the noncompliant originator-seller. The proposal appears to require notification of investors even if the ABCP conduit responds by transferring the noncompliant asset to the liquidity provider, thereby eliminating any risk of loss to investors. The proposed requirement to provide information that enables investors to identify noncompliant originator-sellers would conflict with the existing confidentiality agreements between many conduits and their originator-sellers. We believe that this requirement would be objectionable to many originator-sellers and could drive them to seek

other sources of financing. We ask the Agencies to eliminate the requirement to notify investors of an originator-seller's noncompliance with its risk retention requirements. We do not object to this information being provided to the conduit sponsor's primary regulator, so long as the final rule makes it clear that this more limited disclosure obligation is contingent on the sponsor's actual knowledge of an originator-seller's noncompliance.

The proposal also would require the sponsor to provide a variety of additional information to investors at or before first sale of the ABCP and monthly thereafter, including with respect to each underlying ABS interest, including a description of the form, fair value (as a percentage of the fair value of all ABS interests and a dollar amount) and nature of the originator-seller's retained interest. Given the ever-changing nature of the asset base of ABCP conduits, it is unlikely that a conduit would be able to comply with the fair value disclosure requirements for individual transactions. New receivables generally come into the pool daily, both because assets are frequently acquired, but also because many of the underlying acquisitions are revolving in nature. Providing all of the information above on a monthly basis with respect to each and every asset would be extremely difficult, if not impossible.

In any event, in response to investor demand, conduit sponsors have already developed a robust monthly reporting package of long standing. Among other things, ABCP conduit sponsors typically report on:

- The type of liquidity (full or partial);
- The identity of the liquidity providers;
- The level and form of program-wide credit support (if any);
- The transaction's and each originator-seller's credit rating (or deemed rating);
- The transaction size, asset type, and industry;
- The level of the bank sponsor's credit support;
- The form of the bank sponsor's credit support (*i.e.*, overcollateralization, a cash reserve, or some other form);
- The level of losses;

- Liquidity draws (if any);
- Pool assets by asset class;
- Pool assets by industry;
- Pool assets added or removed; and
- The amount of outstanding ABCP.

To our knowledge, investors generally have not requested any significant changes in recent years. In our view, these reports already contain sufficient information for ABCP investors to monitor their investments, especially since the most important economic factors will continue to be the performance of the assets themselves, the 100 percent liquidity coverage, and (in the case of partially supported ABCP conduits) the sponsor's 5 percent or more credit enhancement – not any risk retention on the part of the originator-sellers.

Because the assets revolve in and out so frequently, providing detailed notices regarding risk retention failures – even if immaterial – could unduly alarm investors, even if the ABCP itself is (as is extremely likely) still of very high credit quality. In light of investors' reliance on the liquidity and credit support inherent in current ABCP conduit structures, it is difficult to see how information regarding the underlying risk retention for each pool asset would be helpful to investors.

D. The Tenor of ABCP Should Not Be Limited to 270 Days

As re-proposed, ABCP must have a "maturity at the time of issuance not exceeding nine months, exclusive of any days of grace, or any renewal thereof the maturity of which is likewise limited." According to the Agencies, "it would be inappropriate to expand the ABCP option to commercial paper that has a term of over nine months, because a duration of nine months accommodates almost all outstanding issuances and the bulk of those issuances have a significantly shorter term of 90 days or less."[64]

While historical commercial paper tenors may have been shorter, many aspects of the Basel III regulatory scheme will combine to push average tenors out further, including the liquidity coverage ratio and the net stable funding ratio. Other than conformance with historical precedent, we do not understand the purpose of limiting the tenor of ABCP to 270 days, given

[64] Re-Proposing Release, 78 Fed. Reg. at 57951.

that such a limit would place the risk retention requirements on a collision course with Basel III compliance. We do not believe that there is any principled reason for any outside limit at all. However, in the event that the Agencies continue to believe there is such a need, we suggest 397 days, the outside limit for securities that are eligible for purchase by money market funds pursuant to Rule 2a-7 under the Investment Company Act of 1940, as amended.

E. Legacy ABCP Conduit Assets Should Be Grandfathered

As described above, we urge the Agencies to adopt a complete exemption from the credit risk retention requirements for legacy assets originated before the effective date of the rules. This point is especially important as it applies to ABCP conduits.

Many ABCP conduits are of long standing. The transactions by which conduits acquire and finance assets often mirror the types of financing transactions by which banks finance assets directly, so many of them are long-term and revolving in nature. Because such transactions represent a contractual commitment, the conduit simply will not be able to force a renegotiation of their terms just because the credit risk retention rules become effective. It will have to wait until there is some opportunity to do so, such as a request from the originator-seller for a renewal. Even if an acquisition transaction is not revolving in nature, assets acquired before the final risk retention rules are adopted may have terms that extend beyond the rules' effective date, and the conduit may not have the leverage to impose retroactive credit risk retention on the originator-seller.

As described above, we believe that the 100 percent liquidity coverage (coupled, in the case of partially supported facilities, with the 5 percent or more credit enhancement provided by the bank sponsor) are the most important "skin in the game" features of ABCP conduits, and they will continue to be in full force as of the effective date of the credit risk retention rules. For this reason, and because of the impracticability of imposing credit risk retention on an originator-seller that has already entered into a financing transaction with a conduit, we request that the Agencies provide a grandfathering exemption from this requirement for legacy pool assets of otherwise eligible and qualifying ABCP conduits, at least until the associated contractual commitments expire or are renewed.

VII. Securitizations of Automobile Loans and the Definition of "Qualifying Automobile Loan"

Unlike other securitization asset classes, automobile loan asset backed securities ("Auto ABS") successfully weathered the financial crisis with few to no losses to investors. We believe that a significant portion of this record is attributable to the existing market-accepted structures

and practices in the Auto ABS industry. Additionally, the industry's adoption of and adherence to the Federal Deposit Insurance Corporation's securitization safe harbor (the "FDIC Safe Harbor"),[65] particularly its standards concerning capital structure, origination and risk retention, move further in the same direction. Indeed, in the crisis years from 2007 to 2010, only 13 auto ABS classes rated by Standard & Poor's were downgraded, while 296 were upgraded.[66] This history informs our comments below.

A. Risk Retention of a Representative Sample Should Remain an Option

As mentioned above, we believe the Agencies should reconsider their decision to exclude the use of a representative sample of underlying assets to meet the re-proposed risk retention requirement, since the Auto ABS industry already has a successful track record of using the representative sample methodology to implement risk retention. The Agencies provide no rationale for dispensing with this customary practice that directly aligns the interests of sponsors and investors, especially in light of the fact that Auto ABS pools have maintained low rates of default through the economic downturn. We urge the Agencies to adopt a final rule that would include a representative sample risk retention mechanism, at least for Auto ABS. Adopting a viable method of risk retention for Auto ABS takes on particular importance in light of the significant problems with the proposed definition of "qualifying automobile loan," as discussed below. We urge the Agencies adopt a viable method of risk retention for Auto ABS, and we believe that representative sample is one such method.

As provided for in the Original Proposing Release, and as we noted in our Prior Comment Letters, permitting a sponsor to satisfy its risk retention obligation by holding a representative sample of the assets in a manner consistent with to the FDIC Safe Harbor may be attractive for many asset classes, including Auto ABS. In relevant part, the FDIC Safe Harbor provides certain protections for securitizations when, among other things, the sponsor retains an economic interest in a material portion of the interests or assets, which retention may be in the form of "a representative sample of the securitized financial assets equal to not less than five (5) percent of the principal amount of the financial assets."[67] The FDIC adopted this change to its securitization rule" in recognition of the goals of section 941 of the Dodd-Frank Act, to align the economic interests of originators and investors. The FDIC also realized that the joint rulemaking contemplated under section 941 was imminent when it proposed the safe harbor requirements as a precursor to the eventual rulemaking. Therefore, at least insofar as the risk retention rules

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[65] Treatment of financial assets transferred in connection with a securitization or participation, 12 C.F.R. § 360.6 (2013).

[66] *See* http://www.standardandpoors.com/spf/swf/auto_abs/data/document.pdf?, at p. 25.

[67] 12 C.F.R. § 360.6(b)(5)(A) (2013).

would apply to Auto ABS, we recommend that the Agencies continue with the FDIC's framework, which the Auto ABS industry has utilized effectively for three years.

In addition to continuing an effective practice already deemed to be an acceptable mechanism for risk retention in the Auto ABS industry, there are additional rationales for allowing sponsors to use the representative sample to satisfy their risk retention obligation. First, using a representative sample preserves the ability to achieve "sale accounting" for the transferred assets, which is an important component in the ability of securitization sponsors to make efficient use of their capital in further lending activities. We note that a representative sample approach is likely to be most appropriate in an asset class where pools of assets are large and granular; indeed, auto loan ABS typically are collateralized by many thousands of contracts. As such, the removal of the representative sample mechanism, which is particularly suitable for the Auto ABS industry, is especially detrimental to that industry.

As we noted in our Prior Comment Letters, the Original Proposal's representative sample risk retention mechanism was unworkable, so while we propose a representative sample risk retention mechanism should be restored in the Auto ABS context, we suggest any such mechanism be consistent with the following structural characteristics.

B. We Support Several Specific Requirements for a Representative Sample Option

In order to create a valid representative sample, an issuer would start with an initial asset pool of potential Auto ABS assets comprising assets chosen based upon the sponsor's selection criteria (the "Initial Auto ABS Pool"). Once the Initial Auto ABS Pool has been established, the sponsor would retain assets equal to 5 percent of the aggregate unpaid principal balance of the Initial Auto ABS Pool, determined by taking a random sample in accordance with an established randomizing methodology (the "Retained Auto ABS Pool"). The assets remaining in the Initial Auto ABS Pool would subsequently be securitized (the "Securitized Auto ABS Pool"). The sponsor would then hold the Retained Auto ABS Pool to satisfy its risk retention requirement in accordance with other provisions of the rules. The random sample would preclude "cherry picking" of more creditworthy assets for the Retained Auto ABS Pool.

The original proposal included a requirement that material characteristics of a Retained Auto ABS Pool as compared to the Securitized Auto ABS Pool be disclosed to investor. In our view, if the selection of the Retained Auto ABS Pool complies with our suggested random process, requiring the disclosure of a comparison of the material characteristics between the two pools would be unnecessary. At a minimum we believe there should no such disclosure requirement under circumstances where the Initial Auto ABS Pools contains at least 6,000 assets. Based on statistical analyses done by some of our respective members, where the Initial Auto

ABS Pool has 6,000 or more assets, a randomly selected Retained Auto ABS Pool will always be within 5 percent or less variance from the material characteristics of the Initial Auto ABS Pool.[68]

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[68] Our members have examined the threshold at which point a Retained Auto ABS Pool would consistently be deemed to be truly representative of the related Securitized Auto ABS Pool, pursuant to the following definitions and assumptions:

Definitions:

The "Confidence Level" tells you how sure you can be of the test results. For instance, a 95% Confidence Level with a 5% Confidence Interval indicates that in 100 tests of the sample, the results will fall within the 5% margin of error 95 times.

The "Confidence Interval" is the margin of error in the test results and is reported as a plus-or-minus figure in the test results. For example, a poll of a limited sample size of voters indicates that 50 percent of voters favor a particular candidate with a margin of error of 4%. The actual number of favorable opinions that would be obtained if one sampled the entire voting population (instead of just a sample) will likely fall between 46 percent to 54 percent of voters.

The "Expected Error Rate" is, for each Loan Attribute, the anticipated percentage variance of the Retained Auto ABS Pool from the Initial Auto ABS Pool. A low percentage requires a low sample rate because the occurrence of error is remote.

Assumptions:

Confidence Level: 2 standard deviations, 95.45% confidence level
Confidence Interval: 2%, assumption
Expected Error Rate: 3%, consistent with other market metrics of similar intent
Maximum Error Rate: 5% (Expected Error Rate + Confidence Interval)

Given these assumptions, testing indicates that at a population size of 5,480 loans (with a sample size of 276 loans, which is 5.03% of 5480) a Retained Auto ABS Pool drawn from an Initial Auto ABS Pool would result in a pool that would be within the appropriate Confidence Level of the Securitized Auto ABS Pool. A pool size of less than 5,480 loans may not fall within the parameters above. In other words, if the pool size is any smaller than 5,480 loans, the 5% retained risk would be too small to expect that the Retained Auto ABS Pool would fall within the targeted Confidence Level of two standard deviations (95.45% confidence).

The formula used to determine the threshold whereby an appropriate Confidence Level would be reached is as follows:

Sample size formula for a large population:

$$\text{Sample Size} = \frac{CL^2 * ER * (1 - ER)}{CI^2}$$

where CL = Confidence Level expressed as number of standard deviations (ex. 2)

Accordingly, we suggest that for Initial Auto ABS Pools of 6,000 assets or greater, the disclosure obligations would be limited to (i) a statement that the composition of the random sample was prepared in accordance with applicable legal and regulatory requirements, and (ii) disclosure of the randomizing methodology utilized. We believe this disclosure obligation would be consistent with current practices under the FDIC Safe Harbor. Given the statistical validity associated with pools of this size, imposing additional disclosures on the representative sample's performance would create administrative burdens, and impose costs for which there would not be any real corresponding benefit to investors.

If the Initial Auto ABS Pool is not comprised of at least 6,000 assets, certain additional disclosures that illustrate the randomness of the Retained Auto ABS Pool could be included in the offering documentation, which would enable investors to determine that the Retained Auto ABS Pool is materially similar to the Securitized Auto ABS Pool. These additional disclosures could include, with respect to both the Retained Auto ABS Pool and the Securitized Auto ABS Pool:

- Aggregate receivables balance;
- Aggregate principal balance;
- Average original amount financed;
- Weighted average APR;
- Weighted average original term to maturity;
- Weighted average remaining term to maturity;
- Percentage by principal balance of used auto loans;
- Percentage by principal balance of new auto loans; and
- Non-zero weighted average FICO score.

We do not believe that sponsors should be required to "rework" the Retained Auto ABS Pool based upon a *post hoc* examination of the performance of the Retained Auto ABS Pool compared to the performance of the Securitized Auto ABS Pool. A requirement of this type

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ER = Error Rate (ex. 3%)
CI = Confidence Interval (ex. 2%)

inevitably would prove to be unworkable, as there would be no real remedy beyond unwinding the entire structure should the *post hoc* examination reveal that the performance of the Retained Auto ABS Pool was not comparable to the that of the Securitized Auto ABS Pool. Such a result would not only be overly burdensome, but would result in large potential risks for investors, who could potentially find their entire collateral pool being reshuffled. Given that such a result would be detrimental to investors, such a requirement would be harmful and would serve no purpose. A structure that results in a Retained Auto ABS Pool that complies with the random sampling and retention requirements described above should not need periodic review of performance.

C. Risk Retention Options Should Include Existing Structures Common in Automobile ABS

Auto ABS have a history of strong performance even through economic downturns, with robust risk retention in the form of reserve accounts, overcollateralization and residual interests. With the exception of the seller's interest in floorplan transactions, the Agencies have not recognized any risk retention alternatives currently used for Auto ABS. For example, these securitizations often are significantly over-collateralized, creating what is effectively a first-loss position. However, the typical existing structure would not meet the proposed eligible horizontal residual interest requirements, which would limit the rate of payments to the sponsor to the rate of payments made to the holders of senior ABS interests.

We believe these are technical distinctions rather than substantive ones. Auto ABS transactions have robust cash flow structures that preserve credit enhancement before allowing payments to flow out to residual interests, with no erosion of risk retention. The validity of this structure has been proven through its performance through severe economic downturns, and we see no reason that the implementation of the risk retention rules should materially change a structure that has proven itself to be sound. Where the proposed definitions do not adequately capture this, we ask the Agencies to revise the definitions rather than dispense with currently functioning structures that already align the interests of sponsors and investors, which is the ultimate goal of section 941 of the Dodd-Frank Act.

D. The Criteria Proposed for the Definition of "Qualifying Automobile Loan" Are Impractical and Inconsistent with Industry Practice

The re-proposal's modestly amended criteria for the definition of "qualifying automobile loans" ("QALs") does not sufficiently remedy the shortcomings in the definition. The re-proposed definition remains too restrictive and relies on information that simply is not available to most prime and super prime auto lenders. In our view, virtually no automobile loans would meet the proposed criteria, thereby rendering the exemption useless.

The Agencies' proposed definition of QAL would impose standards more appropriate for unsecured installment loans rather than for automobile loans. These include documentation of income and determinations of debt-to-income ratios, physical possession of title, and a requirement that the borrower make a cash payment equal to all vehicle title, tax and registration costs, all dealer-imposed costs and, most importantly, 10 percent of the purchase price of the automobile. We appreciate the Agencies' lowering of the proposed down payment requirement from the 20 percent set forth in the original proposal, but even that lowered requirement is still significantly out of step with industry practice. Given that the proposed definition of QRM has no down payment requirement despite the fact that down payments are common in the mortgage space, we believe that there should be no down payment required for QALs, where down payments are rare.

The QAL requirements could lead to the counterintuitive result that the best, most-creditworthy customers – those who *might* be able to qualify for a QAL – would be subjected to the most onerous documentation and verification process. An industry that traditionally has placed heavy reliance on credit scoring would be unable to rely on that method of qualifying even its best borrowers, and would be required to undertake a cumbersome underwriting process that is not required for credit purposes. As a practical matter, automobile lenders will not allow that to happen for fear of scaring away these desirable borrowers. The Agencies do not advance a rationale for creating an automobile loan process that would likely depress sales at the dealers who adopted them. In our view, securitization should serve as a tool for financing consumer receivables, but the regulatory scheme should not attempt to completely retool the financial tools that have made for a successful industry for both consumers and lenders, absent strong justification. Unless the QAL criteria are revised to reflect actual lending practices in the automobile industry, we believe this option is unlikely ever to be used.

We recommend that the Agencies tailor the criteria to provide a commercially reasonable standard that reflects the unique practices and conventions of the automobile lending market, and is more likely to be accessible to a meaningful subset of the market's participants. The criteria also should be expanded to include qualifying automobile leases, which are extremely common in the industry and, as an economic matter, function very similarly to automobile loans. Also, in addition to the passenger cars, minivans, vans, sport-utility vehicles, pickup trucks and other light duty trucks that currently would be permitted to collateralize QALs, loans and leases of motorcycles should be included, as they are subject to substantially similar financing practices.

Given the strong performance of the Auto ABS asset class, especially with respect to prime loans, we do not believe that changes to underwriting practices are necessary or that such changes are likely to result from adoption of the proposed narrow definition. The QAL

exemption simply would not be used. We urge the Agencies to draw their criteria from best practices that are currently in wide use in the automobile industry and set the bar for a QAL at a level that includes a meaningful percentage of all loans originated. The QAL criteria should not be set based on practices imported from other market sectors that are irrelevant to the automobile industry.

VIII. Securitizations of Credit Card Receivables and Revolving Master Trusts

The re-proposed credit risk retention rule for revolving master trusts incorporates many of the suggestions and concerns expressed in our Prior Comment Letters, and by other securitization industry participants in comments made with respect to the original proposal, and we appreciate the efforts of the Agencies to "better reflect the way revolving master trust securitizations operate in the current market."[69] We believe that the re-proposal revolving master trust option reflects a great deal of improvement in this regard over the requirements set forth in the original proposal. Nonetheless, we note that the seller's interest requirements in the re-proposal remain inconsistent with current market practice in several important ways. We also note that most existing revolving master trust agreements effectively prohibit compliance with the proposed risk retention requirements. Therefore, we respectfully ask that the Agencies make further revisions to the proposed revolving master trust retention option to fulfill their stated goal of formulating "the seller's interest form of risk retention in a fashion that provides meaningful risk retention on par with the base forms of risk retention under the rule, and at the same time accommodates prudent features of existing market structures."[70]

A. The Definition of "Seller's Interest" Should Be Refined to Reflect Market Practice

The re-proposal defines a "seller's interest" as

> an ABS interest or ABS interests: (1) collateralized by all of the securitized assets and servicing assets owned or held by the issuing entity other than assets that have been allocated as collateral only for a specific series; (2) that is *pari passu* to each series of investors' ABS interests issued by the issuing entity with respect to the allocation of all distributions and losses with respect to the securitized assets prior to an early amortization event (as defined in the securitization transaction documents); and (3) that adjusts for fluctuations in the outstanding principal balance of the securitized assets in the pool.

[69] Re-Proposing Release, 78 Fed. Reg. at 57942.
[70] *Id.*, 78 Fed. Reg. at 57946.

Clause (2) of the definition of "seller's interest" is inconsistent with current market norms. In all structures of which we are aware, the allocation of distributions of principal collections to the seller's interest is not done on a *pro rata* basis after the revolving period ends – and the revolving period may end before the occurrence of an early amortization event. After the revolving period ends, there is a disproportionate allocation of principal collections to ABS interests that will be repaid from the distribution of principal collections. This is because credit card securitizations generally fix the numerator of the allocation percentage used to allocate principal collections during scheduled amortization periods or accumulation periods, as well as early amortization periods, based on the outstanding principal balance of the applicable ABS interests as of the end of the revolving period. For certain variable funding note transactions, the fixing of the numerator of the principal allocation percentage takes place at the beginning of each limited amortization period. Fixing the numerator of the allocation percentage for principal collections allows a quicker repayment of principal to the investor ABS interests. It is good for the holders of the ABS interests because it shortens what could otherwise be a long tail of principal repayments. As a result, the seller's interest is effectively time-subordinated in the right to payment of principal during scheduled amortization or accumulation periods.

This practice of fixing the allocation percentage during principal repayment periods is more protective of investors than the *pari passu* or *pro rata* allocation required in the re-proposal, in that it promotes the timely repayment of principal. Allocations of principal collections based on a fixed allocation percentage is also significant for the ratings of credit card securitizations, so imposing the *pari passu* requirement on outstanding ABS interests would likely lead to ratings downgrades.

To summarize, the re-proposal results in a risk retention requirement for revolving master trusts that:

- Is not consistent with the method of allocations of principal distributions to the seller's interest;
- Is less protective of investor interests than current market practice
- Would likely lead to downgrades of outstanding rated ABS interests if outstanding securities were modified to be consistent with the proposed definition; and
- Fails to "balance implementation costs for sponsors utilizing the master trust structure with the benefits that investors receive through improved selection of underlying assets by the sponsors."[71]

[71] *Id.,* 78 Fed. Reg. at 58028.

We request that clause (2) of the definition of "seller's interest" be modified by replacing the phrase "prior to an early amortization event (as defined in the securitization transaction documents)" with the phrase "during the revolving period (as defined in the securitization transaction documents)."[72] This modification would help align the definition of seller's interest with current market practice.

In addition, we support the idea of allowing a seller's interest to be subordinated to other ABS interests. Given the complexity of determining fair value of a subordinated seller's interest we believe that a subordinated seller's interest should be measured on a face value basis, and not on a fair value basis.

B. The Proposed Pre-Closing Disclosure Requirements Should Be Modified to Take Account of the Fluctuating Nature of a Seller's Interest, and Measurement Dates Thereafter Should Be at Least Monthly and Should Incorporate a Reasonable Cure Period

Section __.5(g) of the re-proposed rules would require a sponsor to disclose within "a reasonable period of time prior to the sale of the asset-backed securities in the securitization transaction" the value of the seller's interest expressed both as a percentage of the investors' ABS interests and a dollar amount at the closing of the securitization transaction.

The amount of a seller's interest at any time generally equals the portion of the unpaid principal balance of the receivables in excess of the unpaid principal amount of the investors' ABS interests. The seller's interest fluctuates on a daily basis as new receivables are generated and existing receivables are repaid. Therefore, the requirement to disclose on a date prior to the closing date the dollar amount of the seller's interest and the percentage of the ABS interests that it will represent on the closing date would be impossible to comply with.

The proposed rules should be revised to allow sponsors to disclose the dollar amount and percentage of ABS interests represented by the seller's interest as of a date within a reasonable time prior to the closing date, such as the immediately preceding measurement date as specified in the transaction documents (or, in the case of new revolving master trusts, the immediately preceding date that would have been a measurement date had the transaction documents been in effect). The final rule should allow this disclosure to be made on a *pro forma* basis giving effect to the ABS interests to be issued on the closing date and any additions or removals of assets that

[72] Or "except during any period of amortization or accumulation (as defined in the securitization transaction documents)."

will take place on or prior to the closing date based on balances in those accounts on the measurement date.

The requirement to measure the seller's interest at every measurement date should be clarified to require that the measurement take place at least once a month. This would be consistent with current market practice as credit card securitization trusts generally calculate the seller's interest on a monthly basis. However, the requirement should be modified to explicitly contemplate and permit the existence of a reasonable "cure period" specified in the relevant transaction documents within which the failure of the seller's interest to meet required levels may be remedied prior to triggering an early amortization event. Typically, an issuing entity can add assets within a specified time frame to meet the minimum seller's interest requirement and only if it fails to do so will an early amortization event occur. Given the constant fluctuations in the size of a seller's interest, we request that the final rule provide for a similar cure period.

C. Changes Are Required to the Provisions Permitting Combined Retention at Trust and Series Level in Order to Conform with Existing Structures

Section __.5(f) would allow for a reduction in the seller's interest risk retention requirement below 5 percent to the extent that, for all series of ABS interests issued by the revolving master trust, the sponsor or a wholly-owned affiliate of the sponsor retains a corresponding percentage of the fair value of all ABS interests issued in each series held in the form of either an eligible horizontal residual interest or a specialized horizontal interest meeting the following requirements:

- Whether certificated or uncertificated, in a single or multiple classes, subclasses, or tranches, the horizontal interest meets, individually or in the aggregate, the requirements of § __.5(f);

- Each series distinguishes between the series' share of the interest and fee cash flows and the series' share of the principal repayment cash flows from the securitized assets;

- The horizontal interest's claim to any of the series' share of the interest and fee cash flows for any interest payment period is subordinated to all accrued and payable interest and principal due on the payment date to more senior ABS interests in the series for that period, and further reduced by the series' share of losses, including defaults on principal of the securitized assets collateralizing the revolving master trust for that period, to the extent that such payments would have been included in amounts payable to more senior interests in the series; and

- The horizontal interest has the most subordinated claim to any part of the series' share of principal repayment cash flows.

Unfortunately, neither the standard eligible horizontal risk retention option nor the specialized horizontal risk retention option, as proposed, presents a workable option for revolving master trusts. First, the requirement that the sponsor has to hold a horizontal residual interest in each class, subclass or tranche of each separate series ignores common forms of risk retention currently utilized by revolving master trusts. In many cases, a sponsor would not appear to receive credit for retaining these forms of subordinated interests because those interests do not represent an interest in every series. For example, some master trust sponsors have created and retained a "super-subordinated" ABS interest that absorbs losses before any other investors' ABS interests are affected. In some cases, subordinated tranches may be issued and retained by the sponsor to serve as enhancement for all ABS interests within the series. Finally, as recognized by the Agencies in the Re-Proposing Release, a common structure for credit card securitization programs features a sponsor that controls a legacy revolving master trust that no longer issues ABS to investors, but maintains credit card accounts and credit lines that generate new receivables for that legacy trust. Such a legacy trust may transfer a certificate collateralized by these receivables to a newer issuing entity to serve as collateral, along with the credit card accounts and receivables directly assigned to the newer issuing entity, for the ABS interests issued by the newer issuing entity. The legacy trust may also issue and transfer one or more subordinated certificates to serve as credit enhancement for the collateral certificate that supports the ABS interests issued by the newer issuing entity. This type of subordinated certificate should also be considered as a valid form of horizontal risk retention.

Furthermore, the requirement that sponsors must hold a specified percentage of the fair value of all ABS interests in each series in order to combine the seller's interest option with the specialized horizontal risk retention option seems overly restrictive and prescriptive. Sponsors should be allowed the flexibility to reduce the 5 percent seller's interest in proportion to the relative size of each series even if the percentage varies across series. Indeed, the definition set forth in the re-proposal recognizes the fundamental concept of revolving master trust securitizations, "one or more series, classes, subclasses or tranches of asset-backed securities all of which are *collateralized by a common pool* of securitized assets."[73] Therefore, as long as the total amount of risk retention represents 5 percent of the ABS interests, whether the horizontal residual interest is held in each series and in specified percentages should be irrelevant to whether such risk retention option receives credit against the seller's interest. We request that the final rule allow sponsors of revolving master trusts to receive credit for the total amount of

[73] *Id.*, 78 Fed. Reg. at 58028.

retained risk in the securitized asset pool when combining the specialized horizontal risk retention option with the seller's interest.

Clause (3) of the specialized horizontal risk retention option provides that a specialized horizontal residual interest's claim to any part of the relevant series' share of interest and fee cash flows for any interest payment period must be subordinated to all accrued and payable interest and principal due to more senior ABS interests in the series for that period. However, interest and fee cash flows (which we collectively refer to as "finance charge collections" to mirror the usage in many credit card securitizations) are applied to pay accrued and payable interest on the ABS interests, and are not applied to repayments of principal in most priority of payment "waterfalls" (except to the extent finance charge collections are applied with respect to defaulted or charge-off amounts and recharacterized as principal collections). Indeed, unlike the wording in the actual proposed rule, the commentary in the Re-Proposing Release appropriately excludes a requirement that the sponsor's claim to finance charge collections to be subordinate to all principal due on the payment date.[74] Clause (2) of § __.5(f) would require the finance charge and principal collections be kept separate, while clause (3) of § __.5(f) would require finance charge collections be used for repayment of principal. We request that the Agencies address this inconsistency by removing the references to principal in clause (3).

Clause (3) also states that the horizontal residual interest's claim to finance charge collections are "further reduced by the series' share of losses, including defaults on principal of the securitized assets collateralizing the revolving master trust for that period." A requirement for the horizontal residual interest to bear losses allocated to the series is consistent with current market practice. However, if the requirement means that the horizontal residual interest may not receive any of its share of finance charge collections prior to using finance charge collections to cover losses, the option is inconsistent for many existing revolving master trusts. Many credit card securitization trusts, for example, issue ABS tranches that are subordinate to other ABS tranches in a series. For instance, consider a credit card revolving master trust with two outstanding tranches, a Class C tranche of ABS interests rated BBB and a Class A tranche of ABS interests rated AAA. The typical finance charge waterfall would allocate interest payable to the Class C tranche in a junior position to the interest payable to the Class A tranche, but in most cases ahead of application of finance charge collections to cover losses. If the Class C tranche were issued but retained by the sponsor as a form of horizontal risk retention, this typical priority of payments would violate the requirement above if the intent was to prohibit the horizontal residual interest from receiving a share of the finance charge collections prior to the use of finance charge collections to cover losses. We request that the final rule allow for the payment of interest to all classes of investor ABS interests prior to the coverage of losses.

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[74] *Id.*, 78 Fed. Reg. at 57945.

Clause (4) requires that the horizontal interest have "the most subordinated claim to any part of the series' share of principal repayment cash flows." It is common in the credit card securitization market for interests in a series to be issued at different times and with different maturities. For example, many securitizations use a de-linked structure, in which a sponsor may issue a subordinated class of ABS interests that has a shorter maturity than that of certain senior ABS interests. Since the varying issuance dates and maturities of classes in a de-linked structure can result in the subordinated classes being entitled by the terms of the transaction documents to receive payments of principal prior to other more senior interests, the re-proposal's requirements for eligible horizontal interests would appear to not give credit for such subordinated notes. The rules should be revised to permit the payoff of subordinated interests pursuant to the terms of the relevant transaction documents so long as sufficient qualifying horizontal interests remain outstanding to comply with the risk retention rules and provide required enhancement for more senior ABS interests. Therefore, we request that the phrase "due on the payment date" be added to clause (4) of § __.5(f).

D. We Also Request Several Other Specific Clarifications and Adjustments

In addition to the broader conceptual issues discussed above, we request several specific, limited changes to defined terms and other provisions, which are intended to clarify the operation of the proposed rules and make them consistent with market practices.

A "revolving master trust" is defined as "an issuing entity that is (1) a master trust; and (2) established to issue on multiple issuance dates one or more series, classes, subclasses, or tranches of asset-backed securities all of which are collateralized by a common pool of securitized assets that will change in composition over time." It is not clear what is added by clause (1) of the definition, which is circular. In addition, we do not understand why the entity type is limited to a "master trust" when current market practice encompasses limited liability companies or corporations. Also, the phrase "established to issue" is similarly needlessly limiting. Therefore, we request that the term "revolving master trust" replaced with "revolving securitization entity" and the phrase "established to issue" be replaced with "issues or plans to issue."

The Agencies prohibit use of the seller's interest risk retention option for any revolving master trust that issues "senior interest-only bonds or premium bonds." While we assume that the Agencies did not intend for the reference to "premium bonds" to include bonds that are priced above par at closing due to movements in interest rates, we request the Agencies to set forth clear definitions of these terms in the final rule to avoid any further confusion. For instance, a sponsor may issue additional notes of a particular tranche of ABS interests after the date of the initial issuance on the same terms and conditions as the originally issued ABS interests. While the terms and conditions of such "re-opened" notes are structured to be the same

as the originally issued notes, the price of the re-opened notes might be higher than the originally issued notes solely due to the fluctuation in interest rates during the interim period.

If indeed the Agencies consider bonds sold at a premium to par in connection with a re-opening to be "premium bonds," we ask for an explicit grandfathering provision for past issuances of such bonds.

The re-proposal gives credit against the seller's interest requirement for funds on deposit in an excess funding accounts only if, among other things, the account is *pari passu* with (or subordinate to) each series of the investors' ABS interests with respect to the allocation of losses. We request that the Agencies remove this *pari passu* requirement with respect to the allocation of losses because losses are not allocated to a cash bearing account which would not itself generate any losses given that it is comprised of cash rather than receivables.

Section __.5(c)(2) provides that the seller's interest "may be retained by one or more wholly-owned affiliates of the sponsor, including one or more depositors of the revolving master trust." In contrast, the hedging, transfer and financing prohibition allows a transfer to " an entity that is and remains a majority-owned affiliate of the sponsor." A majority-owned affiliate of the sponsor would be a consolidated reporting entity and there is no reason why revolving master trusts should be subject to a different standard than the general rule. Therefore, we request that the phrase "wholly-owned" be replaced by "majority-owned".

E. Because the Re-Proposed Rules Are Inconsistent with Existing Revolving Master Trusts, a Broad Grandfathering Provision Is Required

The credit risk retention requirements will apply to existing securitization programs on the effective date of the final rules. This transition policy is worrisome, because none of the proposed risk retention options will work for most master trusts as currently structured.

If the "seller's interest" definition is not revised to be consistent with current market practice, revolving master trust ABS issuers and sponsors may be unable to amend their respective program documents to conform to the seller's interest option. Conforming to the seller's interest as defined in the re-proposal would be disadvantageous to holders of ABS. Among other things, imposing the *pari passu* requirement during the amortization period would slow down the repayment of principal to holders of investor ABS interests. Amendments that are materially adverse to existing ABS holders and could result in a slower repayment of principal generally require 100 percent investor consent, a threshold that is likely to be impossible to reach.

In addition, the proposed horizontal option and the excess funding account option are inconsistent with existing structures. Also, it is unclear whether the Agencies intended to allow a revolving master trust to rely on the vertical retention option. While it would be very difficult to do so for any program with multiple series or tranches outstanding currently, there appears to be no valid reason to preclude revolving master trusts from relying on vertical retention as a last resort.

If the Agencies decide not to revise the seller's interest risk retention option to accommodate the features of seller's interests in current market structures, then we request that existing revolving master trust programs be completely grandfathered when the final rules go into effect. Otherwise, there will be no viable option for compliance by existing revolving master trusts.

IX. Securitizations of Equipment Loans and a Proposed New Definition of "Qualifying Equipment Loan"

ABS collateralized by equipment loans ("Equipment ABS") are an important source of funding for many real-world industries and represent a distinct market for ABS. As of September 2013, $23.2 billion of equipment loan and lease ABS was outstanding. This number has grown from a recent low of $14.5 billion at the end of 2010, with nearly $20 billion of ABS issued in 2012 alone (more than doubling 2011 issuance).[75] Similar to Auto ABS, Equipment ABS have consistently performed well before, during and after the recent financial crisis. The sponsors of Equipment ABS transactions do not generally operate on an "originate-to-distribute" basis, which was one of the driving issues behind mandatory credit risk retention. Because of this, and because the definition of "qualifying commercial loan" does not appropriately reflect equipment originators' businesses, we kindly request that the Agencies consider treating equipment assets separately and provide a new qualifying asset exemption that is workable for Equipment ABS.

A. A New Qualifying Asset Category of "Qualifying Equipment Loans" Should Be Added

We request the Agencies to treat equipment assets separately from commercial loans and provide an exemption from risk retention for qualified loans that is relevant to the equipment business. Because of the diversity of equipment types, we request that the Agencies adopt a broad definition of "equipment loans" that may qualify for an exemption from risk retention,

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[75] *See* http://www.sifma.org/uploadedFiles/Research/Statistics/StatisticsFiles/SF-US-ABS-SIFMA.xls?n=54271.

similar to the definitions used previously by other federal regulators.[76] In general, an "equipment loan" should include any loan made to a company or an individual secured by equipment intended for use by such company or individual in a trade or business or for other commercial purposes, including loans such as trucking or transportation equipment, construction or mining equipment, agricultural equipment, or other similar equipment types. We do not ask for this new qualified asset exemption to encompass leases of equipment, only loans.

We believe that a separate exemption is warranted for sponsors of Equipment ABS. The qualified commercial loan exemption is not relevant to equipment loan originators, as it does not appropriately reflect those underwriting standards used within the equipment business. Our members believe that, under the current proposal, few if any equipment loans would qualify for exemption under the definition of a "qualified commercial loan." This is not because they are in some way a more risky asset or are not as well underwritten, but rather because they are a distinct asset class that demands a distinct set of underwriting criteria. The historical performance of Equipment ABS bears out the overall quality of equipment loan underwriting.

In lieu of applying criteria currently proposed for the definition of "qualifying commercial loan" to equipment loans, we suggest the following underwriting criteria to be incorporated into a new definition of "qualifying equipment loan." These criteria are more reflective of the reality of the equipment loan underwriting process:

- *Term* – an original term not exceeding 84 months;
- *Payment schedule* – any type of payment schedule so long as the loan is fully amortized by the end of the loan term;
- *Equipment value* – all of the following:

[76] For example, the Federal Reserve Board has referred to "equipment loans and leases" as "loans and leases extended to facilitate the purchase or lease of business industrial and farm equipment, including 'large ticket' items such as bulldozers and backhoes and 'small ticket' items such as computers and copiers." Federal Reserve Board, Report to the Congress on Risk Retention (October 2010), available at http://www.federalreserve.gov/boarddocs/rptcongress/securitization/riskretention.html. Similarly, according to the Federal Reserve Bank of New York, the Term Asset-Backed Securities Loan Facility allowed the financing of "eligible equipment-related receivables" including "loans and leases relating to business, industrial, and farm equipment. Such equipment includes, but is not limited to, agricultural, construction or manufacturing equipment: trucks other than light trucks; smaller ticket items such as communications, office, and medical equipment, computers, copiers and security systems; and equipment types (other than aircraft) that have collateralized equipment ABS in the past. The credit exposures underlying an eligible equipment ABS [were permitted to] include a mixture of loans and leases on a mixture of types of equipment." Federal Reserve Bank of New York, Term Asset-Backed Securities Loan Facility: Frequently Asked Questions (July 21, 2010), available at http://www.newyorkfed.org/markets/talf_faq.html.

  - a security interest in the equipment;
  - a requirement that the borrower pay taxes, charges, fees, and claims, where non-payment might give rise to an adverse lien on the related equipment;
  - a requirement that the borrower obtain and maintain physical damage insurance on the equipment;
  - a requirement that the borrower maintain the physical condition of the equipment; and
  - a requirement that the lender (or servicer) be permitted to inspect the equipment.

- *Down payment* – a required down payment (in the form of cash or trade-in allowance) of at least 10 percent of the purchase price of the equipment;
- *Experience of lender* – the lender must have performed underwriting assessments of equipment loans for at least 3 years; and
- *Past dues* – the loan must be no more than 31 days past due as of the cut-off date.

We expect that other commenters will provide detailed input to the Agencies regarding Equipment ABS and equipment loans, and we encourage the Agencies to consider our comments, as well as comments provided by others, relating to the need for further revision of the re-proposal as it relates to Equipment ABS and equipment loans.

X. Securitizations of Federally Guaranteed Student Loans

A. All FFELP Student Loans Should Be Completely Exempted from the Risk Retention Requirements

As originally proposed, there was no exemption for securitization transactions collateralized by student loans originated under the Federal Family Education Loan Program ("FFELP"). The re-proposal includes a partial exemption for securitization transactions collateralized by FFELP student loans. A securitization transaction collateralized solely (other than servicing assets) by FFELP loans that are guaranteed as to 100 percent of defaulted principal and accrued interest (generally, loans originated before October 1, 1993) would be exempt from the risk retention requirements. A securitization transaction collateralized solely (other than servicing assets) by FFELP loans that are guaranteed as to at least 98 percent of defaulted principal and accrued interest (generally, loans originated from October 1, 1993 to July 1, 2006) would have its risk retention requirement reduced to 2 percent. A securitization

transaction collateralized solely (other than servicing assets) by FFELP loans that are guaranteed as to at least 97 percent of defaulted principal and accrued interest (generally, loans originated from July 1, 2006 to July 1, 2010) would have its risk retention requirement reduced to 3 percent.

We appreciate the Agencies' responsiveness to the request in the Prior SIFMA Comment Letter to consider an exemption from the credit risk retention requirements for FFELP loans. However, an asset pool for which every securitized asset is 97 percent (or more) guaranteed constitutes a far greater assurance to investors regarding the quality of the assets than a 2-3 percent, or even 5 percent, risk retention by the sponsor. Requiring additional risk retention by the sponsor is simply unnecessary to further the goals of Congress in enacting the risk retention portions of the Dodd-Frank Act.

We believe there is an anomaly in the proposed rules. Other classes of consumer loans that are of sufficient quality to be considered "qualified assets" benefit from the proposed blended pool option, which would allow reduced retention for an asset pool that consists of both qualified and non-qualified assets. However, no such ability was given to securitizations of FFELP loans, even though FFELP loans have an extremely low risk of loss as a result of the federal guarantee. Thus, using an extreme example, if the lowest guaranteed amount for any single FFELP loan in a given pool is 97 percent, the required risk retention for the entire pool of assets always would be set 3 percent – even if the pool is a mix of the three types of loans substantially all of which are 98 percent or 100 percent federally guaranteed. In these cases, the resulting risk retention requirement is actually higher than the worst case potential losses a securitization trust could experience (given the federal guarantee).

We reiterate the point made in the Prior SIFMA Comment Letter that there are complete exemptions from the risk retention requirements provided for other securitizations of government-guaranteed assets for which far less credit protection is provided. For example, pursuant to Section 15G(e)(3)(B) of the Exchange Act, which provides for the exemption of "any residential, multifamily, or health care facility mortgage loan asset, or securitization based directly or indirectly on such an asset, which is insured or guaranteed by the United States or an agency of the United States," the Agencies have clarified in re-proposed §__.19(b)(1)(i) that this exemption would apply whether the government guarantee is "in whole or in part." As noted in the Original Proposing Release, this provision would exempt of such transactions as securitizations of mortgage loans insured by the FHA or guaranteed by the Department of Veterans Affairs (the "VA") or the Department of Agriculture Rural Development ("Rural Development"). While the FHA insures the lender at approximately 100 percent of losses including advanced taxes, insurance and foreclosure costs, the VA guarantees "between 25 percent and 50 percent of lender losses in the event of residential borrower defaults," and Rural

Development "guarantees a sliding amount against loss of up to 90 percent of the original loan amount for single family loans."[77] There is no reason to treat FFELP loans differently.

In support of their position that most FFELP loans should qualify for only a partial exemption from the risk retention requirements, the Agencies state that "fairly extensive post-default servicing must be properly performed under FFELP rules as a prerequisite to guarantee payment," so "appropriate risk management practices would be encouraged . . . to successfully collect on the guarantee."[78] We do not agree with this assessment. First, each such servicer must be an approved servicer by the U.S. Department of Education. In addition, failure to comply with the FFELP regulations' strict servicing standards could result in the loss of the government guarantee and it is usual and customary in FFELP loan servicing agreements to require the defaulting servicer to compensate the loan's owner for the loss of the related guarantee. The loss of its eligible FFELP loan servicer status, coupled with a buy-out obligation, are more than more than sufficient to incentivize compliance by the servicer with those standards.

The Agencies also assert that requiring partial risk retention on most FFELP loans would encourage sponsors to "select assets for securitization with high quality underwriting standards."[79] This justification also is incorrect. First, FFELP loans are no longer being originated, so risk retention on FFELP securitizations cannot affect the underwriting profile of the loan pool. Second, even when FFELP loans were still being originated, all material origination criteria were mandated by the FFELP regulations. Third, sponsors of FFELP securitizations do not disclose, and investors generally do not rely on, any credit features of the loan pool other than the government guarantee.

In our view, requiring sponsors of FFELP loan securitizations to retain even 3 percent as permanent risk retention is inequitable when the actual loss exposure of a securitization trust is considered. Given the federal guarantee, which thereby exposes each securitization trust to a not more than 3 percent potential aggregate principal loss, the Agencies have effectively proposed

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[77] We note, for example, that pursuant to Section 15G(e)(3)(B) of the Exchange Act, which provides for the exemption of "any residential, multifamily, or health care facility mortgage loan asset, or securitization based directly or indirectly on such an asset, which is insured or guaranteed by the United States or an agency of the United States," the Agencies have clarified in re-proposed §__.19(b)(1)(i) that this exemption would apply whether the government guarantee is "in whole or in part." As noted in the Original Proposing release, this provision would exempt of such transactions as securitizations of mortgage loans insured by the FHA or guaranteed by the VA or Rural Development. While the FHA insures the lender at approximately 100 percent of losses including advanced taxes, insurance and foreclosure costs, the VA guarantees "between 25 percent and 50 percent of lender losses in the event of residential borrower defaults," and Rural Development "guarantees a sliding amount against loss of up to 90 percent of the original loan amount for single family loans." Original Proposing Release, 76 Fed. Reg. at 24136.

[78] Re-Proposing Release, 78 Fed. Reg. at 57971.

[79] *Id.*

100% risk retention requirement on sponsors of these deals. To be generally consistent with other asset classes, the true measure of risk retention would have to be set at 5% of the total amount of capital that is "at risk," which in this case 5% of no more than 3%, or no more than 0.15% of each FFELP loan pool. At this level risk retention is truly *de minimis.* As it serves no useful function, it should be waived entirely, just as it is for other federally guaranteed asset pools.

For all of these reasons, we believe that it is consistent with the public interest and investor protection not to impose a risk retention requirement on a transaction in which ABS are backed by FFELP loans that are 97 percent (or more) guaranteed.

XI. Cross-Border Issues

We recognize that the primary focus of the Agencies is on the U.S. markets. However, in today's world, the ABS markets are global. Transactions may be structured by and issued in one jurisdiction, but the resulting ABS may be sold in another. When those different jurisdictions have different – or even conflicting – requirements for risk retention, multi-jurisdictional offerings may become extremely difficult, if not impossible.

We appreciate the Agencies' proposed safe harbor for certain foreign transactions, and their efforts to address comments received on this topic. However, in our view, the safe harbor only addresses a very limited subset of the cross-border issues raised by the risk retention proposal, if the global markets for these important instruments are not to be significantly impeded.

A. We Support AFME's Comment Letter Regarding Cross-Border Issues

The Association for Financial Markets in Europe ("AFME") has submitted a letter outlining significant issues that would arise for cross-border offerings under the proposed risk retention rules. Among the issues raised by AFME's letter are:

- *The need for a mutual recognition process* – AFME considers such a process to be essential to preserve cross-border market access and we urge the Agencies to reconsider this issue and, to the extent that the Agencies believe that this is beyond their mandate, to refer the issue to those authorities empowered to progress the matter to reconsider their ability to provide for this;

- *The need for clarification clarifications and adjustments with respect to the proposed safe harbor for certain foreign transactions* – AFME strongly supports the inclusion of

provisions intended to clarify the jurisdictional scope of the US regime, but requests confirmation that secondary market trading activities are not relevant under the proceeds trigger condition, notes the significant practical difficulties that will arise for transactions involving a US offering which seek to rely on the safe harbor as proposed, and seeks clarifications and adjustments to the safe harbor conditions with respect to the proposed safe harbor for certain foreign transactions;

- *The need for development of certain holding options and exemptions* – AFME urges the Agencies to reconsider making provision for a representative sample holding option, note the need for certain technical clarifications to the seller's interest holding option to properly accommodate UK mortgage master trust structures and highlight the current lack of feasible holding options with respect to many ABCP conduit programs and CLOs; and

- *The need for a level playing field for compliance* – AFME notes that aspects of the proposals appear to assume that the US regime would apply in respect of US-originated transactions only, and as such would not properly accommodate non-US transactions and/or would give rise to disproportionately onerous obligations for EU and other non-US market participants.

We strongly concur with AFME's views, and urge the Agencies to carefully consider the issues raised by AFME. We further address some of those issues, as well as some additional concerns, below.

B. <u>A Mutual Recognition Process Is Necessary to Avoid Irreconcilable Jurisdictional Conflicts</u>

Like AFME, we strongly favor a mutual recognition process with respect to credit risk retention. We believe that such a process is necessary to preserve the global nature of the ABS markets and to enhance global liquidity. As the International Organisation of Securities Commissions noted in its final report on Global Developments in Securitisation Regulation published in November 2012, "[c]ross border activity creates opportunities to broaden and deepen markets and amplify the economic benefits securitisation markets offer … the potential impact of differences in regulatory requirements across jurisdictions in impeding cross-border activity are issues of concern."[80]

[80] The report is available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD394.pdf .

The differences between the European Union ("EU") retention regime and the proposed U.S. rules are significant. Unless a mutual recognition framework is adopted, sponsors desiring to comply with both regimes for cross-border market access would have to comply with the more onerous compliance standard in cases where they differ, and would be limited to methods that work under both regimes. Generally, the portions of the regimes that provide the most flexibility (*i.e.*, specific risk retention methods and exemptions crafted for particular types of structures and assets) will be unavailable. In some cases, the two regimes may directly conflict. For example, as proposed, the U.S. rules would require risk retention by one sponsor, whereas the EU regime (based on proposals in connection with the coming CRD IV regime) would require proportionate retention where there are multiple sponsors. Because it would not be possible to comply with conflicting requirements, cross-border offerings in these cases would be impossible.

Because the EU scheme generally would prohibit any investment in a securitization transaction unless credit risk was retained in the prescribed form, the failure of the Agencies and the EU regulators to come to terms on mutual recognition could have even more far-reaching effects. EU banks may be prohibited from acquiring ABS that do not comply with the EU risk retention scheme, even if they comply with the U.S. rules. This would effectively prohibit EU banks from providing liquidity and market making activity in the U.S. securitization market. Since EU banks issue and trade a large share of U.S. securitizations, the inconsistencies between the EU and U.S. rules would have a large impact on lending and liquidity in the ABS markets and otherwise. Generally, investors look at a particular bank's entire spectrum capital markets products when assessing their potential relationship with a bank, so the inability of EU banks to provide liquidity and make markets in the U.S. could meaningfully diminish their fixed income businesses across the board. U.S. firms could not easily replace all of that capacity and expertise, so the costs of lending overall could rise, liquidity could decline, and the overall economy could suffer.

For all of these crucial reasons, we urge the Agencies to work together with the EU authorities to adopt a mutual recognition scheme in the final rules. In our view, appropriate mutual recognition creates the necessary flexibility to allow national regulators to mandate the risk retention rules that they consider appropriate for domestic transactions, yet still providing for a means of coordination across different regional pools of liquidity.

Mutual recognition could be accomplished in numerous ways. For the reasons stated in AFME's letter, we support AFME's suggestion to amend the foreign transactions safe harbor condition with the U.S. investor limitation, so that it may be satisfied either by compliance with the U.S. investor limitation or by commitment of the non-U.S. sponsor to retain a net economic interest in compliance with the EU retention regime (or another recognized credit risk retention regime).

We acknowledge that making mutual recognition work properly may involve complex and difficult decisions. However, we believe it is crucial to do so in order to maintain the proper functioning of cross-border markets. Therefore, we urge the Agencies to reconsider the feasibility of mutual recognition and to work with the EU authorities to come up with a workable solution.

C. In the Proposed Safe Harbor, The U.S. Person Limitation on Investors Should Be Eliminated in Favor of Mutual Recognition – or Substantially Raised

The proposed safe harbor would require that no more than 10 percent of the dollar value (or equivalent if sold in a foreign currency) of all classes of ABS interests are sold or transferred to U.S. persons or for the account or benefit of U.S. persons. We support AFME's request for clarification that the phrase "sold or transferred" refers only to transfers by the issuing entity (whether directly or through an underwriter or initial purchaser), rather than transfers that occur after completion of the transaction through secondary market trading.

According to the Agencies, "the 10 percent threshold is consistent with other Commission exemptive rules relating to cross-border offerings under which the Commission has provided accommodations for not applying its rules even though there is a limited offering of securities in the United States."[81] The Agencies appear to be referring to Rules 801 and 802 under the Securities Act. Rule 801 provides an exemption from registration under the Securities Act for certain rights offerings by foreign private issuers where U.S. holders hold no more than 10 percent of the relevant class of securities. Rule 802 provides an exemption from registration under the Securities Act for certain exchange offers of foreign private issuers in a business combination, where U.S. holders hold more than 10 percent of the securities that are subject to the exchange offer or business combination. The context of the proposed safe harbor from credit risk retention is quite different. Rules 801 and 802 address situations where the number of *existing* U.S. securityholders is relevant, whereas in the safe harbor, the proposed 10 percent limit would apply to all potential purchasers in a securities offering. For this reason, the relevance of Rules 801 and 802 is not clear to us.

As discussed by AFME, it will be extremely difficult for market participants to rely on the safe harbor. Generally, it is not possible to forecast in advance the level of U.S. investor participation, and the relevant placement levels will not be known until pricing or even later. We agree with AFME's request that the limitation on sales and transfers of ABS interests sold in the securitization transaction be construed to relate only to sales and transfers by the issuing

[81] Original Proposing Release, 76 Fed. Reg. at 24140 n. 198.

entity only, and only at the time of the initial issuance of the ABS interests. We also agree that even this limitation, while helpful, does not solve the fundamental problem of the impossibility of knowing with precision, in advance, the ultimate level of involvement of US persons in an offering. We support AFME's conclusion that a mutual recognition regime is necessary to ensure the continued ability of sponsors to issue cross-border transactions, and retain the global base of liquidity for securitization transactions. An outcome where sponsors are forced to comply with two inconsistent risk retention regimes is neither efficient nor beneficial for securitization investors, as the most likely outcome will be sponsors choosing not to access global markets.

In sum, we believe that the final rules should reflect mutual recognition, and where a securitization complies with another recognized credit risk retention regime, there should not be any limit on U.S. persons' investment in an ABS transaction.

However, to the extent that the Agencies ultimately disagree with our position and determine that, notwithstanding the severe practical difficulties discussed above, some limitation on sales to U.S. persons is required, a 10 percent limit on U.S. purchasers provides very little tolerance for error – and very little certainty. The supposed safe harbor, as a result, would not be terribly safe. Assuming that a transaction could be marketed and sold in compliance with investor domicile limitations, we urge the Agencies to provide a greater margin of safety for sponsors that wish to rely on the proposed safe harbor. If the Agencies adopt any limit, we ask that it be set at 20 percent, rather than 10 percent as proposed. This would reduce the risk of good-faith errors having a significant, negative consequence for securitization sponsors. In any case, however, a more efficient solution would be for compliance with a foreign jurisdiction's risk retention regime to be recognized as compliance with the U.S. rules, as discussed above.

D. There Should Be a Safe Harbor for Sales by U.S. Entities Modeled on Regulation S Under the Securities Act

In addition to all of the foregoing concerns, we note that the prerequisites for compliance with the proposed safe harbor for foreign securitization transactions include that:

- Neither the sponsor nor the issuing entity is organized under the laws of the U.S. or a U.S. state or territory, or is an unincorporated branch or office located in the U.S. of an entity not organized under the laws of the U.S. or a U.S. state or territory; and

- No more than 25 percent (based on unpaid principal balance) of the securitized assets were acquired by the sponsor or issuing entity, directly or indirectly, from a majority-owned affiliate of the sponsor or issuing entity that is organized under the laws of the

U.S. or a U.S. state, or an unincorporated branch or office of the sponsor or issuing entity that is located in the U.S.

Because of these requirements, any U.S.-based securitization (either involving a U.S.-based sponsor or issuer, or containing assets exceeding the limit for U.S.-generated assets) would be required to satisfy the credit risk retention requirements or find another exemption – even if none of the securities are offered or sold to U.S. persons by the issuer, and restrictions are adopted to discourage flowback of the securities into the United States. In our view, such transactions, which clearly are intended for a foreign investor base, should not be subject to U.S. risk retention requirements.

Regulation S under the Securities Act contains a carefully calibrated safe harbor scheme delineating the outer jurisdictional scope of the registration requirements of the Securities Act, generally requiring adherence to stricter standards when the issuer is not a foreign issuer. Since it was adopted by the Commission in 1990 and strengthened substantially in 1998, Regulation S has served as a flexible and workable boundary for when compliance with U.S. regulations is required. As noted in preliminary note 1 to Regulation S, that rule by its terms relates solely to the application of Section 5 of the Securities Act. However, as described in the adopting release, Regulation S is "based on a territorial approach" and is "intended to protect U.S. capital markets and investors purchasing in the U.S. market, whether U.S. or foreign nationals. Principles of comity and the reasonable expectations of participants in the global markets justify reliance on laws applicable in jurisdictions outside the United States to define the requirements for transactions effected offshore. The territorial approach recognizes the primacy of the laws in which a market is located."[82] We believe that this approach is also appropriate for credit risk retention.

Therefore, in addition to the safe harbor proposed by the Agencies (together with any modifications adopted in response to our and AFME's respective comments), we urge the Agencies to adopt an additional safe harbor for transactions in which all securities offered or sold to non-affiliates of the sponsor are offered and sold in accordance with the applicable provisions of Regulation S. Making the threshold for compliance with U.S. securities registration requirements co-extensive with the threshold for compliance with U.S. risk retention rules, particularly with respect to foreign offerings by U.S. issuers, would set clear and consistent guidelines for sponsors, would protect investors who have reasonable expectations of reliance on U.S. law, would simplify and ease regulatory burdens, and would reflect important principles of comity.

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[82] Offshore Offers and Sales, SEC Release No. 33-6863, 1990 WL 311658, at *5 (Apr. 24, 1990).

Conclusion

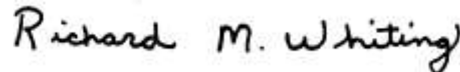
We appreciate the Agencies' careful consideration of the comments submitted on the Original Proposing Release, and believe that, as re-proposed, the credit risk retention rules are in some important respects much more workable. In our view, not all aspects of the Agencies' proposals provide sufficient flexibility to minimize the possibility of significant market disruptions, a concern that is exacerbated for those asset classes that exhibited strong financial performance during the financial crisis. The ABS markets remain an important source of financing for the global economy, which is just now starting to show signs of real rebound. We continue to urge the Agencies to consider carefully how the re-proposed rules can be further revised to avoid unduly harsh impacts on the access to credit for companies and individuals, while adequately addressing the risks and the types of ABS that have been the subject of concern since the onset of the financial crisis.

We greatly appreciate your consideration of the views set forth in this letter, and we would be pleased to have the opportunity to discuss these matters further with you or with any member of the staff of any of the Agencies. We also would be very interested in meeting with representatives of any of the Agencies at a time and place convenient for you in order to discuss the issues addressed in this letter.

Please feel free to contact Chris Killian (at 212-313-1126 or ckillian@sifma.org) on behalf of SIFMA, Rich Whiting (at rich.whiting@fsroundtable.org) or Richard Foster (at richard.foster@fsroundtable.org) on behalf of FSR, Bob Davis (at rdavis@aba.com) on behalf of ABA, or Cecelia Calaby (at ccalaby@aba.com) or Cristeena Naser (at cnaser@aba.com) on behalf of ABASA, to discuss our specific views or general comments on the issues addressed in our letter.

Sincerely yours,

Christopher B. Killian
Securities Industry and Financial Markets Association
Managing Director, Securitization



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