DEPARTMENT OF THE TREASURY
Office of the Comptroller of the Currency
12 CFR Part 43
Docket No. OCC-2011-0002
RIN 1557-AD40

FEDERAL RESERVE SYSTEM
12 CFR Part 244
Docket No. 2011 - 1411
RIN 7100 AD 70

FEDERAL DEPOSIT INSURANCE CORPORATION
12 CFR Part 373
RIN 3064-AD74

U.S. SECURITIES AND EXCHANGE COMMISSION
17 CFR Part 246
Release No. 34-64148; File No. S7-14-11
RIN 3235-AK96

FEDERAL HOUSING FINANCE AGENCY
12 CFR Part 1234
RIN 2590-AA43

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Credit Risk Retention

AGENCIES: Office of the Comptroller of the Currency, Treasury (OCC); Board of Governors of the Federal Reserve System (Board); Federal Deposit Insurance Corporation (FDIC); U.S. Securities and Exchange Commission (Commission); Federal Housing Finance Agency (FHFA); and Department of Housing and Urban Development (HUD).

ACTION: Proposed rule.

SUMMARY: The OCC, Board, FDIC, Commission, FHFA, and HUD (the Agencies) are proposing rules to implement the credit risk retention requirements of section 15G of the Securities Exchange Act of 1934 (15. U.S.C. § 78o-11), as added by section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Section 15G generally requires the securitizer of asset-backed securities to retain not less than five percent of the credit risk of the assets collateralizing the asset-backed securities. Section 15G includes a variety of exemptions from these requirements, including an exemption for asset-backed securities that are collateralized exclusively by residential mortgages that qualify as “qualified residential mortgages,” as such term is defined by the Agencies by rule.

DATES: Comments must be received by June 10, 2011.

ADDRESSES: Interested parties are encouraged to submit written comments jointly to all of the Agencies. Commenters are encouraged to use the title "Credit Risk Retention" to facilitate the organization and distribution of comments among the Agencies. Commenters are also encouraged to identify the number of the specific request for comment to which they are responding.

Office of the Comptroller of the Currency: Because paper mail in the Washington, DC area and at the OCC is subject to delay, commenters are encouraged to submit comments by the Federal eRulemaking Portal or e-mail, if possible. Please use the title "Credit Risk Retention" to facilitate the organization and distribution of the comments. You may submit comments by any of the following methods:

- **Federal eRulemaking Portal – "Regulations.gov":** Go to http://www.regulations.gov, under the "More Search Options" tab click next to the "Advanced Docket Search" option where indicated, select "Comptroller of the Currency" from the agency drop-down menu, then click "Submit." In the "Docket ID" column, select "OCC-2010-0002" to submit or view public comments and to view supporting and related materials for this proposed rule. The "How to Use This Site" link on the Regulations.gov home page provides information on using Regulations.gov, including instructions for submitting or viewing public comments, viewing other supporting and related materials, and viewing the docket after the close of the comment period.

- **E-mail:** regs.comments@occ.treas.gov.

- **Mail:** Office of the Comptroller of the Currency, 250 E Street, SW., Mail Stop 2-3, Washington, DC 20219.

- **Fax:** (202) 874-5274.

- **Hand Delivery/Courier:** 250 E Street, SW., Mail Stop 2-3, Washington, DC 20219.

Instructions: You must include "OCC" as the agency name and "Docket Number OCC-2010-0002" in your comment. In general, OCC will enter all comments received into the docket and publish them on the Regulations.gov Web site without change, including any business or personal information that you provide such as name and address information, e-mail addresses, or phone numbers. Comments received, including attachments and other supporting materials, are part of the public record and subject to public disclosure. Do not enclose any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

You may review comments and other related materials that pertain to this proposed rulemaking by any of the following methods:

- **Viewing Comments Electronically:** Go to http://www.regulations.gov, under the "More Search Options" tab click next to the "Advanced Document Search" option where indicated, select "Comptroller of the Currency" from the agency drop-down menu, then click “Submit.” In the “Docket ID” column, select “OCC-2011-0002” to view public comments for this rulemaking action.

- **Viewing Comments Personally:** You may personally inspect and photocopy comments at the OCC, 250 E Street, SW., Washington, DC. For security reasons, the OCC requires that visitors make an appointment to inspect comments. You may do so by calling (202) 874-4700. Upon arrival, visitors will be required to present valid government-issued photo identification and submit to security screening in order to inspect and photocopy comments.

- **Docket:** You may also view or request available background documents and project summaries using the methods described above.

Board of Governors of the Federal Reserve System:

You may submit comments, identified by Docket No. R-1411, by any of the following methods:

- **Agency Web Site**: http://www.federalreserve.gov. Follow the instructions for submitting comments at http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm.
- **Federal eRulemaking Portal**: http://www.regulations.gov. Follow the instructions for submitting comments.
- **E-mail**: regs.comments@federalreserve.gov. Include the docket number in the subject line of the message.
- **Fax**: (202) 452-3819 or (202) 452-3102.
- **Mail**: Address to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW, Washington, DC 20551.

All public comments will be made available on the Board’s web site at http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm as submitted, unless modified for technical reasons. Accordingly, comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper in Room MP-500 of the Board’s Martin Building (20th and C Streets, N.W.) between 9:00 a.m. and 5:00 p.m. on weekdays.

Federal Deposit Insurance Corporation: You may submit comments, identified by RIN number, by any of the following methods:

- **Agency Web Site:** http://www.FDIC.gov/regulations/laws/federal/notices.html. Follow instructions for submitting comments on the Agency Web Site.

- **E-mail:** Comments@FDIC.gov. Include the RIN number on the subject line of the message.

- **Mail:** Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.

- **Hand Delivery**: Comments may be hand delivered to the guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7:00 a.m. and 5:00 p.m.

Instructions: All comments received must include the agency name and RIN for this rulemaking and will be posted without change to http://www.fdic.gov/regulations/laws/federal/propose.html, including any personal information provided.

Securities and Exchange Commission: You may submit comments by the following method:

Electronic Comments

- Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml); or

- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-14-11 on the subject line; or

- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090.

- All submissions should refer to File Number S7-14-11. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/proposed.shtml). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

Federal Housing Finance Agency: You may submit your written comments on the proposed rulemaking, identified by RIN number 2590-AA43, by any of the following methods:

- **E-mail**: Comments to Alfred M. Pollard, General Counsel, may be sent by e-mail at RegComments@fhfa.gov. Please include "RIN 2590-AA43" in the subject line of the message.

- **Federal eRulemaking Portal: http://www.regulations.gov**. Follow the instructions for submitting comments. If you submit your comment to the Federal eRulemaking Portal, please also send it by e-mail to FHFA at RegComments@fhfa.gov to ensure timely receipt by the Agency. Please include ‘‘RIN 2590–AA43’’ in the subject line of the message.

- **U.S. Mail, United Parcel Service, Federal Express, or Other Mail Service:** The mailing address for comments is: Alfred M. Pollard, General Counsel, Attention: Comments/RIN 2590-AA43, Federal Housing Finance Agency, Fourth Floor, 1700 G Street, NW., Washington, DC 20552.

- **Hand Delivery/Courier**: The hand delivery address is: Alfred M. Pollard, General Counsel, Attention: Comments/RIN 2590-AA43, Federal Housing Finance Agency, Fourth Floor, 1700 G Street, NW., Washington, DC 20552. A hand-delivered package should be logged at the Guard Desk, First Floor, on business days between 9:00 a.m. and 5:00 p.m.

All comments received by the deadline will be posted for public inspection without change, including any personal information you provide, such as your name and address, on the FHFA website at http://www.fhfa.gov. Copies of all comments timely received will be available for public inspection and copying at the address above on government-business days between the hours of 10 a.m. and 3 p.m. To make an appointment to inspect comments please call the Office of General Counsel at (202) 414-6924.

Department of Housing and Urban Development: Interested persons are invited to submit comments regarding this rule to the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street, SW, Room 10276, Washington, DC 20410-0500. Communications must refer to the above docket number and title. There are two methods for submitting public comments. All submissions must refer to the above docket number and title.

- **Submission of Comments by Mail.** Comments may be submitted by mail to the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street, SW, Room 10276, Washington, DC 20410-0500.

- **Electronic Submission of Comments.** Interested persons may submit comments electronically through the Federal eRulemaking Portal at www.regulations.gov. HUD strongly encourages commenters to submit comments electronically. Electronic submission of comments allows the commenter maximum time to prepare and submit a comment, ensures timely receipt by HUD, and enables HUD to make them immediately available to the public. Comments submitted electronically through the www.regulations.gov website can be viewed by other commenters and interested members of the public. Commenters should follow the instructions provided on that site to submit comments electronically.

- **Note**: To receive consideration as public comments, comments must be submitted through one of the two methods specified above. Again, all submissions must refer to the docket number and title of the rule.

- **No Facsimile Comments.** Facsimile (FAX) comments are not acceptable.

- **Public Inspection of Public Comments**. All properly submitted comments and communications submitted to HUD will be available for public inspection and copying between 8 a.m. and 5 p.m. weekdays at the above address. Due to security measures at the HUD Headquarters building, an appointment to review the public comments must be scheduled in advance by calling the Regulations Division at 202-708-3055 (this is not a toll-free number). Individuals with speech or hearing impairments may access this number via TTY by calling the Federal Information Relay Service at 800-877-8339. Copies of all comments submitted are available for inspection and downloading at www.regulations.gov.

FOR FURTHER INFORMATION CONTACT:

OCC: Chris Downey, Risk Specialist, Financial Markets Group, (202) 874-4660; Kevin Russell, Director, Retail Credit Risk, (202) 874-5170; Darrin Benhart, Director, Commercial Credit Risk, (202) 874-5670; or Jamey Basham, Assistant Director, or Carl Kaminski, Senior Attorney, Legislative and Regulatory Activities Division, (202) 874-5090, Office of the Comptroller of the Currency, 250 E Street SW., Washington, DC 20219.

Board: Benjamin W. McDonough, Counsel, (202) 452-2036; April C. Snyder, Counsel, (202) 452-3099; Sebastian R. Astrada, Attorney, (202) 452-3594; or Flora H. Ahn, Attorney, (202) 452-2317, Legal Division; Thomas R. Boemio, Manager, (202) 452-2982; Donald N. Gabbai, Senior Supervisory Financial Analyst, (202) 452-3358; or Sviatlana A. Phelan, Financial Analyst, (202) 912-4306, Division of Banking Supervision and Regulation; Andreas Lehnert, Deputy Director, Office of Financial Stability Policy and Research, (202) 452-3325; or Brent Lattin, Counsel, (202) 452-3367, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, 20th and C Streets, NW., Washington , D.C. 20551.

FDIC: Beverlea S. Gardner, Special Assistant to the Chairman, (202) 898-3640; Mark L. Handzlik, Counsel, (202) 898-3990; Phillip E. Sloan, Counsel, (703) 562-6137; or Petrina R. Dawson, Counsel, (703) 562-2688, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.

Commission: Jay Knight, Attorney-Advisor in the Office of Rulemaking, or Katherine Hsu, Chief of the Office of Structured Finance, Division of Corporation Finance, at (202) 551-3753, U.S. Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-3628.
FHFA: Patrick J. Lawler, Associate Director and Chief Economist, Patrick.Lawler@fhfa.gov, (202) 414-3746; Austin Kelly, Associate Director for Housing Finance Research, Austin.Kelly@fhfa.gov, (202) 343-1336; Phillip Millman, Principal Capital Markets Specialist, Phillip.Millman@fhfa.gov, (202) 343-1507; or Thomas E. Joseph, Senior Attorney Advisor, Thomas.Joseph@fhfa.gov, (202) 414-3095; Federal Housing Finance Agency, Third Floor, 1700 G Street, NW., Washington, DC 20552. The telephone number for the Telecommunications Device for the Hearing Impaired is (800) 877-8339.

HUD: Robert C. Ryan, Deputy Assistant Secretary for Risk Management and Regulatory Affairs, Office of Housing, Department of Housing and Urban Development, 451 7th Street, SW, Room 9106, Washington, DC 20410; telephone number 202-402-5216 (this is not a toll-free

number). Persons with hearing or speech impairments may access this number through TTY by calling the toll-free Federal Information Relay Service at 800-877-8339.

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I. Introduction

The Agencies are requesting comment on proposed rules (proposal or proposed rules) to implement the requirements of section 941(b) of the Dodd–Frank Wall Street Reform and

Consumer Protection Act (the Act, or Dodd–Frank Act),[1] which is codified as new section 15G of the Securities Exchange Act of 1934 (the Exchange Act).[2] Section 15G of the Exchange Act, as added by section 941(b) of the Dodd-Frank Act, generally requires the Board, the FDIC, the OCC (collectively, referred to as the Federal banking agencies), the Commission, and, in the case of the securitization of any "residential mortgage asset," together with HUD and FHFA, to jointly prescribe regulations that (i) require a securitizer to retain not less than five percent of the credit risk of any asset that the securitizer, through the issuance of an asset-backed security (ABS), transfers, sells, or conveys to a third party, and (ii) prohibit a securitizer from directly or indirectly hedging or otherwise transferring the credit risk that the securitizer is required to retain under section 15G and the Agencies' implementing rules.[3]

Section 15G of the Exchange Act exempts certain types of securitization transactions from these risk retention requirements and authorizes the Agencies to exempt or establish a lower risk retention requirement for other types of securitization transactions. For example, section 15G specifically provides that a securitizer shall not be required to retain any part of the credit risk for an asset that is transferred, sold, or conveyed through the issuance of ABS by the securitizer, if all of the assets that collateralize the ABS are qualified residential mortgages (QRMs), as that term is jointly defined by the Agencies.[4] In addition, section 15G states that the Agencies must permit a securitizer to retain less than five percent of the credit risk of commercial mortgages, commercial loans, and automobile loans that are transferred, sold, or conveyed through the issuance of ABS by the securitizer if the loans meet underwriting standards established by the Federal banking agencies.[5]

As shown in tables A, B, C, and D below, the securitization markets are an important source of credit to U.S. households and businesses and state and local governments.[6]

[1] Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[2] 15 U.S.C. § 78o-11

[3] See 15 U.S.C. §78o-11(b), (c)(1)(A) and (c)(1)(B)(ii).

[4] See 15 U.S.C. § 78o-11(c)(1)(C)(iii), (4)(A) and (B).

[5] See id. at § 78o-11(c)(1)(B)(ii) and (2).

[6] Data are through September 2010. All data from Asset Backed Alert except: CMBS data from Commercial Mortgage Alert, CLO data from Securities Industry and Financial Markets Association. The tables do not include any data on securities issued or guaranteed by the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation.

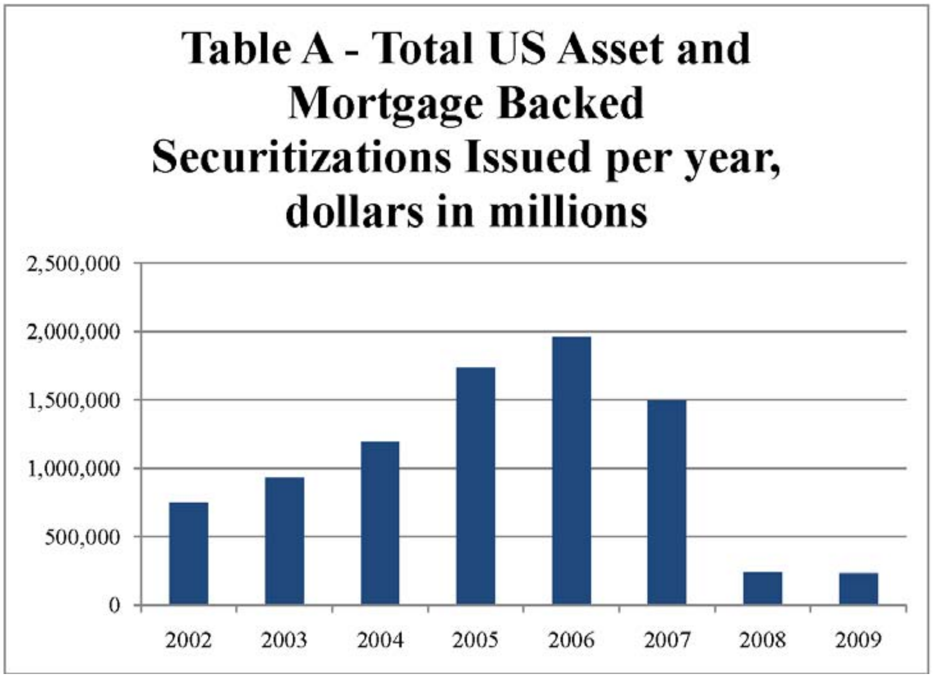
Table A - Total US Asset and Mortgage Backed Securitizations Issued per year, dollars in millions
2,500,000
2,000,000
1,500,000
1,000,000
500,000
0
2002
2003
2004
2005
2006
2007
2008
2009

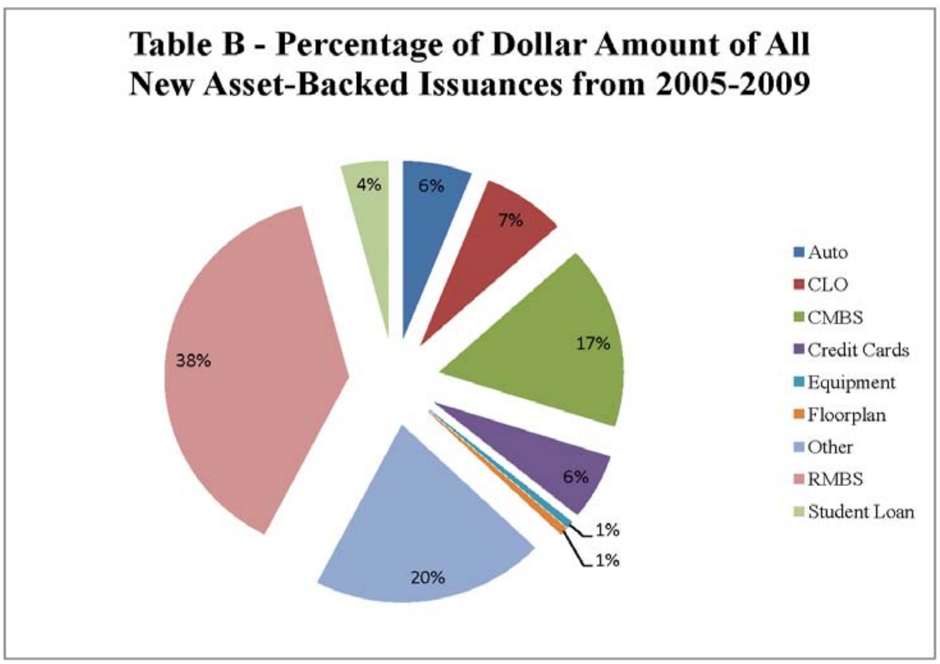
Table B - Percentage of Dollar Amount of All New Asset-Backed Issuances from 2005-2009
4%
6%
7%
17%
38%
6%
1%
1%
20%
Auto
CLO
CMBS
Credit Cards
Equipment
Floorplan
Other
RMBS
Student Loan

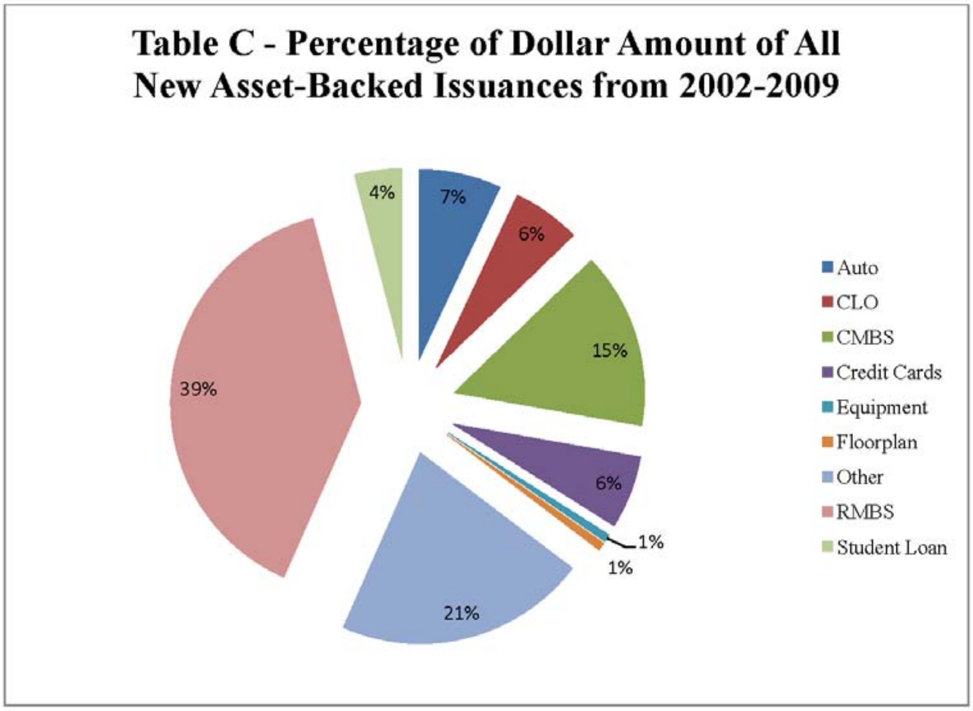

Table D - Total US Asset and Mortgage Backed Securitizations Issued per year (dollars in millions)

	2002	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**Total 2002 3Q2010**
Auto	95484	86350	72881	103717	82000	66773	35469	53944	43104	**639,724**
CLO	30388	22584	32192	69441	171906	138827	27489	2033		**494,860**
CMBS	89900	107354	136986	245883	305714	319863	33583	38750	27297	**1,305,329**
Credit Cards	73004	67385	51188	62916	72518	94470	61628	46581	6149	**535,839**
Equipment	7062	9022	6288	9030	8404	6066	3014	7240	5010	**61,137**
Floorplan	3000	6315	11848	12670	12173	6925	1000	4959	8619	**67,510**
Other	135384	196769	330161	444137	516175	165515	19872	10652	24936	

										1,843,601
RMBS	287916	396288	503911	724115	723257	641808	28612	48082	39830	**3,393,819**
Student Loan	25367	40067	45759	62212	65745	58122	28199	20839	13899	**360,210**
Total	**747,506**	**932,134**	**1,191,216**	**1,734,122**	**1,957,891**	**1,498,370**	**238,868**	**233,079**	**168,843**	

Note: 2010 Data are through the month of September.

When properly structured, securitization provides economic benefits that lower the cost of credit to households and businesses.[7] However, when 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. During the financial crisis, securitization displayed significant vulnerabilities to informational and incentive problems among various parties involved in the process.[8]

For example, as noted in the legislative history of section 15G, under the "originate to distribute" model, loans were made expressly to be sold into securitization pools, with lenders often not expecting to bear the credit risk of borrower default.[9] In addition, participants in the securitization chain may be able to affect the value of the ABS in opaque ways, both before and after the sale of the securities, particularly if those assets are resecuritized into complex instruments such as collateralized debt obligations (CDOs) and CDOs-squared.[10] Moreover, some lenders using an "originate-to-distribute" business model loosened their underwriting standards knowing that the loans could be sold through a securitization and retained little or no continuing exposure to the quality of those assets.[11]

The risk retention requirements added by section 15G are intended to help address problems in the securitization markets by requiring that securitizers, as a general matter, retain an economic interest in the credit risk of the assets they securitize. As indicated in the legislative history of section 15G, "When securitizers retain a material amount of risk, they have 'skin in the

[7] Securitization may reduce the cost of funding, which is accomplished through several different mechanisms. For example, firms that specialize in originating new loans and that have difficulty funding existing loans may use securitization to access more liquid capital markets for funding. In addition, securitization can create opportunities for more efficient management of the asset–liability duration mismatch generally associated with the funding of long-term loans, for example, with short-term bank deposits. Securitization also allows the structuring of securities with differing maturity and credit risk profiles that may appeal to a broad range of investors from a single pool of assets. Moreover, securitization that involves the transfer of credit risk allows financial institutions that primarily originate loans to particular classes of borrowers, or in particular geographic areas, to limit concentrated exposure to these idiosyncratic risks on their balance sheets. See generally Report to the Congress on Risk Retention, Board of Governors of the Federal Reserve System, at 8 (October 2010), available at http://federalreserve.gov/boarddocs/rptcongress/securitization/riskretention.pdf (Board Report).
[8] See Board Report at 8-9.
[9] See S. Rep. No. 111-176, at 128 (2010).
[10] See id.
[11] See id.

game,' aligning their economic interest with those of investors in asset-backed securities."[12] By requiring that the securitizer retain a portion of the credit risk of the assets being securitized, section 15G provides securitizers an incentive to monitor and ensure the quality of the assets underlying a securitization transaction, and thereby helps align the interests of the securitizer with the interests of investors. Additionally, 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.[13]

The credit risk retention requirements of section 15G are an important part of the legislative and regulatory efforts to address weaknesses and failures in the securitization process and the securitization markets. Section 15G complements other parts of the Dodd-Frank Act intended to improve the securitization markets. These include, among others, provisions that strengthen the regulation and supervision of nationally recognized statistical rating agencies (NRSROs) and improve the transparency of credit ratings;[14] provide for issuers of registered ABS offerings to perform a review of the assets underlying the ABS and disclose the nature of the review;[15] and require issuers of ABS to disclose the history of the repurchase requests they received and repurchases they made related to their outstanding ABS.[16]

In developing the proposed rules, the Agencies have taken into account the diversity of assets that are securitized, the structures historically used in securitizations, and the manner in which securitizers may have retained exposure to the credit risk of the assets they securitize.[17] As described in detail below, the proposed rules provide several options securitizers may choose from in meeting the risk retention requirements of section 15G, including, but not limited to, retention of a five percent "vertical" slice of each class of interests issued in the securitization or retention of a five percent "horizontal" first-loss interest in the securitization, as well as other risk retention options that take into account the manners in which risk retention often has occurred in credit card receivable and automobile loan and lease securitizations and in connection with the issuance of asset-backed commercial paper. The proposed rules also include a special "premium capture" mechanism designed to prevent a securitizer from structuring an ABS transaction in a manner that would allow the securitizer to effectively negate or reduce its retained economic exposure to the securitized assets by immediately monetizing the excess spread created by the securitization transaction.[18] In designing these options and the proposed rules in general, the Agencies have sought to ensure that the amount of credit risk retained is meaningful—consistent with the purposes of section 15G—while reducing the potential for the

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[12] See id. at 129.
[13] See 15 U.S.C. § 78o-11(c)(1)(B)(ii),(e)(1)-(2).
[14] See, e.g., sections 932, 935, 936, 938, and 943 of the Dodd-Frank Act.
[15] See section 945 of the Dodd-Frank Act.
[16] See section 943 of the Dodd-Frank Act.
[17] Both the language and legislative history of section 15G indicate that Congress expected the agencies to be mindful of the heterogeneity of securitization markets. See, e.g., 15 U.S.C. § 78o-11(c)(1)(E),(c)(2),(e); S. Rep. No. 111-76, at 130 (2010) ("The Committee believes that implementation of risk retention obligations should recognize the differences in securitization practices for various asset classes.")
[18] "Excess spread" is the difference between the gross yield on the pool of securitized assets less the cost of financing those assets (weighted average coupon paid on the investor certificates), charge-offs, servicing costs, and any other trust expenses (such as insurance premiums, if any).

proposed rules to negatively affect the availability and costs of credit to consumers and businesses.

As required by section 15G, the proposed rules provide a complete exemption from the risk retention requirements for ABS that are collateralized solely by QRMs and establish the terms and conditions under which a residential mortgage would qualify as a QRM. In developing the proposed definition of a QRM, the Agencies carefully considered the terms and purposes of section 15G, public input, and the potential impact of a broad or narrow definition of QRMs on the housing and housing finance markets.

As discussed in greater detail in Part V of this Supplementary Information, the proposed rules would generally prohibit QRMs from having product features that contributed significantly to the high levels of delinquencies and foreclosures since 2007—such as terms permitting negative amortization, interest-only payments, or significant interest rate increases—and also would establish underwriting standards designed to ensure that QRMs are of very high credit quality consistent with their exemption from risk retention requirements. These underwriting standards include, among other things, maximum front-end and back-end debt-to-income ratios of 28 percent and 36 percent, respectively;[19] a maximum loan-to-value (LTV) ratio of 80 percent in the case of a purchase transaction (with a lesser combined LTV permitted for refinance transactions); a 20 percent down payment requirement in the case of a purchase transaction; and credit history restrictions.

The proposed rules also would not require a securitizer to retain any portion of the credit risk associated with a securitization transaction if the ABS issued are exclusively collateralized by commercial loans, commercial mortgages, or automobile loans that meet underwriting standards included in the proposed rules for the individual asset class. As for QRMs, these underwriting standards are designed to be robust and ensure that the loans backing the ABS are of very low credit risk. In this Supplementary Information, the Agencies refer to these assets (including QRMs) as "qualified assets."

The Agencies recognize that many prudently underwritten residential and mortgage loans, commercial loans, and automobile loans may not satisfy all the underwriting and other criteria in the proposed rules for qualified assets. Securitizers of ABS backed by such prudently underwritten loans would, as a general matter, be required to retain credit risk under the rule. However, as noted above, the Agencies have sought to structure the proposed risk retention requirements in a flexible manner that would allow the securitization markets for non-qualified assets to function in a manner that both facilitates the flow of credit to consumers and businesses on economically viable terms and is consistent with the protection of investors.

Section 15G allocates the authority for writing rules to implement its provisions among the Agencies in various ways. As a general matter, the Agencies collectively are responsible for adopting joint rules to implement the risk retention requirements of section 15G for

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[19] A front-end debt-to-income ratio measures how much of the borrower's gross (pretax) monthly income is represented by the borrower's required payment on the first-lien mortgage, including real estate taxes and insurance. A back-end debt-to-income ratio measures how much of a borrower's gross (pretax) monthly income would go toward monthly mortgage and nonmortgage debt service obligations.

securitizations that are backed by residential mortgage assets and for defining what constitutes a QRM for purposes of the exemption for QRM-backed ABS.[20] The Federal banking agencies and the Commission, however, are responsible for adopting joint rules that implement section 15G for securitizations backed by all other types of assets,[21] and also are the agencies authorized to adopt rules in several specific areas under section 15G.[22] In addition, the Federal banking agencies are responsible for establishing, by rule, the underwriting standards for non-QRM residential mortgages, commercial mortgages, commercial loans and automobile loans that would qualify ABS backed by these types of loans for a less than five percent risk retention requirement.[23] Accordingly, when used in this proposal, the term "Agencies" shall be deemed to refer to the appropriate Agencies that have rulewriting authority with respect to the asset class, securitization transaction, or other matter discussed. The Secretary of the Treasury, as Chairperson of the Financial Stability Oversight Council, coordinated the development of these joint proposed rules in accordance with the requirements of section 15G.[24]

For ease of reference, the proposed rules of the Agencies are referenced using a common designation of §__.1 to §__.23 (excluding the title and part designations for each Agency). With the exception of HUD, each Agency will codify the rules, when adopted in final form, within each of their respective titles of the Code of Federal Regulations.[25] Section __.1 of each Agency's proposed rules identifies the entities or transactions that would be subject to such Agency's rules.[26]

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[20] See id. at § 78o-11(b)(2), (e)(4)(A) and (B).

[21] See id. at § 78o-11(b)(1).

[22] See, e.g. id. at §§ 78o-11(b)(1)(E) (relating to the risk retention requirements for ABS collateralized by commercial mortgages); (b)(1)(G)(ii) (relating to additional exemptions for assets issued or guaranteed by the United States or an agency of the United States); (d) (relating to the allocation of risk retention obligations between a securitizer and an originator); and (e)(1) (relating to additional exemptions, exceptions or adjustments for classes of institutions or assets).

[23] See id. at § 78o-11(b)(2)(B). Therefore, pursuant to section 15G, only the Federal banking agencies are proposing the underwriting definitions in § __.16 (except the asset class definitions of automobile loan, commercial loan, and commercial real estate loan, which are being proposed by the Federal banking agencies and the Commission), and the underwriting standards in §§__.18(b)(1) – (6), __.19(b)(1) – (9), and __.20(b)(1) – (8) of the proposed rules. At the final rule stage, FHFA proposes to adopt only those provisions of the common rules that address the types of asset securitization transactions in which its regulated entities could be authorized to engage under existing law. The remaining provisions, such as those addressing underwriting standards for non-residential commercial loans and auto loans, would be designated as [reserved], and the provisions adopted would be numbered and otherwise designated so as to correspond to the equivalent provisions appearing in the regulations of the other Agencies.

[24] See id. at § 78o-11(h).

[25] Specifically, the agencies propose to codify the rules as follows: 12 CFR part 43 (OCC); 12 CFR part 244 (Regulation RR) (Board); 12 CFR part 373 (FDIC); 17 CFR part 246 (Commission); 12 CFR part 1234 (FHFA). As required by section 15G, HUD has jointly prescribed the proposed rules for a securitization that is backed by any residential mortgage asset and for purposes of defining a qualified residential mortgage. Because the proposed rules would exempt the programs and entities under HUD's jurisdiction from the requirements of the proposed rules, HUD does not propose to codify the rules into its title of the CFR at the time the rules are adopted in final form.

[26] The joint proposed rules being adopted by the Agencies would apply to all sponsors that fall within the scope of 15G, including state and federal savings associations and savings and loan holding companies. These entities are currently regulated and supervised by the Office of Thrift Supervision (OTS), which is not among the Federal banking agencies with rulemaking authority under section 15G. Authority of the OTS under the Home Owners' Loan Act (12 U.S.C. 1461 et seq.) with respect to such entities will transfer from the OTS to the Board, FDIC, and

In light of the joint nature of the Agencies' rulewriting authority under section 15G, the appropriate Agencies will jointly approve any written interpretations, written responses to requests for no-action letters and legal opinions, or other written interpretive guidance concerning the scope or terms of section 15G and the final rules issued thereunder that are intended to be relied on by the public generally.[27] Similarly, the appropriate Agencies will jointly approve any exemptions, exceptions, or adjustments to the final rules.[28] For these purposes, the phrase "appropriate Agencies" refers to the Agencies with rulewriting authority for the asset class, securitization transaction, or other matter addressed by the interpretation, guidance, exemption, exceptions, or adjustments. The Agencies expect to coordinate with each other to facilitate the processing, review and action on requests for such written interpretations or guidance, or additional exemptions, exceptions or adjustments.

II. General Definitions and Scope

Section __.2 of the proposed rules defines terms used throughout the proposed rules. Certain of these definitions are discussed in this part of the Supplementary Information. Other terms are discussed together with the section of the proposed rules where they are used. For example, certain definitions that relate solely to the exemptions for securitizations based on QRMs and certain qualifying commercial, commercial real estate, and automobile loans, are contained in, and are discussed in the context of, those sections (see subpart C of the proposed rules).

A. Asset-Backed Securities, Securitization Transaction and ABS Interests

The proposed risk retention rules would apply to securitizers in securitizations that involve the issuance of "asset-backed securities" as defined in section 3(a)(77) of the Exchange Act, which also was added to the Exchange Act by section 941 of the Dodd-Frank Act.[29] Section 3(a)(77) of the Exchange Act generally defines an "asset-backed security" to mean "a fixed-income or other security collateralized by any type of self-liquidating financial asset (including a loan, lease, mortgage, or other secured or unsecured receivable) that allows the holder of the security to receive payments that depend primarily on cash flow from the asset."[30] The proposed rules incorporate by reference this definition of asset-backed security from the

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OCC on the transfer date provided in section 311 of the Dodd-Frank Act. This transfer will take place well before the effective date of the Federal banking agencies' final rules under section 15G. Accordingly, the final rules issued by the appropriate Federal banking agency would include the relevant set of these entities in the agency's Purpose, Authority, and Scope section (§ __.1).

[27] These items would not include staff comment letters and informal written guidance provided to specific institutions or matters raised in a report of examination or inspection of a supervised institution, which are not intended to be relied on by the public generally.

[28] See 15 U.S.C. §§ 78o-11(c)(1)(G)(i) and (e)(1); proposed rules at § __.22.

[29] See section 941(a) of the Dodd-Frank Act.

[30] See 15 U.S.C. § 78c(a)(77). The term also (i) includes any other security that the Commission, by rule, determines to be an asset-backed security for purposes of section 15G of the Exchange Act; and (ii) does not include a security that is issued by a finance subsidiary and held by the parent company of the finance subsidiary or a company that is controlled by such parent company provided that none of the securities issued by the finance subsidiary are held by an entity that is not controlled by the parent company.

Exchange Act.[31] Consistent with this definition, the proposed rules also define the term "asset" to mean a self-liquidating financial asset, including loans, leases, or other receivables.[32] The proposal defines the term "securitized asset" to mean an asset that is transferred, sold, or conveyed to an issuing entity and that collateralizes the ABS interests issued by the issuing entity.[33]

Section 15G does not appear to distinguish between transactions that are registered with the Commission under the Securities Act of 1933 (the "Securities Act") and those that are exempt from registration under the Securities Act. For example, section 15G provides authority for exempting from the risk retention requirements certain securities that are exempt from registration under the Securities Act.[34] In addition, the statutory definition of asset-backed security is broader than the definition of asset-backed security in the Commission's Regulation AB,[35] which governs the disclosure requirements for ABS offerings that are registered under the Securities Act.[36] The definition of asset-backed security for purposes of section 15G also includes securities that are typically sold in transactions that are exempt from registration under the Securities Act, such as CDOs, as well as securities issued or guaranteed by a government sponsored entity (GSE), such as the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). In light of the foregoing, the proposed risk retention requirements would apply to securitizers of ABS offerings whether or not the offering is registered with the Commission under the Securities Act.

As discussed further below, the proposed rules generally apply the risk retention requirements to the securitizer in each "securitization transaction," which is defined as a transaction involving the offer and sale of ABS by an issuing entity.[37] Applying the risk retention requirements to the securitizer of each issuance of ABS ensures that the requirements apply in the aggregate to all ABS issued by an issuing entity, including an issuing entity—such as a master trust—that issues ABS periodically.

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[31] See proposed rules at §__.2 (definition of "asset-backed security").

[32] See proposed rules at §__.2 (definition of "asset"). Because the term "asset-backed security" for purposes of section 15G includes only those securities that are collateralized by self-liquidating financial assets, "synthetic" securitizations are not within the scope of the proposed rules.

[33] See proposed rules at § __.2. Assets or other property collateralize an issuance of ABS interests if the assets or property serves as collateral for such issuance. Assets or other property serve as collateral for an ABS issuance if they provide the cash flow for the ABS interests issued by the issuing entity (regardless of the legal structure of the issuance), and may include security interests in assets or other property of the issuing entity, fractional undivided property interests in the assets or other property of the issuing entity, or any other property interest in such assets or other property. The term collateral includes leases that may convert to cash proceeds from the disposition of the physical property underlying the assets. The cash flow from an asset includes any proceeds of a foreclosure on, or sale of, the asset. See proposed rules at §__.2 (definition of "collateral" for an ABS transaction).

[34] See, e.g., 15 U.S.C. 78o-11(c)(1)(G) (authorizing exemptions from the risk retention requirements certain transactions that are typically exempt from Securities Act registration); 15 U.S.C. 78o-11(e)(3)(B)(providing for certain exemptions for certain assets, or securitizations based on assets, which are insured or guaranteed by the United States).

[35] 17 CFR 229.1100 through 17 CFR 229.1123.

[36] See 15 U.S.C. § 78b.

[37] An "issuing entity" is defined to mean, with respect to a securitization transaction, the trust or other entity created at the direction of the sponsor that owns or holds the pool of assets to be securitized, and in whose name the ABS are issued. See proposed rules at
§ __.2.

The proposed rules use the term "ABS interest" to refer to 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, the payments on which are primarily dependent on the cash flows on the collateral held by the issuing entity. The term, however, does not include common or preferred stock, limited liability interests, partnership interests, trust certificates, or similar interests in an issuing entity that are issued primarily to evidence ownership of the issuing entity, and the payments, if any, on which are not primarily dependent on the cash flows of the collateral held by the issuing entity.[38]

B. Securitizer, sponsor, and depositor

Section 15G generally provides for the Agencies to apply the risk retention requirements of the statute to a "securitizer" of ABS. Section 15G(a)(3) in turn provides that the term "securitizer" with respect to an issuance of ABS includes both "(A) an issuer of an asset-backed security; or (B) a person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuer."[39]

The Agencies note that the second prong of this definition (i.e., the person who organizes and initiates the ABS transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuer) is substantially identical to the definition of a "sponsor" of a securitization transaction in the Commission's Regulation AB governing disclosures for ABS offerings registered under the Securities Act.[40] In light of this, the proposed rules provide that a "sponsor" of an ABS transaction is a "securitizer" for the purposes of section 15G, and define the term "sponsor" in a manner consistent with the definition of that term in the Commission's Regulation AB.[41]

The proposal would, as a general matter, require that a sponsor of a securitization transaction retain the credit risk of the securitized assets in the form and amount required by the proposed rules. The Agencies believe that proposing to apply the risk retention requirement to the sponsor of the ABS—as permitted by section 15G—is appropriate in light of the active and direct role that a sponsor typically has in arranging a securitization transaction and selecting the

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[38] See proposed rules at § __.2. In securitization transactions where ABS interests are issued and some or all of the cash proceeds of the transaction are retained by the issuing entity to purchase, during a limited time period after the closing of the securitization, self-liquidating financial assets to support the securitization, the terms "asset," "collateral," and "securitized assets" should be construed to include such cash proceeds as well as the assets purchased with such proceeds and any assets transferred to the issuing entity on the closing date. Accordingly, the terms "asset-backed security" and "ABS interest" should also be construed to include securities and other interests backed by such proceeds. Such securitization transactions are commonly referred to as including a "pre-funding account."

[39] See 15 U.S.C. § 78o-11(a)(3).

[40] See Item 1101 of the Commission's Regulation AB (17 CFR 229.1101) (defining a sponsor as "a person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuing entity.")

[41] See proposed rules at §__.2. Consistent with the Commission's definition of sponsor, the Agencies interpret the term "issuer" as used in section 15G(a)(3)(B) to refer to the issuing entity that issues the ABS.

assets to be securitized.[42] In 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 this proposal.[43] Each sponsor in the transaction, however, would remain responsible for ensuring that at least one sponsor complied with the requirements.

As noted above, the definition of "securitizer" in section 15G(a)(3)(A) includes the "issuer of an asset-backed security." The term "issuer" when used in the federal securities laws may have different meanings depending on the context in which it is used. For example, for several purposes under the federal securities laws, including the Securities Act[44] and the Exchange Act[45] and the rules promulgated under these Acts,[46] the term "issuer" when used with respect to an ABS transaction is defined to mean the entity—the depositor—that deposits the assets that collateralize the ABS with the issuing entity. The Agencies interpret the reference in section 15G(a)(3)(A) to an "issuer of an asset-backed security" as referring to the "depositor" of the ABS, consistent with how that term has been defined and used under the federal securities laws in connection with ABS.[47] As noted above, the proposed rules generally would apply the risk retention requirements of section 15G to a sponsor of a securitization transaction (and not the depositor for the securitization transaction).

C. Originator

As permitted by section 15G, §__.13 of the proposed rules permit a sponsor to allocate its risk retention obligations to the originator(s) of the securitized assets in certain circumstances and subject to certain conditions. The proposed rules define the term originator in the same

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[42] For example, in the context of collateralized loan obligations (CLOs), the CLO manager generally acts as the sponsor by selecting the commercial loans to be purchased by an agent bank for inclusion in the CLO collateral pool, and then manages the securitized assets once deposited in the CLO structure.

[43] See proposed rules at § __.3(a). Because the term sponsor is used throughout the proposed rules, the term is separately defined in § __.2 of the proposed rules. The definition of "sponsor" in § __.2 is identical to the sponsor part of the proposed rules' definition of a "securitizer."

[44] Section 2(a)(4) of Securities Act (15 U.S.C. § 77b(a)(4)) defines the term "issuer" in part to include every person who issues or proposes to issue any security, except that with respect to certificates of deposit, voting-trust certificates, or collateral trust certificates, or with respect to certificates of interest or shares in an unincorporated investment trust not having a board of directors (or persons performing similar functions), the term issuer means the person or persons performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which the securities are issued.

[45] See Exchange Act § 3(a)(8) (15 U.S.C. § 78c(a)(8) (defining "issuer" under the Exchange Act).

[46] See, e.g., Securities Act Rule 191 (17 CFR 230.191) and Exchange Act Rule 3b-19 (17 CFR 240.3b-19).

[47] For asset-backed securities transactions where there is not an intermediate transfer of the assets from the sponsor to the issuing entity, the term depositor refers to the sponsor. For asset-backed securities transactions where the person transferring or selling the pool assets is itself a trust (such as in an issuance trust structure), the depositor of the issuing entity is the depositor of that trust. See proposed rules at § __.2. Securities Act Rule 191 and Exchange Act Rule 3b-19 also note that the person acting as the depositor in its capacity as depositor to the issuing entity is a different ''issuer'' from that person in respect of its own securities in order to make clear -- for example -- that any applicable exemptions from Securities Act registration that person may have with respect to its own securities are not applicable to the asset-backed securities. That distinction does not appear relevant here.

manner as section 15G, that is, as a person who, through the extension of credit or otherwise, creates a financial asset that collateralizes an asset-backed security, and sells the asset directly or indirectly to a securitizer (i.e., a sponsor or depositor). Because this definition refers to the person that "creates" a loan or other receivable, only the original creditor under a loan or receivable—and not a subsequent purchaser or transferee—is an "originator" of the loan or receivable for purposes of section 15G.[48]

Request for Comment

1. Do the proposed rules appropriately implement the terms "securitizer" and "originator" as used in section 15G and consistent with its purpose?

2. Are there other terms, beyond those defined in §__.2 of the proposed rules, that the Agencies should define?

3(a). As a general matter, is it appropriate to impose the risk retention requirements on the sponsor of an ABS transaction, rather than the depositor for the transaction? 3(b). If not, why?

4(a). With respect to the terms defined, would you define any of the terms differently? 4(b). If so, which ones would you define differently, and how would you define them? For example, credit risk is defined to mean, among other things, the risk of loss that could result from failure of the issuing entity to make required payments or from bankruptcy of the issuing entity.

5. Is it appropriate for the definition of credit risk to include risk of non-payment by the issuing entity unrelated to the assets, such as risk that the issuing entity is not bankruptcy remote?

6. Are all of the definitions in §__.2 of the proposed rules necessary? For instance, is a definition of "asset" necessary?

7(a). As proposed, 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. Is this the best approach to take when there are multiple sponsors in a single securitization transaction? 7(b). If not, what is a better approach and why? For example, should all sponsors be required to retain credit risk in some proportional amount, should the sponsor selling the greatest number of assets or with a particular attribute be required to retain the risk, or should the proposed rules only allow a sponsor that has transferred a minimum percentage (e.g., 10 percent, 20 percent, or 50 percent) of the total assets into the trust to retain the risk?

8(a). Should the proposed rules allow for allocation of risk to a sponsor (among multiple sponsors in a single transaction) similar to the proposed rules' parameters for allocation of risk among multiple originators? 8(b). Why or why not?

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[48] See 15 U.S.C. § 78o-11(a)(3).

9. A securitization transaction is proposed to be defined as a transaction involving the offer and sale of asset-backed securities by an issuing entity. In a single securitization transaction, there may be intermediate steps; however, the proposed rules would only require the sponsor to retain risk for the securitization transaction as a whole.[49] Should the rules provide additional guidance for when a transaction with intermediate steps constitutes one or more securitization transactions that each should be subject to the rules' risk retention requirements?

III. General Risk Retention Requirement

A. Minimum 5 percent risk retention required

Section 15G of the Exchange Act generally requires that the Agencies jointly prescribe regulations that require a securitizer to retain not less than five percent of the credit risk for any asset that the securitizer, through the issuance of an ABS, transfers, sells, or conveys to a third party, unless an exemption from the risk retention requirements for the securities or transaction is otherwise available (e.g., if the ABS is collateralized exclusively by QRMs). Consistent with the statute, the proposed rules generally would require that a sponsor retain an economic interest equal to at least five percent of the aggregate credit risk of the assets collateralizing an issuance of ABS (the "base" risk retention requirement).[50] This exposure should provide a sponsor with an incentive to monitor and control the quality of the assets being securitized and help align the interests of the sponsor with those of investors in the ABS. As discussed in Part III.D of this Supplementary Information, the sponsor also would be prohibited from hedging or otherwise transferring this retained interest.

As required by section 15G, the proposed risk retention requirements would apply to all ABS transactions that are within the scope of section 15G, regardless of whether the sponsor is an insured depository institution, a bank holding company or subsidiary thereof, a registered broker-dealer, or other type of federally supervised financial institution. Thus, for example, it would apply to securitization transactions by any nonbank entity that is not an insured depository institution (such as an independent mortgage firm), as well as by Fannie Mae and Freddie Mac.

The Agencies note that the five percent risk retention requirement established by the proposed rules would be a regulatory minimum. The sponsor, originator, or other party to a securitization may retain, or be required to retain, additional exposure to the credit risk of assets that the sponsor, originator, or other party helps securitize beyond that required by the proposed

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[49] For example, in auto lease securitizations, the auto leases and car titles are originated in the name of a separate trust to avoid the administrative expenses of retitling the physical property underlying the leases. The separate trust will issue to the issuing entity for the asset-backed security a collateral certificate, often called a ''special unit of beneficial interest'' (SUBI). The issuing entity will then issue the asset-backed securities backed by the SUBI certificate.

[50] See proposed rules at §__.3 through §__.11. We note that the proposed rules, in some instances, permit a sponsor to allow another person to retain the required amount of credit risk (e.g., originators, third-party purchasers in commercial mortgage-backed securities transactions, and originator-sellers in asset-backed commercial paper conduit securitizations). However, in such circumstances the proposal includes limitations and conditions designed to ensure that the purposes of section 15G continue to be fulfilled. Further, we note that even when a sponsor would be permitted to allow another person to retain risk, the sponsor would still remain responsible under the rule for compliance with the risk retention requirements.

rules, either on its own initiative or in response to the demands of private market participants. Moreover, the proposed rules would require that a sponsor, in certain circumstances, fund a premium capture cash reserve account in connection with a securitization transaction (see Part III.B.9 of this Supplementary Information). Any amount a sponsor might be required to place in a premium capture cash reserve account would be in addition to the five percent "base" risk retention requirement of the proposed rules.

Request for Comment

10. The Agencies request comment on whether the minimum five percent risk retention requirement established by the proposed rules for non-exempt ABS transactions is appropriate, or whether a higher risk retention requirement should be established for all non-exempt ABS transactions or for any particular classes or types of non-exempt ABS.

11. If a higher minimum requirement should be established, what minimum should be established and what factors should the Agencies take into account in determining that higher minimum? For example, should the amount of credit risk be based on expected losses, or a market-based test based on the interest rate spread relative to a benchmark index?

12(a). Would the minimum five percent risk retention requirement, as proposed to be implemented, have a significant adverse effect on liquidity or pricing in the securitization markets for certain types of assets (such as, for example, prudently underwritten residential mortgage loans that do not satisfy all of the requirements to be a QRM)? 12(b). If so, what markets would be adversely affected and how? What adjustments to the proposed rules (e.g., the minimum risk retention amount, the manner in which credit exposure is measured for purposes of applying the risk retention requirement, or the form of risk retention) could be made to the proposed rules to address these concerns in a manner consistent with the purposes of section 15G? Please provide details and supporting data.

B. Permissible Forms of Risk Retention

As recognized in recent studies and reports on securitization and risk retention that have examined historical market practices, there are several ways in which a sponsor or other entity may have retained exposure to the credit risk of securitized assets.[51] These include (i) a "vertical" slice of the ABS interests, whereby the sponsor or other entity retains a specified pro rata piece of every class of interests issued in the transaction; (ii) a "horizontal" first-loss position, whereby the sponsor or other entity retains a subordinate interest in the issuing entity that bears losses on the assets before any other classes of interests; (iii) a "seller's interest" in securitizations structured using a master trust collateralized by revolving assets whereby the sponsor or other entity holds a separate interest that is pari passu with the investors' interest in the pool of receivables (unless and until the occurrence of an early amortization event); or (iv) a representative sample, whereby the sponsor retains a representative sample of the assets to be

[51] See Board Report; see also Macroeconomic Effects of Risk Retention Requirements, Chairman of the Financial Stability Oversight Counsel (January 2011), available at http://www.treasury.gov/initiatives/wsr/Documents/Section 946 Risk Retention Study (FINAL).pdf.

securitized that exposes the sponsor to credit risk that is equivalent to that of the securitized assets. These examples are not exclusive.

The various forms of risk retention have developed, in part, due to the diversity of assets that are securitized and the structures commonly used in securitizing different types of assets. For example, due to the revolving nature of credit card accounts and the fact that multiple series of ABS collateralized by credit card receivables typically are issued using a single master trust structure, sponsors of ABS transactions collateralized by credit card receivables often have maintained exposure to the credit risk of the underlying loans through use of a seller's interest. On the other hand, sponsors of ABS backed by automobile loans where the originator of the loan is often a finance company affiliated with the sponsor will often retain a portion of the loans that would ordinarily be securitized, thus providing the sponsor some continuing exposure to the credit risk of those loans. In connection with the securitization of commercial mortgage-backed securities ("CMBS"), a form of horizontal risk retention often has been employed, with the horizontal first-loss position being initially held by a third-party purchaser that specifically negotiates for the purchase of the first-loss position and conducts its own credit analysis of each commercial loan backing the CMBS.[52] Sponsors across a wide range of asset classes may initially hold a horizontal piece of the securitization (such as a residual interest). Different forms of risk retention also may have different accounting implications for a sponsor or other entity.[53] Historically, whether or how a sponsor retained exposure to the credit risk of the assets it securitized was determined by a variety of factors including the rating requirements of the NRSROs, investor preferences or demands, accounting considerations, and whether there was a market for the type of interest that might ordinarily be retained (at least initially by the sponsor).

Section 15G expressly provides the Agencies the authority to determine the permissible forms through which the required amount of risk retention must be held.[54] Consistent with this flexibility, Subpart B of the proposed rules would provide sponsors with multiple options to satisfy the risk retention requirements of section 15G. The options in the proposed rules are designed to take into account the heterogeneity of securitization markets and practices, and to reduce the potential for the proposed rules to negatively affect the availability and costs of credit to consumers and businesses. However, importantly, each of the permitted forms of risk retention included in the proposed rules is subject to terms and conditions that are intended to

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[52] Section 15G(c)(1)(E) allows the Federal banking agencies and the Commission to determine that with respect to CMBS, a form of retention that satisfies the requirements includes retention of a first-loss position by a third-party purchaser that meets certain criteria. See 15 U.S.C. § 78o-11(c)(1)(E).

[53] The determination whether a legal entity established to issue ABS must be included in the consolidated financial statements of the sponsor or another participant in the securitization chain is primarily addressed by the following generally accepted accounting principles issued by the Financial Accounting Standards Board (FASB): Accounting Standards Codification Topic 860, Transfers and Servicing (ASC 860, commonly called FAS 166); and FASB Accounting Standards Codification Topic 810, Consolidation (ASC 810, commonly called FAS 167). ASC 860 addresses whether securitizations and other transfers of financial assets are treated as sales or financings. ASC 810 addresses whether legal entities often used in securitization and other structured finance transactions should be included in the consolidated financial statements of any one of the parties involved in the transaction. Together, this guidance determines the extent to which an originator, sponsor, or another company is required to maintain securitized assets and corresponding liabilities on their balance sheets.

[54] See 15 U.S.C. § 78o-11(c)(1)(C)(i); see also S. Rep. No. 111-176, at 130 (2010) ("The Committee [on Banking, Housing, and Urban Affairs] believes that implementation of risk retention obligations should recognize the differences in securitization practices for various asset classes.").

help ensure that the sponsor (or other eligible entity) retains an economic exposure equivalent to at least five percent of the credit risk of the securitized assets. Thus, the forms of risk retention would help to ensure that the purposes of section 15G are fulfilled. In addition, as discussed further in Part III.D of this Supplementary Information below, the proposed rules would prohibit a sponsor from transferring, selling or hedging the risk that the sponsor is required to retain, thereby preventing sponsors from circumventing the requirements of the rules by selling or transferring the risk after the securitization transaction has been completed. The proposed rules also include disclosure requirements that are an integral part of and specifically tailored to each of the permissible forms of risk retention. The disclosure requirements are integral to the proposed rules because they would provide investors with material information concerning the sponsor's retained interests in a securitization transaction, such as the amount and form of interest retained by sponsors, and the assumptions used in determining the aggregate value of ABS to be issued (which generally affects the amount of risk required to be retained). Further, the disclosures are also integral to the rule because they would provide investors and the Agencies with an efficient mechanism to monitor compliance with the risk retention requirements of the proposed rules.[55]

Request for Comment

13. Is the proposed menu of options approach to risk retention, which would allow a sponsor to choose the form of risk retention (subject to all applicable terms and conditions), appropriate?

14(a). Should the Agencies mandate that sponsors use a particular form of risk retention (e.g., a vertical slice or a horizontal slice) for all or specific types of asset classes or specific types of transactions? 14(b). If so, which forms should be required for with which asset classes and why?

15. Does the proposed menu approach achieve the objectives of the statute to provide securitizers an incentive to monitor and control the underwriting quality of securitized assets and help align incentives among originators, sponsors, and investors?

16. Is each of the proposed forms of risk retention appropriate? In particular, the Agencies seek comment on the potential effectiveness of the proposed forms of risk retention in achieving the purposes of section 15G, their potential effect on securitization markets, and any operational or other problems these forms may present.

17. Are there any kinds of securitizations for which a particular form of risk retention is not appropriate?

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[55] The Agencies note that a variation of the vertical, horizontal, seller's interest and representative sample options described below are forms of eligible risk retention in the proposed European Union capital requirement directive relating to securitizations. See "Call for Technical Advice on the Effectiveness of a Minimum Retention Requirement for Securitizations," Committee of European Bank Supervisors (October 30, 2009) (CEBS proposal).

18. How effective would each of the proposed risk retention options be in creating incentives to monitor and control the quality of assets that are securitized and in aligning the interests among the parties in a securitization transaction?

19(a). Are there other forms of risk retention that the Agencies should permit? 19(b). If so, please provide a detailed description of the form(s), how such form(s) could be implemented, and whether such form(s) would be appropriate for all, or just certain, classes of assets.

20. Should the proposed rules require disclosure as to why the sponsor chose a particular risk retention option?

21(a). Are there ways that sponsors could avoid the risk retention requirements in an effort to reduce or eliminate their risk retention requirements? 21(b). If so, how should we modify the proposed rules to address this potential?

22. Are the methodologies proposed for calculating the required five percent exposure under each of the options appropriate?

23(a). Are there other ways that the minimum five percent requirement should be calculated? 23(b). Would such calculation methods be difficult to enforce? 23(c). If so, how can we address those difficulties? 23(d). Are there other alternatives?

1. <u>Vertical risk retention</u>

As proposed, a sponsor may satisfy its risk retention requirements with respect to a securitization transaction by retaining at least five percent of each class of ABS interests issued as part of the securitization transaction.[56] A sponsor using this approach must retain at least five percent of each class of ABS interests issued in the securitization transaction regardless of the nature of the class of ABS interests (e.g., senior or subordinated) and regardless of whether the class of interests has a par value, was issued in certificated form, or was sold to unaffiliated investors. For example, if four classes of ABS interests were issued by an issuing entity as part of a securitization—a senior AAA-rated class, a subordinated class, an interest-only class, and a residual interest—a sponsor using this approach with respect to the transaction would have to retain at least five percent of each such class or interest.[57] The proposed rules do not specify a method of measuring the amount of each class, because the amount retained, regardless of method of measurement, should equal at least five percent of the par value (if any), fair value, and number of shares or units of each class.

Under the vertical risk retention option, by holding a five percent vertical slice in an ABS issuance, a sponsor is exposed to five percent of the credit risk that each class of investors has to

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[56] <u>See</u> proposed rules at § __.4.

[57] As noted previously, the proposed definition of ABS interests does not include common or preferred stock, limited liability interests, partnership interests, trust certificates or similar interests that are issued primarily to evidence ownership of the issuing entity and the payments, if any, on which are not primarily dependent on the cash flows of the assets of the issuing entity. <u>See</u> proposed rules at § __.2 (definition of "ABS interests").

the underlying collateral. This provides the sponsor an interest in the entire structure of the securitization transaction.

Under the proposed rules, a sponsor that elects to retain risk through the vertical slice option would be required to provide, or cause to be provided, to potential investors a reasonable time prior to the sale of the asset-backed securities in the securitization transaction and, upon request, to the Commission and to its appropriate Federal banking agency (if any), the amount (expressed as a percentage and a dollar amount) of each class of ABS interests in the issuing entity that the sponsor will retain (or did retain) at closing as well as the amount (expressed, again, as a percentage and dollar amount) that the sponsor is required to retain under the proposed rules. This disclosure would allow investors to know what risk the sponsor will actually retain in the transaction and compare this amount to the risk that the sponsor is required to retain under the proposed rules. In addition, the proposed rules would require a sponsor to disclose, or cause to be disclosed, the material assumptions and methodologies it used to determine the aggregate dollar amount of ABS interests issued by the issuing entity in the securitization transaction, including those pertaining to any estimated cash flows and the discount rate used. Disclosure of these assumptions and methodologies should help investors and the Agencies monitor the sponsor's compliance with its risk retention requirements because the five percent risk retention requirement is based on the aggregate amount of each class of ABS interests issued as part of the transaction.[58]

<u>Request for Comment</u>

24. Are the disclosures proposed sufficient to provide investors with all material information concerning the sponsor's retained interest in a securitization transaction, as well as to enable investors and the Agencies to monitor the sponsor's compliance with the rule?

25(a). Should additional disclosures be required? 25(b). If so, what should be required and why?

26. Are there any additional factors, such as cost considerations, that the Agencies should consider in formulating an appropriate vertical risk retention option?

2. <u>Horizontal risk retention</u>

As proposed, the second risk retention option permits a sponsor to satisfy its risk retention obligations by retaining an "eligible horizontal residual interest" in the issuing entity in an amount that is equal to at least five percent of the par value of all ABS interests in the issuing

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[58] For similar reasons, disclosure of such assumptions and methodologies would be required under the other risk retention options where the amount of the sponsor's required amount of risk retention is based on the amount of interests issued by the issuing entity or the amount of the collateral underlying such interests. Depending on the circumstances, a sponsor may have an incentive to inflate the value of the underlying collateral and the ABS supported by such collateral (for example, to increase the proceeds from the securitization transaction) or to underestimate the value of such collateral and ABS (for example, to reduce the sponsor's risk retention requirement). The material assumptions relating to estimated cash flows likely would include those relating to the estimated default rate, prepayment rate, the time between default and recoveries on the underlying assets, as well as interest rate projections for assets with variable interest rates.

entity that are issued as part of the securitization transaction.[59] As discussed below, the eligible horizontal residual interest would expose the sponsor to a five percent first-loss exposure to the credit risk of the entire pool of securitized assets.

The proposed rules include a number of terms and conditions governing the structure of an eligible horizontal residual interest in order to ensure that the interest would be a "first-loss" position,[60] and could not be reduced in principal amount (other than through the absorption of losses) more quickly than more senior interests and, thus, would remain available to absorb losses on the securitized assets. Specifically, an interest qualifies as an "eligible horizontal residual interest" under the proposed rules only if it is an ABS interest that is allocated all losses on the securitized assets until the par value of the class is reduced to zero and has the most subordinated claim to payments of both principal and interest by the issuing entity.[61]

Moreover, until all other ABS interests in the issuing entity are paid in full, the eligible horizontal residual interest generally cannot receive any payments of principal made on a securitized asset. However, the interest may receive its proportionate share of scheduled payments of principal received on the securitized assets in accordance with the relevant transaction documents. For example, so long as any other ABS interests are outstanding, a sponsor, through its ownership of the eligible horizontal residual interest, would be prohibited from receiving any prepayments of principal made on the underlying assets because these are, by definition, unscheduled payments. This sponsor also would be prohibited from receiving principal payments made on the underlying assets derived from proceeds from the sale of, or foreclosure on, an underlying asset. The prohibition of unscheduled payments to the eligible horizontal residual interest is designed to ensure that unscheduled payments would not accelerate the payoff of the eligible horizontal residual interest before other ABS interests. Such acceleration would reduce the capacity of the eligible horizontal residual interest to absorb losses on the securitized assets as well as the duration of the sponsor's interest in the securitized assets. The proposed rules would, however, permit the eligible horizontal residual interest to receive its pro rata share of scheduled principal payments on the underlying assets.[62]

Similar to the vertical slice risk retention option, under the proposed rules, a sponsor using the horizontal risk retention option would be required to provide, or cause to be provided, to potential investors a reasonable period of time prior to the sale of ABS interests in the issuing entity and, upon request, to the Commission and its appropriate Federal banking agency (if any): the amount (expressed as a percentage and dollar amount) of the eligible horizontal residual interest that will be retained (or was retained) by the sponsor at closing, and the amount (expressed as a percentage and dollar amount) of the eligible horizontal residual interest required

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[59] See proposed rules at § __.4.

[60] As discussed in Part III.B.9 of this Supplemental Information, if a sponsor is required to establish and fund a premium capture cash reserve account in connection with a securitization transaction, such account would first bear losses on the securitized assets (even before an eligible horizontal residual interest) until the account was depleted.

[61] See proposed rules at § __.2 (definition of "eligible horizontal residual interest").

[62] Thus, an eligible horizontal residual interest with a par value of five percent of the aggregate par value of all ABS interests could, subject to its most subordinate place in the payments waterfall, (i) initially be entitled to receive up to five percent of scheduled principal payments received on the securitized assets, and (ii) if losses reduced the par value of the interest to three percent, receive no more than three percent of scheduled principal payments received on the securitized assets.

to be retained by the sponsor in connection with the securitization transaction; a description of the material terms of the eligible horizontal residual interest, such as when such interest is allocated losses or may receive payments; and the material assumptions and methodologies used in determining the aggregate dollar amount of ABS interests issued by the issuing entity in the securitization transaction, including those pertaining to any estimated cash flows and the discount rate used.

In lieu of holding an eligible horizontal residual interest, the proposed rules would allow a sponsor to cause to be established and funded, in cash, a reserve account at closing (horizontal cash reserve account) in an amount equal to at least five percent of the par value of all the ABS interests issued as part of the transaction (i.e., the same dollar amount as would be required if the sponsor held an eligible horizontal residual interest).[63] This horizontal cash reserve account would have to be held by the trustee (or person performing functions similar to a trustee) for the benefit of the issuing entity. The proposed rules include several important restrictions and limitations on such a horizontal cash reserve account. These limitations and restrictions are intended to ensure that a sponsor that establishes a horizontal cash reserve account would be exposed to the same amount and type of first-loss credit risk on the underlying assets as would be the case if the sponsor held an eligible horizontal residual interest.

Specifically, the proposed rules would provide that, until all ABS interests in the issuing entity are paid in full or the issuing entity is dissolved, the horizontal cash reserve account must be used to satisfy payments on ABS interests on any payment date when the issuing entity has insufficient funds from any source (including any premium capture cash reserve account established under § ____.12 of the proposed rules) to satisfy an amount due on any ABS interest.[64] Thus, the amounts in the account would bear first loss on the securitized assets in the same way as an eligible horizontal residual interest. In addition, until all ABS interests in the issuing entity are paid in full or the issuing entity is dissolved, the proposed rules would prohibit any other amounts from being withdrawn or distributed from the account, with only two exceptions. The first exception would allow amounts in the account to be released to the sponsor (or any other person) due to receipt by the issuing entity of scheduled payments of principal on the securitized assets, provided that the issuing entity distributes such payments of principal in accordance with the transaction documents and the amount released from the horizontal cash reserve account on any date does not exceed the product of: (i) the amount of scheduled payments of principal on the securitized assets received by the issuing entity and for which the release is being made; and (ii) the ratio of the current balance in the horizontal cash reserve account to the aggregate remaining principal balance of all ABS interests in the issuing entity. This limitation is intended to ensure that, like an eligible horizontal residual interest, a horizontal cash reserve account would not be depleted by unscheduled payments of principal on the underlying assets. The second exception would be that the sponsor would be permitted to

[63] See proposed rules at §__.4(b).
[64] See proposed rules at §__.4(b)(3)(i).

receive interest payments (but not principal payments) received by the horizontal cash reserve account on its permitted investments.[65]

A sponsor electing to establish and fund a horizontal cash reserve account would be required to provide disclosures similar to those required with respect to an eligible horizontal residual interest, except that these disclosures have been modified to reflect the different nature of the account.

Request for Comment

27. Do the conditions and limitations in the proposed rules effectively limit the ability of the sponsor to structure away its risk exposure?

28(a). Is the restriction on certain payments to the sponsor with respect to the eligible horizontal residual interest appropriate and sufficient? 28(b). Why or why not?

29(a). Is the proposed approach to measuring the size of horizontal risk retention (five percent of the par value of all ABS interests in the issuing entity that are issued as part of the securitization transaction) appropriate? 29(b). Would a different measurement be better? Please provide details and data supporting any alternative measurements.

30. Are the disclosures proposed sufficient to provide investors with all material information concerning the sponsor's retained interest in a securitization transaction, as well as enable investors and the Agencies to monitor whether the sponsor has complied with the rule?

31(a). Should additional disclosures be required? 31(b). If so, what should be required and why?

32. Are there any additional factors, such as accounting or cost considerations that the Agencies should consider with respect to horizontal risk retention?

33. Should a sponsor be prohibited from utilizing the horizontal risk retention option if the sponsor (or an affiliate) acts as servicer for the securitized assets?

34. Are the terms and conditions of the horizontal cash reserve account appropriate?

35. Do the terms and conditions ensure that such an account will expose the sponsor to the same type and amount of credit risk and have the same incentive effects as an eligible horizontal residual interest?

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[65] Under the proposed rules, amounts in a horizontal cash reserve account may only be invested in (i) United States Treasury securities with remaining maturities of 1 year or less; and (ii) deposits in one or more insured depository institutions (as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813)) that are fully insured by federal deposit insurance. See proposed rules at §__.4(b)(2).

36(a). Should the eligible horizontal residual interest be required to be structured as a "Z bond" such that it pays no interest while principal is being paid down on more senior interests? 36(b). Why or why not?

3. L-Shaped risk retention

The next risk retention option in the proposed rules would allow a sponsor, subject to certain conditions, to use an equal combination of vertical risk retention and horizontal risk retention as a means of retaining the required five percent exposure to the credit risk of the securitized assets. This form of risk retention is referred to as an "L-Shaped" form of risk retention because it combines both vertical and horizontal forms. Specifically, § __.6 of the proposed rules would allow a sponsor to meet its risk retention obligations under the rules by retaining:

(i) Not less than 2.5 percent of each class of ABS interests in the issuing entity issued as part of the securitization transaction (the vertical component); and

(ii) An eligible horizontal residual interest in the issuing entity in an amount equal to at least 2.564 percent of the par value of all ABS interests in the issuing entity issued as part of the securitization transaction, other than those interests required to be retained as part of the vertical component (the horizontal component).[66]

The amount of the horizontal component is calibrated to avoid double counting that portion of an eligible horizontal residual interest that the sponsor is required to hold as part of the vertical component. This calibration also ensures that the combined amount of the vertical component and the horizontal component would be five percent of the aggregate transaction. For example, in a securitization transaction structured with three classes of interests: a certificated senior class whose par value is equal to $950, an uncertificated subordinated class of $24 and an uncertificated eligible horizontal residual interest whose par value is equal to $26, a sponsor would be required to retain $23.75 of the senior class ($950*2.5%), $0.60 of the subordinated class ($24*2.5%) and $25.65 of the eligible horizontal residual interest (($26*2.5%) + ($1000 – ($23.75 + $0.60 + $0.65))*2.564%) for a total of $50 in risk retention requirements. Because the required size of the sponsor's retained eligible horizontal residual interest ($25.65) is less than the amount of the eligible horizontal residual interest, retention of the entire horizontal residual interest by the sponsor complies with the minimum L-shape retention requirements for the securitization.[67]

The proposal would require that a sponsor hold 50 percent of its required risk retention amount in the form of a vertical component and 50 percent in the form of a horizontal component in order to help ensure that each component is large enough to affect the sponsor's incentives and to help align the incentives of the sponsor and investors. In addition, requiring

[66] As under the horizontal risk retention option itself, a sponsor would have the option of establishing and funding, in cash, a horizontal cash reserve account at the closing of the securitization transaction in this amount rather than holding an eligible horizontal residual interest. See proposed rules at §__.4(b). Any such horizontal cash reserve account would be subject to the same restrictions and limitations as under the horizontal risk retention option.
[67] This example is provided for simple illustration only.

that each component represent 50 percent of the total minimum risk retention requirement should assist investors and the Agencies with monitoring compliance with the proposed rules.

Because a sponsor using the L-shape risk retention option would retain both a vertical and a horizontal component, the proposed rules would require that the sponsor provide the disclosures required under the vertical risk retention option, as well as those required under the horizontal risk retention option.

Request for Comment

37. Are the disclosures proposed sufficient to provide investors with all material information concerning the sponsor's retained interest in a securitization transaction, as well as enable investors and the Agencies to monitor whether the sponsor has complied with the rule?

38(a). Should additional disclosures be required? 38(b). If so, what should be required and why?

39. Are there any additional factors, such as cost considerations, that the Agencies should consider with respect to L-shape risk retention?

40(a). Should the Agencies permit or require that a higher proportion of the risk retention held by a sponsor under this option be composed of a vertical component or a horizontal component? 40(b). What implications might such changes have on the effectiveness of the option in helping achieving the purposes of section 15G?

4. Revolving asset master trusts (seller's interest)

Securitizations backed by revolving lines of credit, such as credit card accounts or dealer floorplan loans, often are structured using a revolving master trust, which allows the trust to issue more than one series of ABS backed by a single pool of the revolving assets.[68] In these types of transactions, the sponsor typically holds an interest known as a "seller's interest." This interest is pari passu with the investors' interest in the receivables backing the ABS interests of the issuing entity until the occurrence of an early amortization event. A seller's interest is a direct, shared interest with all of the investors in the performance of the underlying assets and, thus, exposes the sponsor to the credit risk of the pool or receivables.

In light of and to accommodate those types of securitizations, the proposed rules would allow a sponsor of a revolving asset master trust that is collateralized by loans or other extensions of credit that arise under revolving accounts to meet its base risk retention requirement by retaining a seller's interest in an amount not less than five percent of the unpaid principal balance of all the assets held by the issuing entity.[69] The proposed rules define a "revolving asset master trust" as an issuing entity that (i) is a master trust; and (ii) is established to issue more than one series of ABS, all of which are collateralized by a single pool of revolving

[68] In a master trust securitization, assets (e.g., credit card receivables or dealer floorplan financings) may be added to the pool in connection with future issuances of the securities backed by the pool.
[69] See proposed rules at § __.7.

securitized assets that are expected to change in composition over time. The proposed rules also define a "seller's interest" as an ABS interest (i) in all of the assets that are held by the issuing entity and that do not collateralize any other ABS interests issued by the entity; (ii) that is pari passu with all other ABS interests issued by the issuing entity with respect to the allocation of all payments and losses prior to an early amortization event (as defined in the transaction documents); and (iii) that adjusts for fluctuations in the outstanding principal balances of the securitized assets. The definitions of a seller's interest and a revolving asset master trust are intended to be consistent with market practices and, with respect to seller's interest, designed to ensure that any seller's interest retained by a sponsor under the proposal would expose the sponsor to the credit risk of the underlying assets.

Under the proposed rules, a sponsor using the seller's interest option would be required to provide, or cause to be provided, in writing to potential investors a reasonable period of time prior to the sale of the asset-backed securities in the securitization transaction and, upon request, to the Commission and its appropriate Federal banking agency (if any) the amount (expressed as a percentage and dollar amount) of the seller's interest that the sponsor will retain (or has retained) in the transaction at closing and the amount (expressed as a percentage and dollar amount) that the sponsor is required to retain pursuant to §__.7 of the rule; a description of the material terms of the seller's interest; and the material assumptions and methodology used in determining the aggregate dollar amount of ABS interests issued by the issuing entity in the securitization transaction, including those pertaining to any estimated cash flows and the discount rate used.

Request for Comment

41(a). Should a sponsor of a revolving asset master trust be permitted to satisfy its base risk retention requirement by retaining the seller's interest, as proposed? 41(b). Why or why not?

42(a). Are there additional or different conditions that should be placed on this option? 42(b). If so, please explain in detail what other conditions would be appropriate.

43. Are there alternative methods of structuring risk retention for revolving asset master trust securitization transactions that should be permitted? Provide detailed descriptions and data or other support for any alternatives.

44. Are the proposed disclosures sufficient to provide investors with all material information concerning the sponsor's retained interest in a securitization transaction, as well as enable investors and the Agencies to monitor whether the sponsor has complied with the rule?

45(a). Should additional disclosures be required? 45(b). If so, what should be required and why?

46. Should a seller's interest form of risk retention be applied to any other types of securitization transactions? If so, explain in detail and provide data or other support for application to other types of securitization transactions.

5. Representative sample

The next proposed risk retention option permits a sponsor of a securitization transaction to meet its risk retention requirements by retaining a randomly selected representative sample of assets that is equivalent, in all material respects, to the assets that are transferred to the issuing entity and securitized, subject to certain conditions.[70] This method of risk retention has been used in connection with securitizations involving automobile loans where the underlying loans are not originated purely for distribution, but are securitized by the sponsor as part of a broader funding strategy. By retaining a randomly selected representative sample of assets, the sponsor retains exposure to substantially the same type of credit risk as investors in the ABS. Therefore, this structure provides a sponsor incentives to monitor and control the quality of the underwriting of the securitized assets and helps align the sponsor's incentives with those of investors in the ABS.

Consistent with other risk retention options, a sponsor using the representative sample approach would be required to retain at least five percent of the credit risk of the assets the sponsor identifies for securitization. Therefore, the unpaid principal balance of all the assets in the representative sample would be required to equal at least five percent of the aggregate unpaid principal balance of all the assets in the pool of assets initially identified for securitization (including those that end up in the representative sample). For example, if the assets that are identified for securitization have an aggregate unpaid principal balance of $100 million, the aggregate unpaid principal balance of the assets in the representative sample would be required to equal at least $5 million.[71]

To ensure that a sponsor that retains a representative sample remains exposed to substantially the same aggregate credit risks as investors in the ABS, the proposal would require the sponsor to construct a representative sample according to a specific process. As an initial step, the sponsor would need to designate a pool of at least 1,000 separate assets for securitization (the "designated pool"). The representative sample would be required to be drawn exclusively from the designated pool. Also, the designated pool would be prohibited from containing any assets other than those that are either securitized or selected for the representative sample. In the second step, the sponsor must use a random selection process to identify those loans from within the designated pool that will be included in the representative sample. This random selection process may not take account of any characteristic of the assets other than their unpaid principal balance.

After the sponsor randomly selects a representative sample from the designated pool, it would be required to assess that sample to ensure that, for each material characteristic of the assets, including the average unpaid principal balance, in the designated pool the mean of any quantitative characteristic, and the proportion of any characteristic that is categorical in nature, of the sample of assets randomly selected from the designated pool is within a 95 percent two-tailed

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[70] See proposed rules at § __.8.

[71] Stated otherwise, the unpaid principal balance of the assets comprising the representative sample must be no less than 5/95ths (5.264 percent) of the aggregate unpaid principal balance of all the assets that ultimately are securitized in the securitization transaction. The proposed rules use this approach to defining the minimum size of a representative sample. See proposed rules at § __.8(b)(1)(i).

confidence interval of the mean or proportion, respectively, of the same characteristic of all the assets in the designated pool.[72]

Without these statistical tests, a sample could be biased towards, for example, assets with a larger dollar value or assets with a lower expected risk of default. In summary, this process is designed to ensure that the assets randomly selected from the designated pool are, in fact, representative of the securitized pool. If this process does not produce a sample with equivalent material characteristics (as measured by the required two-tailed confidence level), the sponsor must repeat it as necessary in order to achieve an equivalent result or rely on another permissible option for retaining credit risk. The proposal permits this re-selection and testing process.

The proposal contains a variety of safeguards to ensure that the sponsor has constructed the representative sample in conformance with the requirements described above. For example, the sponsor would be required to have in place, and adhere to, policies and procedures for (i) identifying and documenting the material characteristics of the assets in the designated pool; (ii) selecting assets randomly from the designated pool for inclusion in the representative sample; (iii) testing the randomly selected sample of assets in the designated pool; (iv) maintaining, until all ABS interests are paid in full, documentation that clearly identifies the assets included in the representative sample; and (v) prohibiting, until all ABS interests are paid in full, assets in the representative sample from being included in the designated pool of any other securitization transaction.

In addition, prior to the sale of the asset-backed securities as part of the securitization transaction, the sponsor would be required to obtain an agreed upon procedures report from an independent, public accounting firm. At a minimum, the independent, public accounting firm must report on whether the sponsor has the policies and procedures mentioned above.[73] Once an acceptable agreed upon procedures report has been obtained, the sponsor may rely on such report for subsequent securitizations. However, if the sponsor's policies and procedures change in any material respect, a new agreed upon procedures report would be required. Under the proposal, the independent public accounting firm providing the agreed upon procedures report must report on the following minimum items:

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[72] Depending on the type of assets involved in the securitization, the material characteristics other than the unpaid principal balance of the assets might include, for example, the geographical location of the property securing the loan, the debt-to-income ratio(s) of the borrower (DTI ratio), and the interest rate payable on the loan. Characteristics such as the DTI ratio and the interest rate payable on the loan would be considered quantitative characteristics, and characteristics such as the geographic location of the property securing the loan would be considered categorical characteristics. Assuming the factors above are material, a sponsor using the representative sample option would be required to test the <u>mean</u> of the DTI ratio of loans in the representative sample against the <u>mean</u> of the DTI ratio of all assets in the designated pool (including the ones selected for the random sample). In addition, the sponsor would be required to test the <u>proportion</u> of the number of assets from one geographic location in the representative sample to the total number of assets in the representative sample against the <u>proportion</u> of the number of assets from the same geographic location in the designated pool to the total number of assets in the designated pool.

[73] <u>See</u> proposed rules at § __.8(d)(2)(i)-(v).

(i) Policies and procedures that require the sponsor to identify and document the material characteristics of assets included in a designated pool of assets that meets the requirements of the proposal;

(ii) Policies and procedures that require the sponsor to select assets randomly in accordance with the proposal;

(iii) Policies and procedures that require the sponsor to test the randomly-selected sample of assets in accordance with the proposal of this section;

(iv) Policies and procedures that require the sponsor to maintain, until all ABS interests are paid in full, documentation that identifies the assets in the representative sample established in accordance with the proposal; and

(v) Policies and procedures that require the sponsor to prohibit, until all ABS interests are paid in full, assets in the representative sample from being included in the designated pool of any other securitization transaction.

Because the performance of the assets included in the representative sample could differ from the performance of the securitized assets if the two sets of assets were serviced under different standards or procedures, the proposal provides that, until such time as all ABS interests in the issuing entity have been fully paid or the issuing entity has been dissolved, servicing of the assets included in the representative sample must be conducted by the same entity and under the same contractual standards as the servicing of the securitized assets. In addition, the individuals responsible for servicing the assets comprising the representative sample or the securitized assets must not be able to determine whether an asset is held by the sponsor or held by the issuing entity.

A sponsor would also be required to comply with the hedging, transfer and sale restrictions in section __.14 with respect to the assets in the representative sample. Additionally, the sponsor would be prohibited from removing any assets from the representative sample and, until all ABS interests are repaid, causing or permitting the assets in the representative sample to be included in any other designated pool or representative sample established in connection with any other securitization transaction.[74]

To help ensure that potential investors and the Agencies can monitor and assess the sponsor's compliance with these requirements, the proposal would require the sponsor to provide, or cause to be provided, the following disclosures to potential investors a reasonable period of time prior to the sale of asset-backed securities as part of the securitization transaction and to provide, or cause to be provided, the same information, upon request, to the Commission and its appropriate Federal banking agency (if any):

(i) The amount (expressed as a percentage of the designated pool and dollar amount) of assets included in the representative sample to be retained by the sponsor;

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[74] See proposed rules at § __.8(f).

(ii) The amount (expressed as a percentage of the designated pool and dollar amount) of assets required to be included in the representative sample and retained by the sponsor;

(iii) A description of the material characteristics of the designated pool and the representative sample, including, but not limited to, the average unpaid principal balance of the assets in the designated pool and the representative sample, the means of the quantitative characteristics and proportions of characteristics that are categorical in nature with respect to each of the material characteristics of the assets in the designated pool and the representative sample, of appropriate introductory and explanatory information to introduce the characteristics, the methodology used in determining or calculating the characteristics, and any terms or abbreviations used;[75]

(iv) A description of the policies and procedures that the sponsor used for ensuring that the process for identifying the representative sample complies with the proposal and that the representative sample has equivalent material characteristics to those of the pool of securitized assets;

(v) Confirmation that an agreed upon procedures report was obtained as required by the proposal; and

(vi) The material assumptions and methodology used in determining the aggregate dollar amount of ABS interests issued by the issuing entity in the securitization transaction, including those pertaining to any estimated cash flows and the discount rate used.

Further, after the sale of the ABS, the sponsor would be required to provide, or cause to be provided, to investors at the end of each distribution period (as specified in the governing transaction documents) a comparison of the performance of the pool of securitized assets for the related distribution period with the performance of the assets in the representative sample for the related distribution period. A sponsor selecting the representative sample option also would be required to provide investors disclosure concerning the assets in the representative sample in the same form, level, and manner as it provides, pursuant to rule or otherwise, concerning the securitized assets. Therefore, if loan-level disclosure concerning the securitized assets was required, by rule or otherwise, to be provided to investors, the same level of disclosure would also be required concerning the representative sample.

Request for Comment

47. Should we include the representative sample alternative as a risk retention option?

48. Are the mechanisms that we have proposed adequate to ensure monitoring of the randomization process if such an alternative were permitted?

49. Is the requirement that the designated pool contain at least 1000 assets appropriate, or should a greater number of assets be required or a lesser number be permitted?

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[75] See, e.g., disclosure of pool characteristics required in registered transactions in the Commission's Regulation AB, Item 1111(b).

50. Are there material characteristics other than the average unpaid principal balance of all the assets that should be identified in the rule for purposes of the equivalent risk determination and disclosure requirements?

51. Are there any better ways to ensure an adequate randomization process and the equivalence of the representative sample to the pool of securitized assets? For example, would it be appropriate and sufficient if the sponsor were required to use a third party to conduct the random selection with no subsequent testing to determine if the sample constructed has material characteristics equivalent to those of the securitized assets?

52(a). Alternatively, would it be adequate if the sponsor was required to provide a third-party opinion that the selection process was random and that retained exposures are equivalent (i.e., share a similar risk profile) to the securitized exposures? 52(b). Would this opinion resemble a credit rating, thereby raising concerns about undue reliance on credit ratings? 52(c). If this approach were adopted, should the Agencies impose any standards of performance to be followed by such a third party, or that such third party have certain characteristics?

53. If the Agencies adopt a representative sample option, should the same disclosures be required regarding the securitized assets subject to risk retention that are required for the assets in the pool at the time of securitization and on an ongoing basis?

54. Should the retained exposures, as proposed, be subject to the same servicing standards as the securitized exposures?

55. Are the disclosures proposed sufficient to provide investors with all material information concerning the sponsor's retained interest in a securitization transaction, as well as enable investors and the Agencies to monitor whether the sponsor has complied with the rule?

56(a). Should additional disclosures be required? 56(b). If so, what should be required and why?

57(a). Is the condition that a sponsor obtain an agreed upon procedures report from an independent, public accounting firm appropriate? 57(b). If not, is there another mechanism that should be included in the option that helps ensure that the sponsor has constructed the representative sample in conformance with the requirements of the rule?

58(a). Is the requirement that the sponsor determine equivalency with a 95 percent two-tailed confidence appropriate? 58(b). If not, what measurement of equivalency do you recommend and why?

6. <u>Asset-backed commercial paper conduits</u>

The next risk retention option under the proposed rules is an option specifically designed for structures involving asset-backed commercial paper (ABCP) that is supported by receivables originated by one or more originators and that is issued by a conduit that meets certain conditions.[76] This option is designed to take account of the special structures through which this type of ABCP typically is issued, as well as the manner in which exposure to the credit risk of the underlying assets typically is retained by participants in the securitization chain for this type of ABCP.

ABCP is a type of liability that is typically issued by a special purpose vehicle (or conduit) sponsored by a financial institution or other sponsor. The commercial paper issued by the conduit is collateralized by a pool of assets, which may change over the life of the entity. Depending on the type of ABCP program being conducted, the assets collateralizing the ABCP may consist of a wide range of assets including auto loans, commercial loans, trade receivables, credit card receivables, student loans, and other securities. Like other types of commercial paper, the term of ABCP typically is short, and the liabilities are "rolled," or refinanced, at regular intervals. Thus, ABCP conduits generally fund longer-term assets with shorter-term liabilities.

As proposed, this risk retention option in §__.9 of the proposed rules would be available only for short-term ABCP collateralized by receivables or loans and supported by a liquidity facility that provides 100 percent liquidity coverage from a regulated institution. This risk retention option would not be available to entities or ABCP programs that operate as securities or arbitrage programs.[77] ABCP conduits that purchase loans or receivables from one originator or multiple originators are commonly referred to as single-seller ABCP programs and multi-seller ABCP programs, respectively. In each of these programs, the sponsor of the ABCP conduit approves the originators whose loans or receivables will collateralize the ABCP issued by the conduit. An "originator-seller" will sell the eligible loans or receivables to an intermediate, bankruptcy remote SPV established by the originator-seller. The credit risk of the receivables transferred to the intermediate SPV then typically is separated into two classes – a senior interest that is purchased by the ABCP conduit and a residual interest that absorbs first losses on the receivables and is retained by the originator-seller. The residual interest retained by the originator-seller typically is sized so that it is sufficiently large to absorb all losses on the underlying receivables.

The ABCP conduit, in turn, issues short-term ABCP that is collateralized by the senior interests purchased from the intermediate SPVs (which itself is supported by the subordination provided by the residual interest retained by the originator-seller). The sponsor of these types of ABCP conduit, which is usually a bank or other regulated financial institution, also typically provides (or arranges for another regulated financial institution to provide) 100 percent liquidity coverage on the ABCP issued by the conduit. This liquidity support typically requires the support provider to provide funding to, or purchase assets from, the ABCP conduit in the event that the conduit lacks the funds necessary to repay maturing ABCP issued by the conduit.

The proposal includes several conditions designed to ensure that this option is available only to the type of single-seller or multi-seller ABCP conduits described above. For example,

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[76] See proposed rules at § __.9.

[77] Structured investment vehicles (SIVs) and securities arbitrage ABCP programs both purchase securities (rather than receivables and loans from originators). SIVs typically lack liquidity facilities covering all of these liabilities issued by the SIV, while securities arbitrage ABCP programs typically have such liquidity support.

this option is available only with respect to ABCP issued by an "eligible ABCP conduit," as defined by the proposal. The proposal defines an eligible ABCP conduit as an issuing entity that issues ABCP and that meets each of the following criteria.[78] First, the issuing entity must be bankruptcy remote or otherwise isolated for insolvency purposes from the sponsor and any intermediate SPV. Second, the ABS issued by an intermediate SPV to the issuing entity must be collateralized solely by assets originated by a single originator-seller.[79] Third, all the interests issued by an intermediate SPV must be transferred to one or more ABCP conduits or retained by the originator-seller. Fourth, a regulated liquidity provider must have entered into a legally binding commitment to provide 100 percent liquidity coverage (in the form of a lending facility, an asset purchase agreement, a repurchase agreement, or similar arrangement) to all the ABCP issued by the issuing entity by lending to, or purchasing assets from, the issuing entity in the event that funds are required to repay maturing ABCP issued by the issuing entity.[80]

Under the proposed risk retention option applicable to ABCP conduit structures, the sponsor of an eligible ABCP conduit would be permitted to satisfy its base risk retention obligations under the rule if each originator-seller that transfers assets to collateralize the ABCP issued by the conduit retains the same amount and type of credit risk as would be required under the horizontal risk retention option as if the originator-seller was the sponsor of the intermediate SPV. Specifically, the proposal provides that a sponsor of an ABCP securitization transaction would satisfy its base risk retention requirement with respect to the issuance of ABCP by an eligible ABCP conduit if each originator-seller retains an eligible horizontal residual interest in each intermediate SPV established by or on behalf of that originator-seller for purposes of issuing interests to the eligible ABCP conduit. The eligible horizontal residual interest retained by the originator-seller must equal at least five percent of the par value of all interests issued by the intermediate SPV. Accordingly, each originator-seller would be required to retain credit exposure to the receivables sold by that originator-seller to support issuance of the ABCP.

The eligible horizontal residual interest retained by the originator-seller would be subject to the same terms and conditions as apply under the horizontal risk retention option. Thus, for example, if an originator-seller transfers $100 of receivables to an intermediate SPV, which then issues senior interests and an eligible horizontal residual interest with an aggregate par value of $100, the originator-seller must retain an eligible horizontal residual interest with a par value of

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[78] See proposed rules at §__.2 (definition of "eligible ABCP conduit").

[79] Under the proposal, an originator-seller would mean an entity that creates assets through one or more extensions of credit and sells those assets (and no other assets) to an intermediate SPV, which in turn sells interests collateralized by those assets to one or more ABCP conduits. The proposal defines an intermediate SPV as a special purpose vehicle that is bankruptcy remote or otherwise isolated for insolvency purposes that purchases assets from an originator-seller and that issues interests collateralized by such assets to one or more ABCP conduits. See proposed rules at §__.2 (definitions of "originator-seller" and "intermediate SPV").

[80] The proposal defines a regulated liquidity provider as a depository institution (as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813)); a bank holding company (as defined in 12 U.S.C. 1841) or a subsidiary thereof; a savings and loan holding company (as defined in 12 U.S.C. 1467a) provided all or substantially all of the holding company's activities are permissible for a financial holding company under 12 U.S.C. 1843(k) or a subsidiary thereof; or a foreign bank (or a subsidiary thereof) whose home country supervisor (as defined in § 211.21 of the Federal Reserve Board's Regulation K (12 CFR 211.21)) has adopted capital standards consistent with the Capital Accord of the Basel Committee on Banking Supervision, as amended, provided the foreign bank is subject to such standards. See http://www.bis.org/bcbs/index.htm for more information about the Basel Capital Accord.

$5 or more.[81] Importantly, the originator-seller also would be prohibited from selling, transferring, and hedging the eligible horizontal residual interest that it is required to retain. This option is designed to accommodate the special structure and features of these types of ABCP programs.

Although the proposal would allow the originator-sellers (rather than the sponsor) to retain the required eligible horizontal residual interest, the proposal also imposes certain obligations directly on the sponsor in recognition of the key role the sponsor plays in organizing and operating an eligible ABCP conduit. Most importantly, the proposal provides that the sponsor of an eligible ABCP conduit that issues ABCP in reliance on this option would be responsible for compliance with the requirements of this risk retention option. The proposal also would require that the sponsor maintain policies and procedures to monitor the originator-sellers' compliance with the requirements of the proposal. In the event that the sponsor determines that an originator-seller no longer complies with the requirements of the rule (for example, because the originator-seller has sold the interest it was required to retain), the sponsor would be required to promptly notify, or cause to be notified, the investors in the securitization transaction of such noncompliance.

In addition, consistent with market practice, the proposal would require that the sponsor:

(i) Establish the eligible ABCP conduit;

(ii) Approve the originator-sellers permitted to sell or transfer assets, indirectly through an intermediate SPV, to the ABCP conduit;

(iii) Establish criteria governing the assets the originator-sellers are permitted to sell or transfer to an intermediate SPV;

(iv) Approve all interests in an intermediate SPV to be purchased by the eligible ABCP conduit;

(v) Administer the ABCP conduit by monitoring the interests acquired by the conduit and the assets collateralizing those interests, arranging for debt placement, compiling monthly reports, and ensuring compliance with the conduit documents and with the conduit's credit and investment policy; and

(vi) Maintain, and adhere to, policies and procedures for ensuring that the requirements of the rule have been met.[82]

The sponsor also would have to provide, or cause to be provided, to potential purchasers a reasonable period of time prior to the sale of any ABCP from the conduit, and to the Commission and its appropriate Federal banking agency, if any, upon request, the name and

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[81] As noted above, this would be the minimum amount of credit risk that must be retained as part of a securitization transaction.

[82] The sponsor of an ABCP conduit satisfies the definition of "sponsor" under the proposed rules. If the conduit does not satisfy the conditions for an "eligible ABCP conduit," the sponsor must retain credit risk in accordance with another risk retention option included in the proposal (unless an exemption for the transaction exists).

form of organization of each originator-seller that will retain (or has retained) an interest in the securitization transaction pursuant to §__.9 of the proposed rules (including a description of the form, amount, and nature of such interest), and of each regulated liquidity provider that provides liquidity support to the eligible ABCP conduit (including a description of the form, amount, and nature of such liquidity coverage).

Section 15G permits the Agencies to allow an originator (rather than a sponsor) to retain the required amount and form of credit risk and to reduce the amount of risk retention required of the sponsor by the amount retained by the originator.[83] In developing the proposed risk retention option for eligible ABCP conduits, the Agencies have considered the factors set forth in section 15G(d)(2) of the Exchange Act.[84] The terms of the proposed option for eligible ABCP conduits include conditions designed to ensure that the interests in the intermediate SPVs sold to an eligible ABCP conduit have low credit risk, and to ensure that originator-sellers have incentives to monitor the quality of the assets that are sold to an intermediate SPV and collateralize the ABCP issued by the conduit. In addition, the proposal is designed to effectuate the risk retention requirements of section 15G of the Exchange Act in a manner that facilitates reasonable access to credit by consumers and businesses through the issuance of ABCP backed by consumer and business receivables. Finally, as noted above, an originator-seller would be subject to the same restrictions on transferring the retained eligible horizontal residual interest to a third party as would apply to sponsors under the rule.

Request for Comment

59. Is the proposed risk retention option for eligible ABCP conduits appropriate?

60(a). Have the Agencies appropriately defined the terms (such as an eligible ABCP conduit, intermediate SPV and originator-seller) that govern use of this option? 60(b). Is the foregoing description of ABCP structures accurate? 60(c) Are there additional ABCP structures that are not easily adaptable to the risk retention options proposed? 60(d). If so, should the proposed ABCP option be revised to include these structures and if so, how?

61. Should the proposed option for securitizations structured using ABCP conduits require financial disclosure regarding the liquidity provider?

62(a). Also, should other entities be permitted to be liquidity providers for purposes of the rule? For example, should the rule permit an insurance company to be an eligible liquidity provider if the company is in the business of providing credit protection (such as a bond insurer or re-insurer) and is subject to supervision by a State insurance regulator or is a foreign insurance company subject to comparable regulation to that imposed by U.S. insurance companies? 62(b). Why or why not?

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[83] See 15 U.S.C. § 78o-11(1)(c)(G)(iv) and (d) (permitting the Commission and the Federal banking agencies to allow the allocation of risk retention from a sponsor to an originator).

[84] 15 U.S.C. § 78o-11(d)(2). These factors are whether the assets sold to the securitizer have terms, conditions, and characteristics that reflect low credit risk; whether the form or volume of transactions in securitization markets creates incentives for imprudent origination of the type of loan or asset to be sold to the securitizer; and the potential impact of the risk retention obligations on the access of consumers and businesses to credit on reasonable terms, which may not include the transfer of credit risk to a third party.

63. In addition, the Agencies seek confirmation that the terms of this option effectively prevent structures such as SIVs and ABCP programs that operate as arbitrage programs from using this option.

64. Should the rule, as proposed, allow the liquidity provider to be a depository institution holding company or a subsidiary of a depository institution instead of just the depository institution?

65. Are the disclosures proposed sufficient to provide investors with all material information concerning the originator-seller that will retain an interest in the securitization transaction and of each regulated liquidity provider that provides liquidity support to the eligible ABCP conduit, as well as enable investors and the Agencies to monitor whether the sponsor has complied with the rule?

66(a). Should additional disclosures be required? 66(b). If so, what should be required and why? 66(c). For example, should a sponsor be required to disclose the material assumptions and methodology used in determining the aggregate dollar amount of interests issued by each intermediate SPV? 66(d). Would such a disclosure be beneficial to investors? 66(e). In light of the broad range of asset classes that underlie ABCP conduits, would such a disclosure pose any operational or other challenges for sponsors of ABCP conduits?

67(a). Should we, as proposed, require that the ABCP be for a term of 270 days or less? 67(b). Should we allow for a longer term, such as up to one year?

7. Commercial mortgage-backed securities

Section 15G(c)(1)(E) of the Exchange Act provides that, with respect to securitizations involving commercial mortgages, the regulations prescribed by the Agencies may provide for "retention of the first-loss position by a third-party purchaser that specifically negotiates for the purchase of such first loss position, holds adequate financial resources to back losses, provides due diligence on all individual assets in the pool before the issuance of the asset-backed securities, and meets the same standards for risk retention as the Federal banking agencies and the Commission require of the securitizer[.]"[85] In light of this provision, the Agencies are proposing to permit a sponsor of ABS that is collateralized by commercial real estate loans to meet its risk retention requirements if a third-party purchaser acquires an eligible horizontal residual interest in the issuing entity in the same form, amount, and manner as the sponsor would have been required to retain under the horizontal risk retention option and certain additional conditions are met.

The allocation of a first-loss position to a third-party purchaser has been common practice in CMBS transactions for a number of years.[86] The third-party purchaser has been commonly referred to in the CMBS marketplace as a "B-piece buyer"[87] because the CMBS

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[85] 15 U.S.C. § 78o-11(c)(1)(E)(iv).
[86] See, e.g., Board Report.
[87] We note that under the proposal there is no requirement that the tranche or tranches purchased by the third-party purchaser be assigned any particular credit rating.

tranche or tranches purchased by this investor were either unrated by the credit rating agencies or assigned a below-investment grade credit rating. Typically a B-piece buyer purchases at a discount to face value the most subordinate tranche in the cash flow waterfall of the CMBS transaction. In order to manage its risk, the B-piece buyer often is involved early in the securitization process and has significant influence over the selection of pool assets. For example, the B-piece buyer often performs "due diligence" on the pool assets, which often means a review of the loans in the pool at the property and loan level. As a result of this review, a B-piece buyer may request that specific loans be removed from the pool prior to securitization.

Additionally, a B-piece buyer is often designated as the "controlling class" under the terms of the pooling and servicing agreement governing the CMBS transaction, and in accordance with its rights as the controlling class, a B-piece buyer often names itself, or an affiliated company, as the "special servicer" in the transaction. Such servicer typically is the servicer authorized to service loans in default or having other non-payment issues. The control of special servicing rights by the B-piece buyer has the potential to create conflicts of interest with the senior certificate holders to the securitization. For example, the control of special servicing rights would allow the B-piece buyer to directly or indirectly manage any loan modifications. While some CMBS transactions required an "operating advisor" to oversee the servicing activities of the special servicer, in many instances this operating advisor works on behalf of the controlling class (i.e., the B-piece buyer unless and until losses reduced its junior tranche to zero). To help better address the potential conflict created by special servicer arrangements involving B-piece buyers, newly issued CMBS for which investors received financing through the Term-Asset Backed Securities Lending Facility ("TALF") were required to have an independent operating advisor that acted on behalf of the investors as a collective whole, had consultative rights over major decisions of the special servicer, and had the ability to recommend replacement of the special servicer.[88] These operating advisor requirements also were coupled with enhanced disclosures to investors regarding major decisions by the B-piece buyer and special servicer. Aspects of these TALF requirements have been incorporated into recent CMBS transactions undertaken after the closing of the TALF to new financings.

In light of the specific provisions of Section 15G(c)(1)(E) and the historical market practice of third-party purchasers acquiring first-loss positions in CMBS transactions, the Agencies' proposal would allow a sponsor to meet its risk retention requirements under the rule if a third-party purchaser retains the necessary exposure to the credit risk of the underlying assets provided six conditions are met. These conditions are designed to help ensure that the form, amount, and manner of the third-party purchaser's risk retention are consistent with the purposes of section 15G of the Exchange Act. This option would be available only for securitization

[88] The TALF was a special lending facility established by the Federal Reserve and the Treasury Department in response to the financial crisis to assist the financial markets in accommodating the credit needs of consumers and businesses of all sizes by facilitating the issuance of ABS collateralized by a variety of consumer and business loans. The TALF also was intended to improve the market conditions for ABS more generally. Additional information concerning the TALF is available on the public websites of the Board (see http://www.federalreserve.gov/monetarypolicy/bst_lendingother.htm) and the Federal Reserve Bank of New York (see http://www.newyorkfed.org/markets/talf.html).

transactions where commercial real estate loans constitute at least 95 percent of the unpaid principal balance of the assets being securitized.[89]

The first condition requires that the third-party purchaser retain an eligible horizontal residual interest in the securitization in the same form, amount, and manner as would be required of the sponsor under the horizontal risk retention option (proposed § _____.5).[90] Accordingly, the interest acquired by the third-party purchaser must be the most junior interest in the issuing entity, and must be subject to the same limits on payments as would apply if the eligible horizontal residual interest were held by the sponsor pursuant to the horizontal risk retention option.

The second condition would require that the third-party purchaser pay for the first-loss subordinated interest in cash at the closing of the securitization without financing being provided, directly or indirectly, from any other person that is a party to the securitization transaction (including, but not limited to, the sponsor, depositor, or an unaffiliated servicer), other than a person that is a party solely by reason of being an investor.[91] This would prohibit the third-party purchaser or an affiliate of the third-party purchase from obtaining financing from any such person as well as from any affiliate of any such person. These requirements should help ensure that the third-party purchaser has sufficient financial resources to fund the acquisition of the first-loss subordinated interest and absorb losses on the underlying assets to which it would be exposed through this interest.[92]

The third condition relates to the third-party purchaser's review of the assets collateralizing the ABS. This proposed condition would require that the third-party purchaser perform a review of the credit risk of each asset in the pool prior to the sale of the asset-backed securities. This review must include, at a minimum, a review of the underwriting standards, collateral, and expected cash flows of each commercial loan in the pool.

The fourth condition is intended to address the potential conflicts of interest that can arise when a third-party purchaser serves as the "controlling class" of a CMBS transaction. This condition would prohibit a third-party purchaser from (i) being affiliated with any other party to the securitization transaction (other than investors); or (ii) having control rights in the securitization (including, but not limited to acting as servicer or special servicer) that are not collectively shared by all other investors in the securitization. The proposed prohibition of control rights related to servicing, would be subject to an exception, however, if the underlying

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[89] See proposed rules at §__.10(a). "Commercial real estate loan" is defined in §__.16 of the proposed rules to mean a loan secured by a property with five or more single family units, or by nonfarm nonresidential real property, the primary source (fifty (50) percent or more) of repayment for which is expected to be derived from the proceeds of the sale, refinancing, or permanent financing of the property; or rental income associated with the property other than rental income derived from any affiliate of the borrower. A commercial real estate loan does not include a land development and construction loan (including 1- to 4-family residential or commercial construction loans); any other land loan; a loan to a real estate investment trust (REIT); or an unsecured loan to a developer.

[90] See proposed rules at § __.10.

[91] See proposed rules at § __.10.

[92] This requirement is consistent with section 15G(b)(1)(E)(ii) of the Exchange Act, which provides that the Agencies may consider whether a third-party purchaser of CMBS "holds adequate financial resources to back losses."

securitization transaction documents provide for the appointment of an independent operating advisor (Operating Advisor) with certain powers and responsibilities.[93] Under the proposal, an "Operating Advisor" would be defined as a party that (i) is not affiliated with any other party to the securitization, (ii) does not directly or indirectly have any financial interest in the securitization other than in fees from its role as Operating Advisor, and (iii) is required to act in the best interest of, and for the benefit of, investors as a collective whole.

The Agencies believe that the introduction of an independent Operating Advisor would minimize the ability of third-party purchasers to manipulate cash flows through special servicing. In approving loans for inclusion in the securitization, the third-party purchaser will be mindful of the limits on its ability to offset the consequences of poor underwriting through servicing tactics if a loan becomes troubled, thereby providing stronger incentive for the third-party purchaser to be diligent in assessing credit quality of the pool assets at the time of securitization. For these types of securitization transactions, the third-party purchaser's review of each loan can serve as an effective check on the underwriting quality and credit risk of the underlying loans and the reliability of key information utilized.

Further, in order for a third-party purchaser to have servicing rights in connection with the securitization transaction, the securitization transaction documents must require that the Operating Advisor have certain powers and responsibilities in order to ensure that the Operating Advisor can effectively fulfill its advisory role in the transaction.[94] For example, as proposed, the transaction documents must require that, if the third-party purchaser or an affiliate acts as servicer, the servicer consult with the Operating Advisor in connection with, and prior to, any major decision in connection with the servicing of the securitized assets. Major decisions would include, without limitation, any material modification of, or waiver with respect to, any provision of a loan agreement, any foreclosure upon or comparable conversion of the ownership of a property, and any acquisition of a property.

The securitization transaction documents must also provide that the Operating Advisor is responsible for reviewing the actions of any servicer that is, or is, affiliated with the third-party purchaser and for issuing a report to investors and the issuing entity, on a periodic basis, concerning whether the Operating Advisor believes, in its sole discretion exercised in good faith, the servicer is in compliance with any standards required of the servicer as provided in the applicable transaction documents, and if not, the standard(s) with which the servicer is out of compliance. In addition, the securitization transaction documents must also provide that the Operating Advisor has the authority to recommend that a servicer that is, or is affiliated with, the third-party purchaser be replaced by a successor servicer if the Operating Advisor determines, in its sole discretion exercised in good faith, that the servicer has failed to comply with any standard required of the servicer as provided in the applicable transaction documents and that such replacement would be in the best interest of the investors as a collective whole. The

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[93] See proposed rules at §__.10(a)(4)(i). The proposal also includes a de minimis exception to the general prohibition on affiliation with other parties to the securitization transaction. Under this de minimis exception, the third-party purchaser would be permitted to be affiliated with one or more originators of the securitized assets so long as the assets contributed by such originator(s) collectively comprise less than 10 percent of the assets in the pool (as measured by dollar volume). See proposed rules at §__.10(a)(4)(ii).

[94] See proposed rules at §__.10(a)(4)(B)-(E).

relevant transaction documents must provide that, if such a recommendation is made, the servicer that is, or affiliated with, the third-party purchaser must be replaced unless a majority of each class of certificate holders eligible to vote on the matter votes to retain the servicer.

Consistent with other disclosure requirements under the proposed rules, the fifth proposed condition requires that the sponsor provide, or cause to be provided, potential purchasers certain information concerning the third-party purchaser and other information concerning the transaction. Specifically, the proposal would require that a sponsor disclose to potential investors a reasonable time before the sale of asset-backed securities and, upon request, to the Commission and its appropriate Federal banking agency (if any) the name and form of organization of the third-party purchaser, a description of the third-party purchaser's experience in investing in CMBS, and any other information regarding the third-party purchaser or the third-party purchaser's retention of the eligible horizontal residual interest that is material to investors in light of the circumstances of the particular securitization transaction.

Additionally, a sponsor would be required to disclose the amount of the eligible horizontal residual interest that the third-party purchaser will retain (or has retained) in the transaction (expressed as a percentage of ABS interests in the issuing entity and as a dollar amount); the purchase price paid for such interest; the material terms of such interest; and the amount of the interest that the sponsor would have been required to retain if the sponsor had retained an interest in the transaction pursuant to the horizontal menu option. The material assumptions and methodology used in determining the aggregate amount of ABS interests of the issuing entity, including any estimated cash flows and the discount rate used, also must be included in the disclosure. The proposed rules would require that the sponsor provide, or cause to be provided, to potential investors the representations and warranties concerning the securitized assets, the schedule of any securitized assets that are determined not to comply with such representations and warranties, and what factors were used to make the determination that a securitized asset should be included in the pool notwithstanding that it did not comply with such representations and warranties, such as compensating factors or a determination that the exceptions(s) were not material.

Finally, the sixth condition would require that any third-party purchaser acquiring an eligible horizontal residual interest under this option comply with the hedging, transfer and other restrictions applicable to such interest under the proposed rules if the third-party purchaser was a sponsor who had acquired the interest under the horizontal risk retention option.

Although the third-party purchaser may retain the credit risk required under § __.3 of the proposed rules, the proposal provides that the sponsor remains responsible for compliance with the requirements described above. Therefore, consistent with the menu option available to eligible ABCP conduits, the proposal would require that the sponsor maintain and adhere to policies and procedures to monitor the third-party purchaser's compliance with these requirements. In the event that the sponsor determines that the third-party purchaser no longer complies with the requirements of the rule (for example, because the third-party purchaser has sold the interest it was required to retain), the sponsor must promptly notify the investors in the securitization transaction of such noncompliance.

Request for Comment

68(a). Should the rules allow a third-party purchaser to retain the required amount of risk in a CMBS transaction as described above? 68(b). Why or why not?

69(a). Should a third-party purchaser option be available to other asset classes besides CMBS? Would expanding this option to other asset classes fulfill the purposes of section 15G? 69(b). If so, would any adjustments or requirements be necessary?

70. Should the use of this option be conditioned, as proposed, on a requirement that the third-party purchaser separately examine the assets in the pool and/or not sell or hedge the interest it is required to retain?

71(a). Should the use of this option be conditioned, as proposed, on the requirement that the sponsor disclose the actual purchase price paid by the third-party purchaser for the eligible horizontal residual interest? 71(b). Why or why not?

72. Is any disclosure concerning the financial resources of the third-party purchaser necessary in light of the requirement that the third-party purchaser fund the acquisition of the eligible horizontal residual interest in cash without direct or indirect financing from a party to the transaction?

73(a). Should the rule specify the particular types of information about a third-party purchaser that should be disclosed, rather than requiring disclosure of any other information regarding the third-party purchaser that is material to investors in light of the circumstances of the particular securitization transaction? 73(b). Should the specific types of information about a third-party purchaser be in addition to any other information regarding the third-party purchaser that is material to investors in light of the circumstances of the particular securitization transaction?

74. Are the conditions relating to servicing, including those related to an Operating Advisor, appropriate or should they be modified or supplemented?

75(a). Should the Agencies require any other disclosure relating to representations and warranties concerning the assets for CMBS?

76(a). We are aware of at least one industry group developing model representations and warranties for CMBS.[95] Should the rule require that a blackline of the representations and warranties for the securitization transaction against an industry-accepted standard for model representations and warranties be provided to investors at a reasonable time prior to sale? 76(b). Would this provide more information regarding the adequacy of the representation and warranties being provided? 76(c). Would this be a costly requirement? 76(d). Could investors easily create their own blacklines if needed?

77. Are the disclosures proposed sufficient to provide investors with all material information concerning the third-party purchaser's retained interest in the securitization

[95] See, e.g., comment letter to the Commission from CRE Finance Council dated January 19, 2011, available at http://www.sec.gov/comments/df-title-ix/asset-backed-securities/assetbackedsecurities-37.pdf.

transaction, as well as to enable investors and the Agencies to monitor whether the sponsor has complied with the rule?

78(a). Should additional disclosures be required? 78(b). If so, what should be required and why?

8. Treatment of government-sponsored enterprises

Section ___.11 of the proposed rules would govern the credit risk retention requirements for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) (jointly, the "Enterprises") while operating under the conservatorship or receivership of FHFA, as well as for any limited-life regulated entity succeeding to the charter of either Fannie Mae or Freddie Mac pursuant to section 1367 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (Safety and Soundness Act).[96] The primary business of the Enterprises under their respective charter acts is to pool conventional mortgage loans and to issue securities backed by these mortgages that are fully guaranteed as to the timely payment of principal and interest by the issuing Enterprise.[97] Because of these activities, Fannie Mae or Freddie Mac (or a successor limited-life regulated entity) would be the sponsor of the asset-backed securities that it issues for purposes of section 15G.

In considering how to address in the proposal the risk retention requirements of section 15G with respect to the mortgage-backed securities issued, and fully guaranteed as to timely payment of principal and interest, by the Enterprises or a successor limited-life regulated entity, the Agencies considered several factors. Because Fannie Mae and Freddie Mac fully guarantee the timely payment of principal and interest on the mortgage-backed securities they issue, the Enterprises are exposed to the entire credit risk of the mortgages that collateralize those securities.[98]

Both Fannie Mae and Freddie Mac have been operating under the conservatorship of FHFA since September 6, 2008. As conservator, FHFA has assumed all powers formerly held by each Enterprise's officers, directors, and shareholders. In addition, FHFA, as conservator, is authorized to take such actions as may be necessary to restore each Enterprise to a sound and solvent condition and that are appropriate to preserve and conserve the assets and property of each Enterprise.[99] The primary goals of the conservatorships are to help restore confidence in the Enterprises, enhance their capacity to fulfill their mission, mitigate the systemic risk that contributed directly to instability in financial markets, and maintain the Enterprises' secondary mortgage market role until their future is determined through legislation. To these ends, FHFA's conservatorship of the Enterprises is directed toward minimizing losses, limiting risk exposure, and ensuring that the Enterprises price their services to adequately address their costs and risk. Any limited-life regulated entity established by FHFA to succeed to the charter of an Enterprise

[96] 12 U.S.C. § 4617.
[97] See 12 U.S.C. § 1451, et seq. (Freddie Mac); 12 U.S.C. § 1716, et seq. (Fannie Mae).
[98] The charters of Fannie Mae and Freddie Mac also place limitations on the types of mortgages that the Enterprises may guarantee and securitize.
[99] See 12 U.S.C. § 4617(b)(2)(D).

also would operate under the direction and control of FHFA, acting as receiver of the related Enterprise.[100]

Concurrently with being placed in conservatorship under section 1367 of the Safety and Soundness Act, each Enterprise entered into a Senior Preferred Stock Purchase Agreement (PSPA) with the United States Department of the Treasury (Treasury). Under each PSPA, Treasury purchased senior preferred stock of each Enterprise. In addition, if FHFA determines that the Enterprise's liabilities have exceeded its assets under generally accepted accounting principles (GAAP), Treasury will contribute cash capital to that Enterprise in an amount equal to the difference between its liabilities and assets. In exchange for this cash contribution, the liquidation preference of the senior preferred stock purchased from each Enterprise under the respective PSPA increases in an equivalent amount. The senior preferred stock of each Enterprise purchased by Treasury is senior to all other preferred stock, common stock or other capital stock issued by the Enterprise, and dividends on the aggregate liquidation preference of the senior preferred stock purchased by Treasury are payable at a rate of 10 percent per annum.[101] Under each PSPA, Treasury's commitment to each Enterprise is the greater of (1) $200 billion, or (2) $200 billion plus the cumulative amount of the Enterprise's net worth deficit as of the end of any calendar quarter in 2010, 2011 and 2012, less any positive net worth as of December 31, 2012.[102] Accordingly, the PSPAs provide support to the relevant Enterprise should the Enterprise have a net worth deficit as a result of the Enterprise's guaranty of timely payment on the asset-backed securities it issues. By their terms, the PSPA with an Enterprise may not be assigned or transferred, or inure to the benefit of, any limited-life regulated entity established with respect to the Enterprise without the prior written consent of Treasury.

In light of the foregoing, §___.11 of the proposed rules provides that the guaranty provided by an Enterprise while operating under the conservatorship or receivership of FHFA with capital support from the United States will satisfy the risk retention requirements of the Enterprise under section 15G of the Exchange Act with respect to the mortgage-backed securities issued by the Enterprise. Similarly, an equivalent guaranty provided by a limited-life regulated entity that has succeeded to the charter of an Enterprise, and that is operating under the direction and control of FHFA under section 1367(i) of the Safety and Soundness Act, will satisfy the risk retention requirements, provided that the entity is operating with capital support from the United States. If either Enterprise or a successor limited-life regulated entity were to begin to operate other than as provided in the proposed rules, that Enterprise or entity would no longer be able to avail itself of the credit risk retention option set forth in § ___.11.

For similar reasons, the proposed rules provide that the premium capture cash reserve account requirements in § ___.12, as well as the hedging and financing prohibitions in § ___.14(b),(c), and (d), of the proposed rules shall not apply to an Enterprise while operating under the conservatorship or receivership of FHFA with capital support from the United States, or to a limited-life regulated entity that has succeeded to the charter of an Enterprise and that is

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[100] See 12 U.S.C. § 4617(i). The affairs of a limited-life regulated entity must be wound up not later than two years after its establishment, subject to the potential for a maximum of three one-year extensions at the discretion of the Director of FHFA.
[101] Under the PSPAs, the rate rises to 12 percent per annum if the dividends are not paid in cash.
[102] The PSPAs also provide for the retained portfolios of each Enterprise to be reduced over time.

operating under the direction and control of FHFA with capital support from the United States. In the past, the Enterprises have sometimes acquired pool insurance to cover a percentage of losses on the mortgage loans comprising the pool.[103] Because § ___.11 requires each Enterprise, while in conservatorship or receivership, to hold 100 percent of the credit risk on MBS that it issues, the prohibition on hedging related to the credit risk that the retaining sponsor is required to retain would limit the ability of the Enterprises to require such pool insurance in the future. Because the exception would continue only so long as the relevant Enterprise operates under the control of FHFA and with capital support from the United States, the proposed exception from these restrictions should be consistent with the maintenance of quality underwriting standards, in the public interest, and consistent with the protection of investors.

A sponsor utilizing this section shall provide to investors, in written form under the caption "Credit Risk Retention" and, upon request, to FHFA and the Commission, a description of the manner in which it has met the credit risk retention requirement of this part.

The Agencies recognize both the need for, and importance of, reform of the Enterprises. In recent months, the Administration and Congress have been considering a variety of proposals to reform the housing finance system and the Enterprises. The Agencies expect to revisit and, if appropriate modify § __.11 of the proposed rules after the future of the Enterprises and of the statutory and regulatory framework for the Enterprises becomes clearer.

Request for comment

79. Is our proposal regarding the treatment of the Enterprises appropriate?

80. Would applying the hedging prohibition to all of the credit risk that the Enterprises are required to retain when using § ___.11 to satisfy the risk retention requirements be an unduly burdensome result for the Enterprises?

81(a). Instead of the broad exception from the hedging prohibition for the Enterprises, when satisfying the risk retention requirements pursuant to § ___.11, should the rules prohibit an Enterprise from hedging five percent of the total credit risk in any securitization transaction where the Enterprise acts as a sponsor (thus ensuring the Enterprise retains at least that amount of exposure to the credit risk of the assets)? 81(b). Would this be consistent with statutory intent? 81(c). Would that be feasible for the Enterprises to monitor?

9. Premium Capture Cash Reserve Account

In many securitization transactions, particularly those involving residential and commercial mortgages, conducted prior to the financial crisis, sponsors sold premium or interest-only tranches in the issuing entity to investors, as well as more traditional obligations that paid both principal and interest received on the underlying assets. By selling premium or interest-only tranches, sponsors could thereby monetize at the inception of a securitization transaction the "excess spread" that was expected to be generated by the securitized assets over time. By

[103] Typically, insurers would pay the first losses on a pool of loans, up to one or two percent of the aggregate unpaid principal balance of the pool.

monetizing excess spread before the performance of the securitized assets could be observed and unexpected losses realized, sponsors were able to reduce the impact of any economic interest they may have retained in the outcome of the transaction and in the credit quality of the assets they securitized. This created incentives to maximize securitization scale and complexity, and encouraged aggressive underwriting.

In order to achieve the goals of risk retention, the Agencies propose to adjust the required amount of risk retention to account for any excess spread that is monetized at the closing of a securitization transaction. Otherwise, a sponsor could effectively negate or reduce the economic exposure it is required to retain under the proposed rules. Furthermore, prohibiting sponsors from receiving compensation in advance for excess spread income expected to be generated by securitized assets over time should better align the interests of sponsors and investors and promote more robust monitoring by the sponsor of the credit risk of securitized assets, thereby encouraging the use of sound underwriting in connection with securitized loans. It also should promote simpler and more coherent securitization structures as sponsors would receive excess spread over time and would not be able to reduce the economic exposure they are required to retain.

Accordingly, as proposed, if a sponsor structures a securitization to monetize excess spread on the underlying assets–which is typically effected through the sale of interest-only tranches or premium bonds–the proposed rule would "capture" the premium or purchase price received on the sale of the tranches that monetize the excess spread and require that the sponsor place such amounts into a separate "premium capture cash reserve account."[104] The amount placed into the premium capture cash reserve account would be separate from and in addition to the sponsor's base risk retention requirement under the proposal's menu of options, and would be used to cover losses on the underlying assets before such losses were allocated to any other interest or account. As a likely consequence to this proposed requirements, the Agencies expect that few, if any, securitizations would be structured to monetize excess spread at closing and, thus, require the establishment of a premium capture cash reserve account, which should provide the benefits described above.

Specifically, the proposal would require that a sponsor retaining credit risk under the vertical, horizontal, L-shaped, or revolving asset master trust options of the proposed rules establish and fund (in cash) at closing a premium capture cash reserve account in an amount equal to the difference (if a positive amount) between (i) the gross proceeds received by the issuing entity from the sale of ABS interests in the issuing entity to persons other than the sponsor (net of closing costs paid by a sponsor or the issuing entity to unaffiliated parties); and (ii) 95 percent of the par value of all ABS interests in the issuing entity issued as part of the transaction. The 95 percent of par value amount is designed to take into account the five percent interest that the sponsor is required to retain in the issuing entity under each of these options.

If the sponsor will retain (or caused to be retained) credit risk under the representative sample, ABCP, or CMBS third-party purchaser options of the proposed rules, the sponsor would have to fund in cash at closing a premium capture cash reserve account in an amount equal to the

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[104] See proposed rules at § ___.12.

difference (if a positive amount) between (i) the gross proceeds received by the issuing entity from the sale of ABS interests to persons other than the sponsor (net of the closing costs described above), and (ii) 100 percent of the par value of the ABS interests in the issuing entity issued as part of the transaction. In these cases, the proposal uses 100 percent (rather than 95 percent) of the par value of the ABS interests issued because the relevant menu options do not require that the sponsor itself retain any of the ABS interests issued in the transaction and, accordingly, potentially all of such interests could be sold to third parties.

Under the proposed rules, a premium capture cash reserve account would have to be established and funded whenever a positive amount resulted from the relevant calculation described in the preceding paragraphs. These calculations are designed to capture the amount of excess spread that a sponsor may seek to immediately monetize at closing such as through the issuance of an interest-only tranche (which may have a nominal value assigned to it, but does not have a par value) or premium bonds that are sold for amounts in excess of their par value. On the other hand, the proposal would not require a sponsor to establish and fund a premium capture cash reserve account if the sponsor does not structure the securitization to immediately monetize excess spread, thus resulting in no "premium" that would be captured by the calculations described above. Accordingly, existing types of securitization structures that do not monetize excess spread at closing would not trigger establishment of a premium capture reserve account. Going forward, sponsors would have the ability to structure their securitization transactions in a manner that does not monetize excess spread at closing and would not require the establishment of such a premium capture cash reserve account.

The proposed rules include a number of conditions and limitations on a premium capture cash reserve account. Specifically, the proposed rules would require that the premium capture cash reserve account be held by the trustee, or person performing functions similar to a trustee, in the name and for the benefit of the issuing entity. In addition, until all ABS interests in the issuing entity (including junior or residual interests) are paid in full or the issuing entity is dissolved, amounts in the account would be required to be released to satisfy payments on ABS interests in the issuing entity (in order of the securitization transaction's priority of payments) on any payment date where the issuing entity has insufficient funds to make such payments. The proposal specifies that, the determination of whether insufficient funds are available must be made prior to the allocation of any losses to (i) any eligible horizontal residual interest held under the horizontal, L-shaped, ABCP, or CMBS third-party purchaser risk retention options; or (ii) the class of ABS interests in the issuing entity that is allocated losses before other classes if no eligible horizontal residual interest in the issuing entity is held under such options (or if the contractual terms of the securitization transaction do not provide for the allocation of losses by class, the class of ABS interests that has the most subordinate claim to payment of principal or interest by the issuing entity). Thus, amounts in a premium capture reserve account would be used to cover losses on the underlying assets first before any other interest in or account of the issuing entity, including an eligible horizontal residual interest or a horizontal cash reserve account.[105]

[105] Until needed to cover losses, amounts in a premium capture cash reserve account may be invested in U.S. Treasury securities with remaining maturities of 1 year or less and in fully-insured deposits at one or more insured

In order to prevent a sponsor from circumventing the premium capture requirements of the proposal by taking back at closing, and then reselling, additional ABS interests (thereby reducing the gross proceeds received at closing from the sale of interests to third parties), the proposal includes a special anti-evasion provision. Under this provision, the retaining sponsor would need to add to the "gross proceeds" amount that is used to calculate the amount (if any) that must be placed in the premium capture cash reserve account an amount equal to the par value of any ABS interest (or the fair value of the ABS interest if it does not have a par value) in the issuing entity that is directly or indirectly transferred to the sponsor in connection with the closing of the securitization transaction and that (i) the sponsor does not intend to hold to maturity; or (ii) represents a contractual right to receive some or all of the interest, and no more than a minimal amount of principal payments received by the issuing entity, and that has a priority of payment of interest (or principal, if any) senior to the most subordinated class of interests in the issuing entity. The condition in (i) above is designed to capture proceeds from those interests that the sponsor retains at closing, but expects to sell to third parties after closing. ABS interests retained and expected to be held to maturity by the sponsor increase the sponsor's exposure to the credit risk of the underlying assets, thus mitigating the concerns of a sponsor trying to evade the risk retention requirements.

A sponsor could, however, seek to achieve the same economic benefits that could be achieved from the sale of an interest-only tranche by retaining an interest-only tranche at or near the top of the waterfall that diverts to the sponsor excess spread on the underlying assets before other interests are paid. For this reason, the proposal requires that the value of any interest-only tranche that the sponsor retains at closing be included in the calculation of the premium capture reserve account (regardless of whether the sponsor intends to hold it to maturity) if such tranche has priority of payment senior to the most subordinated class of interests in the issuing entity.[106]

Sponsors required to fund a premium capture cash reserve account under the proposed rules would be required to provide potential investors before the sale of asset-backed securities as part of the securitization transaction and, upon request, the Commission and its appropriate Federal banking agency (if any) disclosures describing the dollar amount the sponsor was required to place in the account and the actual amount the sponsor will deposit (or has deposited) in the account at closing. The sponsor would also be required to disclose the material assumptions and methodology used in (i) determining the fair value of any ABS interest in the issuing entity that does not have a par value (and that was used in calculating the amount required for the premium capture cash reserve account) and is subject to the anti-evasion provisions described above; and (ii) the aggregate amount of ABS interests in the issuing entity, including those pertaining to any estimated cash flows and the discount rate used.

<u>Request for Comment</u>

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depository institutions. Interest received on such investments could be released from the account to any person (including the sponsor), but the principal amount invested must remain in the account and available to absorb losses.

[106] To avoid double counting, the calculation would not include any interest-only tranche required to be retained by a sponsor using the vertical or L-shaped options to meet its risk retention requirement. Also, because an eligible horizontal residual interest, by definition, must have the most subordinated claim to payments of both principal and interest, a sponsor selecting this option of risk retention would be required to include the value of any excess spread tranche retained by the sponsor in its calculation of gross proceeds received by the issuing entity.

82. Do you believe the premium capture cash reserve account will be an effective mechanism at capturing the monetization of excess spread, promoting sponsor monitoring of credit quality, and promoting the sound underwriting of securitized assets?

83. The Agencies seek input on alternative methods for removing incentives to monetize excess spread and whether the proposed premium capture reserve account would have any adverse effects on securitizations that are inconsistent with the purposes of section 15G. For example, is the method of calculating the premium capture cash reserve account appropriate or are there alternative methodologies that would better achieve the purpose of the account?

84. Should amounts from the premium capture reserve account be used only for amounts due to the senior-most class of ABS interests?

85(a). Alternatively, are the conditions imposed on the premium capture cash reserve account more than what is needed to achieve the objectives of the account? 85(b). If so, how?

C. Allocation to the originator

As a general matter, the proposed rules would provide that the sponsor of a securitization transaction is solely responsible for complying with the risk retention requirements established under section 15G of the Exchange Act. However, subject to a number of considerations, section 15G authorizes the Agencies to allow a sponsor to allocate at least a portion of the credit risk it is required to retain to the originator(s) of securitized assets.[107] Accordingly, subject to conditions and restrictions discussed below, § __.13 of the proposed rules permits a sponsor to reduce its required risk retention obligations in a securitization transaction by the portion of risk retention obligations assumed by the originator(s) of the securitized assets.

When determining how to allocate the risk retention requirements, the Agencies are directed to consider whether the assets sold to the sponsor have terms, conditions, and characteristics that reflect low credit risk; whether the form or volume of the transactions in securitization markets creates incentives for imprudent origination of the type of loan or asset to be sold to the sponsor; and the potential impact of the risk retention obligations on the access of consumers and businesses to credit on reasonable terms, which may not include the transfer of credit risk to a third party.[108]

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[107] As discussed above, 15 U.S.C. § 78o-11(a)(4) defines the term "originator" as a person who, through the extension of credit or otherwise, creates a financial asset that collateralizes an asset-backed security; and who sells an asset directly or indirectly to a securitizer (i.e., a sponsor or depositor). Because this definition refers only to the person that "creates" a loan or other receivable, only the original creditor of a loan or receivable—and not a subsequent purchaser or transferee—would be deemed to be the "originator" for purposes of the proposed rules. See 15 U.S.C. § 78o-11(c)(1)(G)(iv); (d).

[108] 15 U.S.C. § 78o-11(d)(2). The Agencies note that section 15G(d) appears to contain an erroneous cross-reference. Specifically, the reference at the beginning of section 15G(d) to "subsection (c)(1)(E)(iv)" is read to mean "subsection (c)(1)(G)(iv)", as the former subsection does not pertain to allocation, while the latter is the subsection that permits the Agencies to provide for the allocation of risk retention obligations between a securitizer and an originator in the case of a securitizer that purchases assets from an originator.

The Agencies are proposing a framework that would permit a sponsor of a securitization to allocate a portion of its risk retention obligation to an originator that contributes a significant amount of assets to the underlying asset pool. The Agencies have endeavored to create appropriate incentives for both the securitization sponsor and the originator(s) to maintain and monitor appropriate underwriting standards, respectively, without creating undue complexity, which potentially could mislead investors and confound supervisory efforts to monitor compliance. Importantly, the proposal does not mandate allocation to an originator. Therefore, it does not raise the types of concerns about credit availability that might arise if certain originators, such as mortgage brokers or small community banks (that may experience difficulty obtaining funding to retain risk positions), were required to do so. Mandatory allocation of risk retention to the originator of the securitized assets also could pose significant operational and compliance problems, as a loan may be sold or transferred several times between origination and securitization and, accordingly, an originator may not know when a loan it has originated is included in a securitization transaction.

The proposed rules would permit a securitization sponsor that satisfies its base risk retention obligation either under the vertical risk retention option as set forth in §__.4 or under the horizontal risk retention option through the acquisition of an eligible horizontal interest as set forth in §__.5, to allocate a portion of its risk retention obligation under such option to any originator of the underlying assets that contributed at least 20 percent of the underlying assets in the pool. The amount of the retention interest held by each originator that is allocated credit risk in accordance with the proposal must be at least 20 percent, but could not exceed the percentage of the securitized assets it originated. The originator would also have to hold its allocated share of the risk retention obligation in the same manner as would have been required of the sponsor and subject to the same restrictions on transferring, hedging, and financing the retained interest that would apply to the sponsor. Thus, for example, if the sponsor satisfies its risk retention requirements by acquiring an eligible horizontal residual interest under the horizontal risk retention option, an originator allocated risk under § __.13 of the proposal would have to acquire a portion of that horizontal first-loss interest, in an amount not exceeding the percentage of pool assets created by the originator. The sponsor's risk retention requirements would be reduced by the amount allocated to the originator.

The Agencies believe this approach is a relatively straightforward way to allow both the sponsor and the originator to retain credit risk in securitized assets, on a basis that should reduce the potential for confusion by investors in asset-backed securities.

By limiting this option to originators that have originated at least 20 percent of the asset pool, the Agencies have sought to ensure that the originator retains risk in an amount significant enough to function as an actual incentive for the originator to monitor the quality of all the assets being securitized (and to which it would retain some credit risk exposure). In addition, by restricting originators to holding no more than their proportional share of the risk retention obligation, the proposal seeks to prevent sponsors from circumventing the purpose of the risk retention obligation by transferring an outsized portion of the obligation to an originator that may be seeking to acquire a speculative investment. These requirements should also reduce the proposal's potential complexity and facilitate investor and regulatory monitoring.

Request for Comment

86(a). Should the proposed rules permit allocation to originators where the sponsor is using other menu options, such as the L-shaped risk retention option in § __6. of the proposed rules, and if so, under what specific conditions and requirements? 86(b). In what cases is it likely that this alternative approach actually would be used? 86(c). What are the specific benefits of an alternative approach, and do they outweigh concerns regarding complexity?

87. Should the rule permit allocation to originators if the sponsor elects the horizontal cash reserve account option in proposed § __.5(b)?

88(a). Should the proposed rules permit allocation of risk to originators that have originated less than 20 percent of the asset pool? 88(b). Alternately, is the minimum 20 percent threshold sufficient to ensure that an originator allocated risk has an incentive to monitor the quality of the entire collateral pool?

89(a). Are there alternative mechanisms for allocating risk to an originator that should be permitted by the Agencies? For example, should the rules permit or require that an originator that is allocated risk retention by a sponsor retain exposure <u>only</u> to the assets that the originator itself originates? 89(b). If so, how might such an allocation mechanism feasibly be structured, incorporated into the rule, and monitored by investors and supervisors?

90. Should the rules permit sponsors to allocate risk to a third party, and if so, how to ensure that incentives between the sponsor and investors are aligned in a manner that promotes quality underwriting standards?

91. Are the proposed disclosures sufficient to provide investors with all material information concerning the originator's retained interest in a securitization transaction, as well as to enable investors to monitor the originator(s) and the Agencies to assess the sponsor's compliance with the rule?

92(a). Should additional disclosures be required? 92(b). If so, what should be required and why?

93(a). As proposed, the retaining sponsor is responsible for compliance with the rule and must maintain and adhere to policies and procedures reasonably designed to monitor compliance by each originator retaining credit risk, including the anti-hedging restrictions. 93(b). What are the practical implications if the originator fails to comply?

94(a). To help ensure that the originator has sufficient incentive to retain its interest in accordance with the rule, should the rule require that a sponsor obtain a contractual commitment from the originator to retain the interest in accordance with the rule? 94(b). If so, how should the Agencies implement this requirement?

95. Are there other methods that could be implemented to help ensure that a sponsor satisfies its obligations under the rule?

D. <u>Hedging, transfer and financing restrictions</u>

Section 15G(a)(1)(A) provides that the risk retention regulations prescribed shall "prohibit a securitizer from directly or indirectly hedging or otherwise transferring the credit risk that the securitizer is required to retain with respect to an asset."[109] Consistent with this statutory directive, the proposed rules would prohibit a sponsor from transferring any interest or assets that it is required to retain under the rule to any person other than an affiliate whose financial statements are consolidated with those of the sponsor (a consolidated affiliate). The rule permits a transfer to one or more consolidated affiliates because the required risk exposure would remain within the consolidated organization and, thus, would not reduce the organization's financial exposure to the credit risk of the securitized assets.

The proposal also would prohibit a sponsor or any consolidated affiliate from hedging the credit risk the sponsor is required to retain under the rule. The proposal extends the hedging prohibition to a sponsor's consolidated affiliates because the rule would allow a sponsor to transfer the risk it is required to retain to a consolidated affiliate. Moreover, even absent such a transfer, if a consolidated affiliate was permitted to hedge the risks required to be retained by a sponsor, the net effect of the hedge on the organization controlling the sponsor would offset the credit risk required to be retained and defeat the purposes of section 15G.

The proposal prohibits a sponsor and its consolidated affiliates from purchasing or selling a security or other financial instrument, or entering into an agreement (including an insurance contract), derivative or other position, with any other person if: (i) payments on the security or other financial instrument or under the agreement, derivative, or position are materially related to the credit risk of one or more particular ABS interests, assets, or securitized assets that the retaining sponsor is required to retain, or one or more of the particular securitized assets that collateralize the asset-backed securities; and (ii) the security, instrument, agreement, derivative, or position in any way reduces or limits the financial exposure of the sponsor to the credit risk of one or more of the particular ABS interests, assets, or securitized assets, or one or more of the particular securitized assets that collateralize the asset-backed securities. The statutory hedging prohibition is focused on the credit risk associated with the interest or assets that a sponsor is required to retain, which itself is dependent on the credit risk of the particular securitized assets that underlie the ABS interests. Therefore, hedge positions that are not materially related to the credit risk of the particular ABS interests or exposures required to be retained by the sponsor or its affiliate would not be prohibited under the proposal. Such positions would include hedges related to overall market movements, such as movements of market interest rates (but not the specific interest rate risk, also known as spread risk, associated with the ABS interest that is otherwise considered part of the credit risk), currency exchange rates, home prices, or of the overall value of a particular broad category of asset-backed securities. Likewise, hedges tied to securities that are backed by similar assets originated and securitized by other sponsors, also would not be prohibited. On the other hand, a security, instrument, derivative or contract generally would be "materially related" to the particular interests or assets that the sponsor is required to retain if the security, instrument, derivative or contract refers to those particular interests or assets or requires payment in circumstances where there is or could reasonably be expected to be a loss due to the credit risk of such interests or assets (e.g., a credit default swap for which the particular interest or asset is the reference asset).

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[109] 15 U.S.C. § 78o-11(a)(1)(A).

The proposal also addresses other hedges based on indices that may include one or more tranches from a sponsor's asset-backed securities transactions, as well as tranches of asset-backed securities transactions of other sponsors. The proposal provides that holding a security tied to the return of an index (such as the subprime ABX.HE index) would not be considered a prohibited hedge by the retaining sponsor so long as: (i) any class of ABS interests in the issuing entity that were issued in connection with the securitization transaction and that are included in the index represented no more than 10 percent of the dollar-weighted average of all instruments included in the index, and (ii) all classes of ABS interests in all issuing entities that were issued in connection with any securitization transaction in which the sponsor was required to retain an interest pursuant to the proposal and that are included in the index represent, in the aggregate, no more than 20 percent of the dollar-weighted average of all instruments included in the index. These restrictions are designed to prevent a sponsor (or a consolidated affiliate) from evading the hedging restrictions through the purchase of instruments that are based on an index that is composed, to a significant degree, of asset-backed securities from securitization transactions in which a sponsor is required to retain risk under the proposed rules.

The proposal would also prohibit a sponsor and a consolidated affiliate from pledging as collateral for any obligation (including a loan, repurchase agreement, or other financing transaction) any interest or asset that the sponsor is required to retain unless the obligation is with full recourse to the sponsor or consolidated affiliate. Because the lender of a loan that is not with full recourse to the borrower has limited rights against the borrower on default, and may rely more heavily on the collateral pledged (rather than the borrower's assets generally) for repayment, a limited recourse financing supported by a sponsor's risk retention interest may transfer some of the risk of the retained interest to the lender during the term of the loan. If the sponsor or consolidated affiliate pledged the interest or asset to support recourse financing and subsequently allowed (whether by consent, pursuant to the exercise of remedies by the counterparty or otherwise) the interest or asset to be taken by the counterparty to the financing transaction, the sponsor will have violated the prohibition on transfer.

The proposed rules would specify that the issuing entity in a securitization would not be deemed a consolidated affiliate of the sponsor for the securitization even if its financial statements are consolidated with those of the sponsor under applicable accounting standards.[110] This provision is designed to ensure that an issuing entity may continue to engage in hedging activities itself because such activities would be for the benefit of all investors in the asset-backed securities.[111] However, if an issuing entity were to obtain credit protection or hedge the exposure on the particular interests or assets that the sponsor is required to retain under the proposal, such credit protection or hedge could negate or limit the sponsor's credit exposure to the securitized assets. Accordingly, under the proposal, any credit protection by or hedging protection obtained by an issuing entity may not cover any ABS interest or asset that the sponsor is required to retain under the rule. For example, if the sponsor uses the vertical approach to risk retention, an issuing entity may purchase (or benefit from) a credit insurance wrap that covers up

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[110] See proposed rules at §__.2 (definition of "consolidated affiliate").

[111] For example, the proposal would not prohibit an issuing entity (and indirectly its investors) from being the beneficiary of loan-level private mortgage insurance (PMI) taken out by borrowers in connection with the underlying assets that are securitized.

to 95 percent of the tranches, but not the five percent of such tranches required to be retained by the sponsor.

Request for Comment

96(a). Under the proposal, a sponsor would not be permitted to sell or otherwise transfer any interest or assets that the sponsor is required to retain to any person other than an entity that is and remains a consolidated affiliated. Is the permitted transfer to consolidated affiliates appropriate? 96(b). Why or why not?

97. Is the proposed hedging prohibition appropriately structured?

98(a). Would the proposal inadvertently capture any kinds of hedging that should be permissible? 98(b). If so, please provide specific recommendations on how we can appropriately tailor the requirements.

99. Does the proposed approach appropriately implement the statutory requirement to prohibit direct and indirect hedging?

100(a). Does the proposal permit hedging that is inconsistent with risk retention and should be prohibited? 100(b). If so, please provide specific recommendations on how we can more appropriately tailor the requirements.

101. Are the proposed provisions concerning the pledging of retained assets appropriate? Should the rule instead prohibit the pledging of retained assets even where the financial transaction is recourse to the sponsor or consolidated affiliate?

102(a). Under the proposal, a sponsor (or a consolidated affiliate) would be prohibited from transferring the retained interest or assets until the retained interest or assets were fully repaid or extinguished. Is this appropriate, or should a sponsor be permitted to freely transfer or hedge its retained exposure after a specified period of time? 102(b). If so, should a period of time be established for different types of securitizations?

103. Are the proposal's requirements pertaining to index hedging appropriate?

104. Are the 10 percent and 20 percent thresholds discussed above consistent with market practice and the underlying goals of the statutory risk retention requirements?

105. Should credit protection and hedging by the issuing entity of any portion of the credit risk on the securitized assets be permitted or, because such credit protection and hedges could limit the incentive of investors to conduct due diligence on the securitized assets, should all credit protection and hedging by the issuing entity (other than interest rate and currency risk) be prohibited?

IV. Qualified Residential Mortgages

Section 15G provides that the risk retention requirements shall not apply to an issuance of ABS if all of the assets that collateralize the ABS are QRMs.[112] Section 15G also directs all of the Agencies to define jointly what constitutes a QRM, taking into consideration underwriting and product features that historical loan performance data indicate result in a lower risk of default.[113] Moreover, section 15G requires that the definition of a QRM be "no broader than" the definition of a "qualified mortgage" (QM), as the term is defined under section 129C(b)(2) of the Truth in Lending Act (TILA) (15 U.S.C. 1639C(b)(2)), as amended by the Dodd-Frank Act, and regulations adopted thereunder.[114]

A. Overall Approach to Defining Qualifying Residential Mortgages

In considering how to define a QRM for purposes of the proposed rules, the Agencies were guided by several factors and principles. The sponsor of an ABS that is collateralized solely by QRMs is completely exempt from the risk retention requirement with respect to such securitization. Accordingly, under the statute, a sponsor will not be required to retain any portion of the credit risk associated with the securitization of residential mortgages that meet the requirements to be a QRM. This requirement suggests that the underwriting standards and product features for QRMs should help ensure that such residential mortgages are of very high credit quality.

In considering how to determine if a mortgage is of sufficient credit quality, the Agencies also examined data from several sources. For example, the Agencies reviewed data on mortgage performance supplied by the Applied Analytics division (formerly McDash Analytics) of Lender Processing Services (LPS). To minimize performance differences arising from unobservable changes across products, and to focus on loan performance through stressful environments, for the most part, the Agencies considered data for prime fixed-rate loans originated from 2005 to 2008. This dataset included underwriting and performance information on approximately 8.9 million mortgages.

As is typical among data provided by mortgage servicers, the LPS data do not include detailed information on borrower income and on other debts the borrower may have in addition to the mortgage. For this reason, the Agencies also examined data from the 1992 to 2007 waves of the triennial Survey of Consumer Finances (SCF).[115] Because families' financial conditions

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112 See 15 U.S.C. 78o-11(c)(1)(C)(iii).
113 See id. at § 78o-11(e)(4).

114 See id. at § 78o-11(e)(4)(C). As adopted, the text of section 15G(e)(4)(C) cross-references section 129C(c)(2) of TILA for the definition of a QM. However, section 129C(b)(2), and not section 129C(c)(2), of TILA contains the definition of a "qualified mortgage." The legislative history clearly indicates that the reference in the statute to section 129C(c)(2) of TILA (rather than section 129C(b)(2) of TILA) was an inadvertent technical error. See 156 Cong. Rec. S5929 (daily ed. July 15, 2010) (statement of Sen. Christopher Dodd) ("The [conference] report contains the following technical errors: the reference to 'section 129C(c)(2)' in subsection (e)(4)(C) of the new section 15G of the Securities and Exchange Act, created by section 941 of the [Dodd-Frank Act] should read 'section 129C(b)(2).' In addition, the references to 'subsection' in paragraphs (e)(4)(A) and (e)(5) of the newly created section 15G should read 'section.' We intend to correct these in future legislation.").
115 The SCF is conducted every three years by the Board, in cooperation with the Treasury, to provide detailed information on the finances of U.S. families. The SCF collects information on the balance sheet, pension, income, and other demographic characteristics of U.S. families. To ensure the representativeness of the study, respondents

will change following the origination of a mortgage, the analysis of SCF data focused on respondents who had purchased their homes either in the survey year or the previous year. This data set included information on approximately 1,500 families. The Agencies also examined a combined data set of loans purchased or securitized by the Enterprises from 1997 to 2009. This data set consisted of more than 75 million mortgages, and included data on loan products and terms, borrower characteristics (e.g., income and credit score), and performance data through the third quarter of 2010.[116]

Based on these and other data, the underwriting and product features established by the Agencies for QRMs include standards related to the borrower's ability and willingness to repay the mortgage (as measured by the borrower's debt-to-income (DTI) ratio); the borrower's credit history; the borrower's down payment amount and sources; the loan-to-value (LTV) ratio for the loan; the form of valuation used in underwriting the loan; the type of mortgage involved; and the owner-occupancy status of the property securing the mortgage. A substantial body of evidence, both in academic literature and developed for this rulemaking, supports the view that loans that meet the minimum standards established by the Agencies have low credit risk even in stressful economic environments that combine high unemployment with sharp drops in house prices.[117]

Any set of fixed underwriting rules likely will exclude some creditworthy borrowers. For example, a borrower with substantial liquid assets might be able to sustain an unusually high DTI ratio above the maximum established for a QRM. As this example indicates, in many cases sound underwriting practices require judgment about the relative weight of various risk factors (e.g., the tradeoff between LTV and DTI ratios). These decisions are usually based on complex statistical default models or lender judgment, which will differ across originators and over time. However, incorporating all of the tradeoffs that may prudently be made as part of a secured underwriting process into a regulation would be very difficult without introducing a level of complexity and cost that could undermine any incentives for sponsors to securitize, and originators to originate, QRMs.

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are selected randomly using a scientific sampling methodology that allows a relatively small number of families to represent all types of families in the nation. Additional information on the SCF is available at http://www.federalreserve.gov/pubs/oss/oss2/method.html.

[116] Additional information concerning the Enterprise data used by the Agencies in developing the proposed QRM standards is provided in Appendix A to this Supplementary Information.

[117] For the importance of loan-to-value ratio at origination, see Quigley, J. and R. Van Order. "Explicit tests of contingent claims models of mortgage default," Journal of Real Estate Finance and Economics, *11*, 99-117(1995) and the extensive literature that has followed, including Foote, C., K. Gerardi and P. Willen, "Negative equity and foreclosures: theory and evidence," Federal Reserve Bank of Boston Public Policy Discussion Papers Number 08-3. (2008) http://www.bos.frb.org/economic/ppdp/2008/ppdp0803.pdf ; for the importance of credit history, see Barakova, I., R. Bostic, P. Calem, and S. Wachter "Does credit quality matter for homeownership?" Journal of Housing Economics, 12, 318-336 (2003); for several other underwriting criteria see Foote, C., K. Gerardi and P. Willen, "Negative equity and foreclosures: theory and evidence," Federal Reserve Bank of Boston Public Policy Discussion Papers Number 08-3 (2008).. http://www.bos.frb.org/economic/ppdp/2008/ppdp0803.pdf , Mayer, C., K. Pence and S. M. Sherlund "The rise in mortgage defaults: facts and myths," Manuscript, Federal Reserve Board, Washington DC. (2008), and S. Sherlund, "The past, present, and future of subprime mortgages," Finance and Economics Discussion Series No. 2008-63, Federal Reserve Board, Washington DC (2008). http://www.federalreserve.gov/pubs/feds/2008/200863/200863abs.html

The Agencies recognize that many prudently underwritten residential mortgage loans will not meet the proposed definition of a QRM. Sponsors of ABS backed by these mortgages will be required to retain some of the credit risk of these mortgage loans in accordance with the proposed regulation (unless another exemption is available). However, as discussed further in Part III.B of this Supplementary Information, the Agencies have sought to provide sponsors with several options for complying with the risk retention requirements of section 15G so as to reduce the potential for these requirements to disrupt securitization markets, including those for non-QRM residential mortgages, or materially affect the flow or pricing of credit to borrowers and businesses. Moreover, the amount of non-QRM residential mortgages should be sufficiently large, and include enough prudently underwritten loans, so that ABS backed by non-QRM residential mortgages may be routinely issued and purchased by a wide variety of investors. As a result, the market for such securities should be relatively liquid, all else being equal. Indeed, the broader the definition of a QRM, the less liquid the market ordinarily would be for residential mortgages falling outside the QRM definition.

The Agencies also have sought to make the standards applicable to QRMs transparent to, and verifiable by, originators, securitizers, investors and supervisors. As discussed further below, whether a residential mortgage meets the definition of a QRM can and will be determined at or prior to the time of origination of the mortgage loan. For example, the DTI ratio and the LTV ratio are measured at or prior to the closing of the mortgage transaction. The Agencies believe that this approach should assist originators of all sizes in determining whether residential mortgages will qualify for the QRM exemption, and assist ABS issuers and investors in assessing whether a pool of mortgages will meet the requirements of the QRM exemption. In addition, the approach taken by the proposal would allow individual QRM loans to be modified after securitization without the loan ceasing to be a QRM in order to avoid creating a disincentive to engage in appropriate loan modifications.

In developing the proposed criteria for a QRM, the Agencies also considered how best to address the interaction between the definitions and standards for QRM and QM, as mandated by the Dodd-Frank Act.[118] The Board currently has sole rulemaking authority for the QM standards, which authority will transfer to the Consumer Financial Protection Bureau (the CFPB) on the designated transfer date, which is set as July 21, 2011 (transfer date). In addition, while Section 15G's risk retention requirements are to be prescribed by the Agencies no later than 270 days after enactment of the Dodd-Frank Act (April 17, 2011), the Dodd-Frank Act provides that the rules implementing the QM standards must be prescribed before the end of the 18-month period beginning on the transfer date.

In light of these provisions, the Agencies propose to incorporate the statutory QM standards, in addition to other requirements, into the QRM requirements and apply those standards strictly in setting the QRM requirements in order to ensure that, consistent with Congress' directive, the definition of a QRM be no broader than a QM. The Agencies have proposed this approach to minimize any potential for conflicts between the QRM standards in the proposed rules and the QM standards that ultimately will be proposed or adopted under TILA, as well as to provide the public a reasonable opportunity to comment on the proposed QRM

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[118] See 15 U.S.C. § 78o-11(e)(4)(C).

standards, including those that are bounded by the statutory QM standards. The proposed approach also helps reinforce the goal of ensuring that QRMs are of very high credit quality.

As noted above, rulemaking authority for the QM standards is vested initially in the Board and, after the transfer date, the CFPB. TILA provides the QM rulewriting agency with the authority to establish key aspects of the QM definition (e.g., any qualifying ratios of the borrower's total debt to monthly income) and to revise, add to, or subtract from the criteria for a residential mortgage loan to qualify as a QM.[119] Accordingly, the Agencies expect to monitor the rules adopted under TILA to define a QM and will review those rules to determine whether changes to the definition of QRM are necessary or appropriate to ensure that the definition of a QRM is "no broader" than the definition of a QM as defined in section 129C(b)(2) of TILA and to appropriately implement the risk retention requirement of section 15G.[120] In light of the different purposes and effects of the QRM and the QM standards,[121] as well as the different agencies responsible for implementing these standards, the proposed standards for QRMs should not be interpreted in any way as reflecting or suggesting the way in which the QM standards under TILA may be defined either in proposed or final form.

As required by section 15G, the Agencies also considered information regarding the credit risk mitigation effects of mortgage guarantee insurance or other credit enhancements obtained at the time of origination.[122] If such guarantees are backed by sufficient capital, they likely lower the credit risk faced by lenders or purchasers of securities because they typically pay out when borrowers default. Such guarantees have historically been required for loans with higher LTV ratios, where borrowers have relatively thin equity cushions.[123] Mortgage insurance companies charge a risk-based premium for this insurance, as well as impose additional underwriting restrictions. The Agencies considered a variety of information and reports relative to such guarantees and other credit enhancements. While this insurance protects creditors from losses when borrowers default, the Agencies have not identified studies or historical loan performance data adequately demonstrating that mortgages with such credit enhancements are less likely to default than other mortgages, after adequately controlling for loan underwriting or other factors known to influence credit performance, especially considering the important role of LTV ratios in predicting default. Therefore, the Agencies are not proposing to include any criteria regarding mortgage guarantee insurance or other types of insurance or credit enhancements at this time. The Agencies note that mortgage guarantee insurance is a form of credit enhancement accepted by the Enterprises for mortgages with higher LTV ratios that allows such mortgages to be securitized through mortgage-backed securities guaranteed by the

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[119] See Section 129C(b)(3)(B)(i) of TILA.

[120] Under section 15G(e)(4)(C), future changes to the QM definition do not, in and of themselves, alter the QRM definition. The QRM definition will not change until the Agencies have determined, through joint rulemaking, that the QRM definition should be altered.

[121] The function of the QM standard is to provide lenders with a presumption of compliance with the requirement in section 129C(a) of TILA to assess a borrower's ability to repay a residential mortgage loan. The purposes of these provisions are to ensure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans and that are understandable and not unfair, deceptive, or abusive. See section 129B(a)(2) of TILA.

[122] See 15 U.S.C. § 78o-11(e)(4)(B)(iv).

[123] See National Association of Realtors, "Financing the Home Purchase: The Real Estate Professional's Guide 1993," Chicago: National Association of Realtors, at 20 and 117.

Enterprises. For the reasons explained in Part III.B.8 of this Supplemental Information, under §__.11 of the proposed rules, the guarantee provided by an Enterprise while operating under the conservatorship or receivership of FHFA with capital support from the United States would satisfy the risk retention requirements of the Enterprise with respect to the mortgage-backed securities issued by the Enterprise.

A number of the proposed standards developed for the QRM exemption (e.g., the DTI ratios and acceptable sources of borrower funds) are dependent upon certain definitions, calculations and verification requirements that are critical to the robustness of the QRM standards. The Agencies believe that it is important to provide clarity on what these definitions, calculations, and verification requirements include for purposes of the QRM standards. The Agencies considered how best to achieve this goal in a manner that is transparent, uniform, and familiar to the mortgage industry. After carefully considering a variety of options, the Agencies propose to incorporate and use certain definitions and key terms established by HUD and required to be used by lenders originating residential mortgages that are insured by the Federal Housing Administration (FHA). Specifically, the proposed rules incorporate the definitions and standards currently set out in the HUD Handbook 4155.1 (New Version), Mortgage Credit Analysis for Mortgage Insurance, as in effect on December 31, 2010 (HUD Handbook)[124] for determining and verifying borrower funds and the borrower's monthly housing debt, total monthly debt and monthly gross income. This proposed approach provides a transparent, uniform and well-known basis for lenders to determine whether a residential mortgage loan qualifies as a QRM, without requiring the Agencies to establish and maintain—and lenders to comply with—new requirements.

In order to facilitate the use of these standards for QRM purposes, the Agencies propose to include in the Additional QRM Standards Appendix of the proposed rules all of the standards in the HUD Handbook that are used for QRM purposes. The only modifications made to the relevant standards in the HUD Handbook would be those necessary to remove those portions unique to the FHA underwriting process (e.g., TOTAL Scorecard instructions). The proposed rules and the Additional QRM Standards Appendix would not affect or change any of the standards in the HUD Handbook as they apply to FHA-insured mortgages. Moreover, HUD continues to have sole authority to modify the HUD Handbook. Any such amendments would not affect the Additional QRM Standards Appendix of the proposed rules unless separately adopted by the Agencies under section 15G.

Request for Comment

106. Is the overall approach taken by the Agencies in defining a QRM appropriate?

107. What impact might the proposed rules have on the market for securitizations backed by QRM and non-QRM residential mortgage loans?

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[124] See HUD Handbook, available at http://www.fhaoutreach.gov/FHAHandbook/prod/contents.asp?address=4155-1.

108. What impact, if any, might the proposed QRM standards have on pricing, terms, and availability of non-QRM residential mortgages, including to low and moderate income borrowers?

109(a). The Agencies seek general comment on the overall approach of using certain longstanding HUD standards for certain definitions and standards within the QRM exemption and whether the Agencies should adopt a different approach. 109(b). Are there any other existing, transparent, and widely recognized standards that the Agencies should use for ensuring that lenders follow consistent and sound processes in determining whether a residential mortgage loan meets the qualifications for a QRM?

110. The Agencies seek comment on all aspects of the proposed definition of a QRM, including the specific terms and conditions discussed in the following section.

111(a). The Agencies seek comment on whether mortgage guarantee insurance or other types of insurance or credit enhancements obtained at the time of origination would or would not reduce the risk of default of a residential mortgage that meets the proposed QRM criteria but for a higher adjusted LTV ratio. Commenters are requested to provide historical loan performance data or studies and other factual support for their views if possible, particularly if they control for loan underwriting or other factors known to influence credit performance. 111(b). If the information indicates that such products would reduce the risk of default, should the LTV ratio limits be increased to account for the insurance or credit enhancement? 111(c). If so, by how much?

112(a). If the proposed QRM criteria were adjusted for the inclusion of mortgage guarantee insurance or other types of insurance or credit enhancements, what financial eligibility standards should be incorporated for mortgage insurance or financial product providers and how might those standards be monitored and enforced? 112(b). What disclosure regarding the entity would be appropriate?

113. Are there additional ways that the Agencies could clarify the standards applicable to QRMs to reduce the potential for uncertainty as to whether a residential mortgage loan qualifies as a QRM at origination?

B. Exemption for QRMs

Consistent with section 15G, § __.15(b) of the proposed rules provides that a sponsor is exempt from the risk retention requirements of the proposed rules with respect to any securitization transaction if all of the securitized assets that collateralize the ABS are QRMs, and none of the securitized assets that collateralize the ABS are other ABS. These conditions implement the requirements in 15 U.S.C. §78o-11(c)(1)(C)(iii) and (e)(5).

Section __.15(b) of the proposed rules includes two additional requirements for a securitization transaction to qualify for the QRM exemption. First, the proposal would require that, at the closing of the securitization transaction, each QRM collateralizing the ABS is currently performing (i.e., the borrower is not 30 days or more past due, in whole or in part, on the mortgage).[125] Because QRMs are completely exempt from the risk retention requirements, the proposed rules would not permit a residential mortgage loan that satisfied the conditions to be a QRM upon origination to be included in an ABS transaction exempt under § __.15(c) of the proposed rules if the loan was not currently performing at the time of closing of the securitization transaction. Second, the depositor[126] for the ABS must certify that it evaluated the effectiveness of its internal supervisory controls for ensuring that all of the assets that collateralize the ABS are QRMs and that it has determined that its internal supervisory controls are effective. This evaluation must be performed as of a date within 60 days prior to the cut-off date (or similar date) for establishing the composition of the collateral pool. The sponsor also must provide, or cause to be provided, a copy of this certification to potential investors a reasonable period of time prior to the sale of ABS and, upon request, to the Commission and its appropriate Federal banking agency, if any. These evaluation and certification conditions implement the requirements in 15 U.S.C. § 78o-11(e)(6).[127]

C. Eligibility Criteria

1. Eligible Loans, First Lien, No Subordinate Liens, Original Maturity and Written Application Requirements

The proposed definition limits a QRM to a closed-end first-lien mortgage to purchase or refinance a one-to-four family property, at least one unit of which is the principal dwelling of a borrower.[128] Under the proposal, construction loans, "bridge" loans with a term of twelve months or less, loans to purchase time-share properties, and reverse mortgages could not be QRMs. Construction loans, bridge loans and other loans designed to offer temporary financing have typically not been securitized in the past, and their underwriting is notably more complex than that of standard mortgage loans. Thus, expanding the definition of QRMs to include such loans would be complex and seem to offer few, if any, benefits. Any loan relating to a time share also may not be a QRM, as these types of loans are excluded from the definition of a "residential mortgage loan" that may be a QM under section 103(cc)(5) of TILA.

Even before the financial crisis, the overwhelming majority of reverse mortgages were insured by the FHA.[129] Reverse mortgages insured by the FHA are separately exempted from the risk retention requirements of section 15G.[130] In addition, reverse mortgages may be QMs only to the extent that they meet certain standards to be determined by regulation by the Board or CFPB under section 129C(b)(2)(A)(ix) of TILA. Because the extent to which reverse mortgages may be considered a QM under TILA is not yet known, the Agencies have excluded reverse mortgages from potential QRM status.

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125 See proposed rules at § __.15(a) (definition of "currently performing" for QRM purposes).
126 See proposed rules at § __.2 (definition of "depositor").
127 For these purposes, the Agencies interpret the term "issuer" as used in section 15G(e)(6) to refer to the depositor for the transaction.
128 Closed-end credit and the related terms consumer credit and open-end credit are defined in a manner consistent with the definition of such terms under the Board's Regulation Z, which implements TILA.
129 See Hui Shan, "Reversing the Trend: The Recent Expansion of the Reverse Mortgage Market Finance and Economics Discussion Series," Board of Governors of the Federal Reserve System, 2009-42 (2009), available at http://www.federalreserve.gov/pubs/feds/2009/200942/200942pap.pdf .
130 See 15 U.S.C. § 78o-11(e)(3)(B).

Under the proposal, a QRM must be secured by a first-lien, perfected in accordance with applicable law, on the one-to-four family property to be purchased or refinanced. In addition, consistent with the QM requirement under section 129C(b)(2) of TILA, the maturity date of a QRM, at the closing of the mortgage transaction, must not exceed 30 years. A one-to-four family property is defined to mean real property that is (i) held in fee simple, or on leasehold under a lease for not less than 99 years which is renewable, or under a lease having a period that is at least 10 years longer than the mortgage, and (ii) improved by a residential structure that contains one to four units.[131] A one-to-four family property may include an individual condominium or cooperative unit, as well as a manufactured home that is constructed in conformance with the National Manufactured Home Construction and Safety Standards and erected on, or otherwise affixed to, a foundation in accordance with requirements established by the FHA.

If the mortgage transaction is to purchase a one-to-four family property, no other recorded or perfected liens on the one-to-four family property can, to the creditor's knowledge, exist at the time of the closing of the mortgage transaction. Thus, the proposed rules prohibit the use of a junior lien in conjunction with a QRM to purchase a home. Data indicate that, controlling for other factors, including combined LTV ratio, the use of junior liens at origination to decrease down payments—so-called "piggyback" mortgages—significantly increased the risk of default.[132] The proposal would not prohibit the existence of junior liens in connection with the refinancing of an existing loan secured by an owner-occupied one-to-four family property, provided that the combined LTV ratio at closing of the mortgage transaction does not exceed certain thresholds established by the proposed rules.[133] The Agencies have not proposed to prohibit the existence of a junior lien in connection with a refinancing transaction (subject to certain combined LTV limits) because the Agencies recognize that some borrowers may have existing home equity loans or lines of credit and are currently performing on all of their mortgage obligations.[134] A prohibition on junior liens in connection with a refinancing transaction would force such performing borrowers to terminate their existing home equity loans or lines of credit and obtain a new home equity loan or line of credit shortly thereafter, with additional transaction costs (including a loan origination fee). To help ensure that the borrower continues to have the ability and incentive to repay a QRM that is originated as part of a refinancing transaction, the proposal includes certain combined LTV limits on refinancing transactions and DTI limits both of which assume that any home equity loan or line of credit is fully drawn.

The proposed rules also would require that the borrower complete and submit to the creditor a written application for the mortgage transaction. The application, as supplemented or amended prior to closing of the mortgage transaction, must include an acknowledgement by the borrower that the information provided in the application is true and correct as of the date

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[131] See proposed rules at §__.15(a) (definition of "one-to-four family property").
[132] See Kristopher Gerardi, Andreas Lehnert, Shane Sherlund, and Paul S. Willen, "Making Sense of the Subprime Crisis," Brookings Papers on Economic Activity (Fall 2008), at 86, Table 3.
[133] See proposed rules at §__.15(d)(9).
[134] As discussed further below, the proposed rules would require that the borrower be currently performing on all of the borrower's debt obligations—including any current first mortgage, home equity loan or line of credit—for any new mortgage to qualify as a QRM.

executed by the borrower, and that any intentional or negligent misrepresentation of the information provided in the application may result in civil liability and/or criminal penalties under 18 U.S.C. 1001.[135] This standard is consistent with the written acknowledgement in the Uniform Residential Loan Application (Form 1003) used by the Enterprises.

Request for Comment

114(a). The Agencies request comment on each of these conditions for QRM eligibility. In addition, should a loan be disqualified from being a QRM if the creditor has "reason to know" of another recorded or perfected lien on the property in a purchase transaction? 114(b). If so, what would constitute a "reason to know" by the creditor?

2. Borrower Credit History

The Agencies' own analysis, as well as work published in academic journals,[136] indicates that borrower credit history is among the most important predictors of default. In many datasets, credit history is proxied using a credit score, often the FICO score determined under the credit scoring model devised by Fair Isaac Corporation. Among the residential mortgage loans in the LPS dataset described above, 13 percent of all loans defaulted (defined as ever having missed three or more consecutive payments or ever being in foreclosure). However, 24.5 percent of residential mortgage loans taken out by borrowers with a FICO score of 690 or below defaulted, compared to a default rate of 7.7 percent among residential mortgage loans taken out by borrowers with a FICO score greater than 690. Even among the higher-FICO group, differences remained: borrowers with FICO scores of 691 to 740 had a default rate of 11.4 percent, while borrowers with FICO scores above 740 had a default rate of 4 percent. Thus, in these data, mortgage borrowers with a FICO score of 690 or below were more than six times as likely to default as borrowers with FICO scores of above 740.

A similar pattern emerges from the SCF data described above. Although the SCF data do not record the borrower's credit score, they do report several important contributors to low credit scores. The most important predictor of whether a household in the SCF data set was delinquent on its mortgage payment was whether it currently was behind on any non-mortgage debt. The second-most important variable was whether the household had filed for bankruptcy within the past five years. Households that were current on their non-mortgage obligations and had not filed for bankruptcy within the previous five years had a mortgage delinquency rate of 0.2 percent, compared to a delinquency rate of 17.9 percent for other households.

Data on residential mortgages purchased or securitized by the Enterprises also show the importance of borrower credit scores as a predictor of default. From 1997 through 2002, loans that are estimated to meet the proposed QRM requirements (except for credit history) had

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135 See proposed rules at §__.15(d)(9).

136 See, e.g., Avery, Robert B., Raphael Bostic, Paul S. Calem, and Glenn B. Canner, "Credit Risk, Credit Scoring, and the Performance of Home Mortgages," Federal Reserve Bulletin 82(7) 621—48 (1996); Pennington-Cross, Anthony, "Credit History and the Performance of Prime and Nonprime Mortgages," Journal of Real Estate Finance and Economics 27(3) 279—301 (2003); Calem, Paul and Susan Wachter, "Community Reinvestment and Credit Risk: Evidence from an Affordable-Home-Loan Program," Real Estate Economics 27(1) 105—134 (1999).

cumulative rates of serious delinquency ranging from 31 to 44 basis points if the borrower's credit score was above 690, but ranged from 267 to 356 basis points for borrowers with credit scores of 690 or lower. The data show that, in the peak years of the housing bubble (from 2005 to 2007), rates of serious delinquency for loans that were estimated to meet the proposed QRM standards with credit scores above 690 ranged from 186 to 272 basis points, while similar loans to borrowers with lower credit scores ranged from 833 to 1,103 basis points.[137]

In developing the proposal, the Agencies carefully considered how to incorporate a borrower's credit history into the standards for a QRM. The Agencies are aware that credit scores are used often by originators in the loan underwriting process. However, the Agencies do not propose to use a credit score threshold as part of the QRM definition because such a standard would require reliance on credit scoring models developed and maintained by privately owned entities and such models may change materially at the discretion of such entities. There also may be inconsistencies across the various credit scoring models used by consumer reporting agencies, as well as among different scoring models used by a single provider. Consequently, in order to ensure that creditors could continue to choose among different credit score providers, the Agencies would have to determine a cutoff score under multiple scoring models and periodically revise the regulation in response to new scoring models that might arise.

Instead, the proposed rules define a set of so-called "derogatory factors" relating to a borrower that would disqualify a mortgage for such borrower from qualifying as a QRM. The Agencies considered how these derogatory factors related to the credit scores observed in the data. A 2007 report to Congress by the Board found that, among all persons with a FICO score, 42 percent had scores below 700, 18 percent had scores between 700 and 749, and 40 percent had scores of 750 or above.[138] Thus, the median FICO score is somewhere between 700 and 749. The analysis of the LPS data found that borrowers with prime fixed-rate mortgages with FICO scores below 700 were substantially more likely than the average of such borrowers to default. The Board's report to Congress also found that any major derogatory factor, including being substantially late on any debt payment (not just a mortgage), as well as bankruptcy or foreclosure, would push a borrower's credit score down substantially. Thus, the relatively stringent set of credit history derogatory factors set forth in § __.15(d)(5) of the proposed rules is designed to be a reasonable proxy for the credit score thresholds associated with low delinquency rates in the data.

Specifically, under the proposal, a mortgage loan could qualify as a QRM only if the borrower was not currently 30 or more days past due, in whole or in part, on any debt obligation, and the borrower had not been 60 or more days past due, in whole or in part, on any debt obligation within the preceding 24 months. Further, a borrower must not have, within the preceding 36 months, been a debtor in a bankruptcy proceeding, had property repossessed or foreclosed upon, engaged in a short sale or deed-in-lieu of foreclosure, or been subject to a Federal or State judgment for collection of any unpaid debt.

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[137] See Appendix A to this Supplementary Information.

[138] See Report to the Congress on Credit Scoring and Its Effects on the Availability and Affordability of Credit, Board of Governors of the Federal Reserve System (August 2007), available at http://www.federalreserve.gov/boarddocs/rptcongress/creditscore/creditscore.pdf .

The proposal would require that the originator verify and document, within 90 days prior to the closing of the mortgage transaction, that the borrower satisfied these credit history requirements. The Agencies are proposing a safe harbor that would allow an originator to satisfy the documentation and verification requirements regarding a borrower's credit history by obtaining, no more than 90 days before the closing of the mortgage, credit reports from at least two consumer reporting agencies that compile and maintain files on consumers on a nationwide basis.[139] Such credit reports must demonstrate that the borrower satisfies the credit history requirements for a QRM and the originator must maintain paper or electronic copies of such credit reports in the loan file for the mortgage transaction. This safe harbor would not be available if the creditor later obtained an additional credit report before closing of the mortgage which indicated that the borrower did not meet the proposed rules' credit history requirements.

Request for Comment

115. Are the proposed credit history standards useful and appropriate indicators of the likelihood that a borrower might default on a new residential mortgage loan?

116. Are there additional or different standards that should be used in considering how a borrower's credit history may affect the likelihood that the borrower would default on a new mortgage?

117(a). Should the Agencies include minimum credit score thresholds as an additional or alternative QRM standard? 117(b). If so, how might the rules incorporate privately developed credit scoring models in a manner that (i) ensures that borrowers, originators, and investors have adequate notice, and an opportunity to comment on, changes to scoring methodologies that may affect a borrower's eligibility for a QRM, (ii) maintains a level competitive playing field for providers and developers of credit scores, and (iii) ensures that any credit scoring methodology used for QRM purposes is and remains predictive of a borrower's default risk?

118. The Agencies request comment on the appropriateness of the safe harbor that would allow an originator to satisfy the documentation and verification requirements regarding a borrower's credit history by obtaining credit reports from at least two consumer reporting agencies that compile and maintain files on consumers on a nationwide basis.

3. Payment Terms

Section __.15(d)(6) of the proposed rules addresses the payment terms of a QRM, based on the terms of the mortgage transaction at closing. Consistent with the requirements for a QM under section 129C(b)(2)(A)(i) of TILA, the proposed rules would prohibit QRMs from having, among other features, payment terms that allow interest-only payments or negative amortization. Under the proposed rules, regularly scheduled principal and interest payments on the mortgage transaction may not result in an increase of the unpaid principal balance of the mortgage and may not allow the borrower to defer payment of interest or repayment of principal.

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[139] The proposal defines a "consumer reporting agency that compiles and maintains files on a nationwide basis" by reference to the definition of that term in the Fair Credit Reporting Act (15 U.S.C. 1681a(p)). See the proposed rules at §__.15(a)(7).

In addition, consistent with the requirements for a QM under section 129C(b)(2)(A)(ii) of TILA, the proposed rules would prohibit the terms of a QRM from permitting any "balloon payment," defined for these purposes as a scheduled payment of principal and interest that is more than twice as large as any earlier scheduled payment of principal and interest. This definition of a balloon payment is consistent with the current definition of that term under the Board's Regulation Z, [140] and somewhat more restrictive than the definition of a balloon payment in section 129C(b)(2)(A)(ii) of TILA and applicable to a QM.[141]

Under the proposed rules, both fixed-rate and adjustable-rate mortgages may qualify as a QRM. However, the Agencies are proposing to limit the amount by which interest rates may increase on adjustable-rate loans that are QRMs to reduce the risk of default on QRMs by limiting the potential for consumers to face a "payment shock" in the event that their monthly mortgage payments were to rise rapidly due to expiration of "teaser rate" periods in the early years of a mortgage loan or other interest rate increases. Section 15G(e)(4)(B)(iii) provides that one of the underwriting and product features the Agencies may take into consideration in defining a QRM are those that mitigate "the potential for payment shock on adjustable rate mortgages through product features and underwriting standards." Under § __.15(d)(6)(iii) of the proposed rules, in order for a mortgage that allows the annual rate of interest to increase after the closing of the mortgage transaction to be a QRM, the terms of the mortgage must provide that any such increase may not exceed: (a) two percent (200 basis points) in any twelve month period and (b) six percent (600 basis points) over the life of the mortgage transaction.[142]

Section __.15(d)(6)(iv) of the proposed rules also would prohibit a QRM from containing any prepayment penalty. The term "prepayment penalty" would be defined as a penalty imposed solely because the mortgage obligation is prepaid in full or in part. For purposes of this definition, a prepayment penalty would not include, for example, fees imposed for preparing and providing documents in connection with prepayment, such as a loan payoff statement, a reconveyance, or other document releasing the creditor's security interest in the one-to-four family property securing the loan.

When defining a QRM, section 15G directs the Agencies to take into consideration underwriting and product features that historical loan performance data indicate result in a lower risk of default, such as a prohibition or restriction on the use of prepayment penalties.[143] In addition, under section 129C(c)(1)(B) of TILA, prepayment penalties are prohibited or subject to

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[140] See 12 CFR 226 Supplement I, comment 32 (d)(1)(i)-1 and 12 CFR 226.18(s)(5)(i).

[141] Section 129C(b)(2)(A)(ii) of TILA defines a balloon payment for QM purposes as a scheduled payment that is more than twice as large as the average of earlier scheduled payments.

[142] As described more fully below, an originator also would be required to calculate the borrower's front-end and back-end DTI ratios based on the maximum interest rate permitted during the first five years of the mortgage transaction. Consequently, originators of adjustable-rate mortgages would have to determine that a borrower had acceptable DTI ratios even if rates rose as rapidly as possible under the terms of the mortgage (subject to the annual and lifetime caps described above).

[143] 15 U.S.C. § 78o-11(e)(4)(B)(v).

significant limitations for certain loans even if those loans otherwise meet the QM definition under section 129C(b)(2) of TILA.[144]

Request for Comment

119(a). The Agencies request comment on all aspects of the proposed rules' limits on the payment terms of a QRM. In addition, the Agencies request comment on the following matters. 119(b). Should additional or different payment terms be established for QRMs? Commenters requesting additional or different limits are encouraged to provide data indicating that such additional or different terms would result in a lower risk of default. 119(c). Would different interest rate caps, such as a one percent (100 basis points) increase in any twelve month period, be more appropriate than the caps set forth in the proposal? 119(d). Recognizing the very damaging effects that prepayment penalties had on some borrowers during the recent housing market distress, the proposed rules do not permit any loans with prepayment penalties to qualify as a QRM. Often, the borrower that suffered because of the existence of such penalties were those with large, unaffordable payment shocks as low initial rates expired or those whose credit standing improved after origination of the loan, but who were not able to benefit from such improvements by refinancing into a potentially lower rate loan. Given the tight credit and product standards proposed for QRMs, such conditions are less likely to be relevant to QRM borrowers, and some QRM borrowers might reasonably benefit from an opportunity to obtain a mortgage with modest prepayment penalties in the early years of the loan in exchange for lower interest rate. Should the Agencies permit prepayment penalties in QRM loans (to the extent otherwise possible within the limits established for QMs)? 119(e). If so, what, if any, limitations should apply to such penalties?

4. Loan-to-Value Ratio

Borrowers with substantial equity in their properties—that is, a low LTV ratio—should in principle default infrequently. If faced with financial hardship, such borrowers typically can sell their homes or otherwise tap their accumulated home equity. To ensure that QRMs have low default risk consistent with their complete exemption from risk retention requirements, the Agencies are proposing that the QRM definition require a sizable equity contribution.

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[144] TILA's prepayment penalty restriction scheme is quite complex. Specifically, section 129C(c)(1)(B) of TILA prohibits prepayment penalties for any residential mortgage loan with an adjustable rate, or for those loans where the annual percentage rate exceeds certain thresholds over the average prime offer rate for a comparable transaction, based on the loan's amount and lien status. In addition, where permitted, prepayment penalties may not exceed three percent of the outstanding balance of the loan in the first year, two percent in the second year, and one percent in the third year. Creditors who offer a consumer a loan with a prepayment penalty must also offer the consumer a loan without a prepayment penalty. Under section 129C(b)(2)(A)(vii) of TILA, the total "points and fees" for a QM may not exceed three percent of the total loan amount, and under section 103(aa)(4) of TILA, the definition of "points and fees" now includes the maximum prepayment penalties and fees which may be charged or collected under the terms of the credit transaction. TILA also limits prepayment penalties in section 103(aa)(1)(A)(iii), which defines a "high-cost" mortgage loan as any mortgage (regardless of its cost or other terms) in which the creditor may charge prepayment fees or penalties more than 36 months after the closing of the transaction, or in which the fees or penalties exceed, in the aggregate, more than two (2) percent of the amount prepaid. And under section 129(c) of TILA, as amended by the Dodd-Frank Act, high-cost mortgage loans may not contain prepayment penalties.

The figure below shows the default rate among loans in the LPS dataset considered by the Agencies (and described above) with the data further restricted to those loans with fully documented income in order to better match the proposed underwriting characteristics of QRMs. These loans are divided by their purpose: to purchase a home, to refinance an existing loan without increasing its principal balance (a so-called "rate and term" refinancing), or to refinance an existing loan and increase the principal balance (a so-called "cash out" refinancing). Different types of mortgage transactions (i.e., purchase, rate and term refinancing, and cash-out refinancing) had varying rates of default.

As shown in the figure below, default rates increase noticeably among loans used to purchase homes at LTV ratios above 80 percent. The precise size of this increase and the LTV ratio at which it occurs are likely to vary across datasets and over time. Nonetheless, lenders have long experience underwriting loans with LTV ratios of 80 percent or less and there is substantial data indicating that loans with LTV ratios of 80 percent or less perform noticeably better than those with LTV ratios above 80 percent.[145] Data from the Enterprises concerning loans purchased or securitized by the Enterprises also show that first-lien purchase loans with high LTV ratios are riskier. The data show that purchase loans estimated to meet other QRM standards, but that exceeded the proposed LTV ratio cap, had serious delinquency rates 80 to 128 basis points higher when examining loans originated from 1997 to 2002, and 287 to 443 basis points higher for loans originated from 2005 to 2007.[146] Based on historical loan performance data, the Agencies are proposing a requirement for a LTV ratio of 80 percent for purchase mortgage transactions.

According to the LPS dataset, loans used to refinance existing mortgages have a greater likelihood of default at every LTV ratio level than those used to purchase homes; moreover, the default rates are steeper for refinance loans than for purchase loans, suggesting that refinance loans are more sensitive to the LTV ratio. Thus, to control risk of default in a manner consistent with the complete exemption afforded QRMs, the Agencies are proposing that these loans have tighter LTV ratio requirements than purchase loans.

The proposed rules put a combined LTV ratio cap for QRMs of 75 percent on rate and term refinance loans and 70 percent for cash-out refinance loans.[147] Again, estimates of the performance of these loans vary across datasets. However, because they have historically performed worse than purchase loans, and because they are more sensitive to LTV ratios than purchase loans, the lower combined LTV ratio caps on refinance loans should work to reduce risk of default on these loans.

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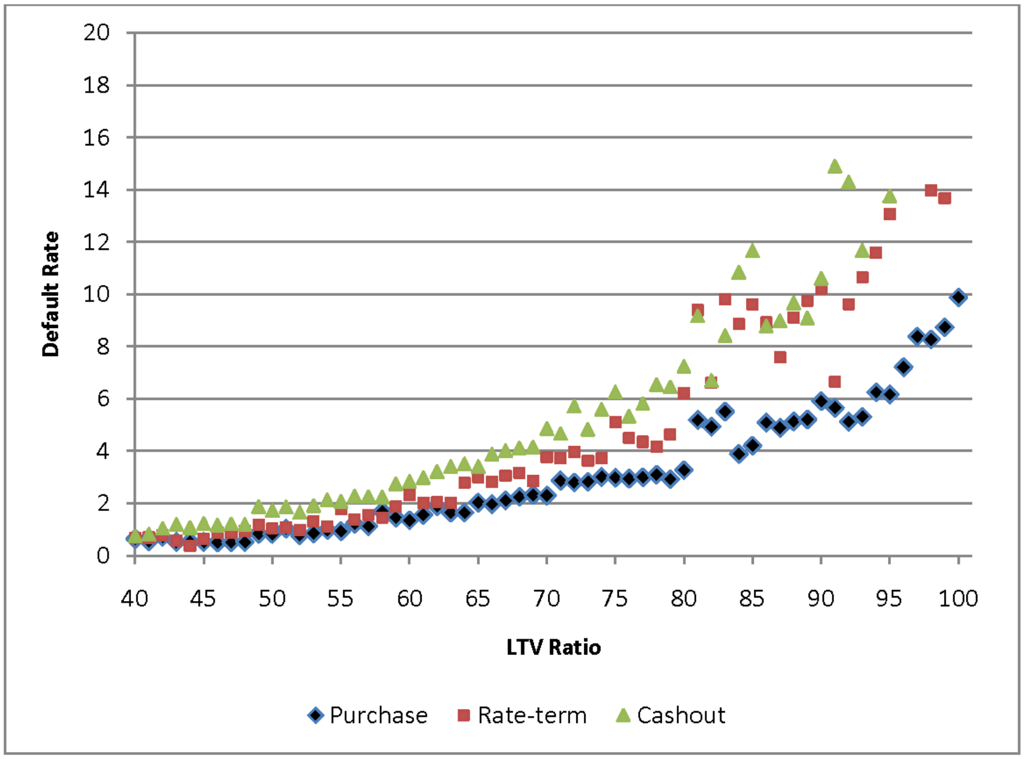
[145] While many creditworthy homebuyers seeking to purchase a home will likely not have the 20 percent down payment required for a QRM, sound underwriting of these loans may well require the prudent use of judgment about the borrower's ability to repay the loan and other risk mitigants that are likely to change over time and vary from borrower to borrower. Such judgments are difficult to incorporate accurately and effectively into a rule without introducing substantial complexity and cost.

[146] See Appendix A to this Supplementary Information.

[147] See proposed rules at § __.15(a) for the proposed definition of a "rate and term refinancing" and a "cash-out refinancing."

Again, the data from the Enterprises indicates that these LTV ratio caps should significantly reduce the default rate on QRMs that are refinancing transactions. These data show that rate and term refinancings that are estimated to meet other QRM standards, but are estimated to have exceeded the proposed combined LTV cap, had serious delinquency rates 32 to 70 basis points higher when examining loans originated from 1997 to 2002, and 196 to 539 basis points higher for loans originated from 2005 to 2007. For cash-out refinancings that are estimated to meet other QRM standards, but are estimated to have exceeded the proposed combined LTV cap, such loans had serious delinquency rates 42 to 81 basis points higher when examining loans originated between 1997 and 2002, and 255 to 405 basis points higher when examining loans originated from 2005 to 2007.



Request for Comment

120. The Agencies seek comment on the appropriateness of the proposed LTV and combined LTV ratios for the different types of mortgage transactions.

5. Down Payment

If a mortgage transaction is for the purchase of a one-to-four family property, then the proposed rules require that the borrower provide a cash down payment in an amount equal to at least the sum of:

(i) The closing costs payable by the borrower in connection with the mortgage transaction;

(ii) 20 percent of the lesser of—

(A) The estimated market value of the one-to-four family property as determined by a qualifying appraisal (as described in the following section); and

(B) The purchase price of the one-to-four family property to be paid in connection with the mortgage transaction; and

(iii) If the estimated market value of the one-to-four family property as determined by a qualifying appraisal is less than the purchase price of the one-to-four family property to be paid in connection with the mortgage transaction, the difference between these amounts.

For example, the down payment amount would equal $30,000 on a mortgage transaction with $10,000 in borrower-paid closing costs, and where the purchase price equaled $100,000 on a property with a qualifying appraisal that reflects a $100,000 market value as follows: (i) $10,000 in closing costs; plus (ii) $20,000 (based on 20 percent of the $100,000 purchase price which is less than or equal to the $100,000 market value); plus (iii) $0 (due to purchase price being less than or equal to the market value of the property). However, the down payment amount would equal $40,000 on a mortgage transaction with $10,000 in closing costs, and where the purchase price equaled $110,000 on a property with a qualifying appraisal that reflects a $100,000 market value as follows: (i) $10,000 in closing costs; plus (ii) $20,000 (based on 20 percent of the $100,000 market value which is less than the $110,000 purchase price); plus (iii) $10,000 (difference between the $110,000 purchase price and the $100,000 market value).

Because historical data indicate that borrowers with a meaningful equity interest in their properties exhibit a lower risk of default, [148] the proposal does not permit the dilution of a borrower's equity position by allowing the financing of closing costs.

The proposal also provides that the funds used by the borrower to meet the 20 percent down payment requirement must come from one or more acceptable sources of the borrower's own funds as specified in the Additional QRM Standards Appendix to the proposed rules. The acceptable sources of funds included in the Additional QRM Standards Appendix are those that would be considered acceptable sources under the "Acceptable Sources of Borrower Funds" section in the HUD Handbook (e.g., savings and checking accounts, cash saved at home, stocks and bonds, and gifts, including eligible downpayment assistance programs).

While the down payment must come from acceptable sources of borrower funds, which as noted above can include gifts, the Agencies are proposing to prohibit the use of any funds subject to a contractual obligation by the borrower to repay and any funds from a person or entity with an interest in the sale of the property (other than the borrower). In addition, the Agencies are proposing to require originators to verify and document the borrower's compliance with the down payment requirements in accordance with the verification and documentation standards set forth in the Additional QRM Standards Appendix. Again, these standards are based on the standards in the HUD Handbook.

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148 See Austin Kelly, "Skin in the Game: Zero Down Payment Mortgage Default," Federal Housing Finance Agency, Journal of Housing Research, Vol. 19, No. 2, 2008, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1330132.

Request for Comment

121. The Agencies request comment on the proposed amount and acceptable sources of funds for the borrower's down payment.

6. Qualifying Appraisal

After considering a variety of valuation information sources, the Agencies are proposing that a QRM be supported by a written appraisal that conforms to generally accepted appraisal standards, as evidenced by the Uniform Standards of Professional Appraisal Practice, the appraisal requirements of the Federal banking agencies, and applicable laws.[149] The Agencies believe these requirements will help ensure that the appraisal is prepared by an independent third party with the experience, competence, and knowledge necessary to provide an accurate and objective valuation based on the property's actual physical condition. These requirements are intended to ensure the integrity of the appraisal process and the accuracy of the estimate of the market value of the residential property.

Request for Comment

122. Should other valuation approaches be considered in determining the value of the real property pledged on the mortgage transaction?

7. Ability to Repay

Section 15G provides that, in defining QRMs, the Agencies should take into consideration underwriting and product features that historical loan performance data indicate result in a lower risk of default, such as standards with respect to the borrower's residual income,[150] after taking account of all monthly obligations, the ratio of the borrower's housing payment to the borrower's monthly income, or the ratio of the borrower's total monthly installment payments to the borrower's income.[151]

Intuitively, a measure of a borrower's debt service burden ought to be an important predictor of default. These burdens are often measured as the ratio of the borrower's mortgage

[149] The appraisal regulations and guidance promulgated by the Federal banking agencies generally do not apply to real estate-related financial transactions that qualify for sale to a U.S. government agency or to the Enterprises, or in which the appraisal conforms to the appropriate Enterprise's appraisal standards applicable to that category of real estate. See 12 CFR 34.43(a)(10) (OCC); 12 CFR 225.63(a)(10); (Board); 12 CFR 323(a)(10) (FDIC). The Interagency Appraisal and Evaluation Guidelines clarify that such transactions are expected to meet all of the underwriting requirements of the appropriate agency or Enterprise, including its appraisal requirements. Residential mortgage loans sold to the Enterprises will, in any case, continue to be required to meet appraisal standards of the appropriate Enterprise applicable to that category of real estate.
[150] Residual income is the borrower's remaining or "residual" monthly income after all of the borrower's monthly obligations, including the residual mortgage loan, have been paid.
[151] See 15 U.S.C. § 78o-11(e)(4)(B)(ii).

payment to his gross income (often known as the "front-end ratio") and the ratio of all of the borrower's debt payments to his gross income (often known as the "back-end ratio").[152]

The Agencies' review found that historical loan performance data did not always contain information on the borrowers' monthly income and debt obligations and, where such data were provided, the information was not always captured in a consistent manner, making it difficult to aggregate for statistical analysis. For example, the loan performance data from the Enterprises reflect that borrowers with lower DTI ratios had lower default rates before consideration of other underwriting factors. These data show that, among all loan types, loans that are estimated to meet the other proposed QRM standards, but had a front-end ratio of more than 28 percent or a back-end ratio of more than 36 percent, had serious delinquency rates 20 to 39 basis points higher when examining loans originated from 1997 to 2002, and 236 to 359 basis points higher for loans originated from 2005 to 2007.[153]

However, in the LPS data described above, payment to income ratios did not add significant predictive power once the effects of credit history, loan type, and LTV were considered. These results could be due to different originators using different definitions of income and non-mortgage debt burdens. Additionally, loan officers and brokers may only verify and report the minimum income necessary to qualify a borrower for a loan (or for the type of loan or interest rate sought). For example, two borrowers with the same loan type and the same reported front-end DTI ratio might actually have different incomes because one borrower's spouse works, but this additional income was not necessary to qualify for the loan and so was not reported.

The rule proposes a front-end ratio limit of 28 percent and a back-end ratio limit of 36 percent, which are consistent with the overall conservative nature of the QRM standards. These ratios are consistent with the standards widely used in the early 1990s that limited front-end ratios to a maximum of 25 to 28 percent and back-end ratios to a maximum of 33 to 36 percent, with the higher ratios only available to borrowers with relatively large down payments.[154] As noted above and described more fully in Appendix A to this Supplementary Information, loan performance data from the Enterprises indicate that these ratios are likely to help contribute to a set of QRM standards indicative of loans of very high credit quality.

For purposes of calculating these proposed ratios, the proposal would require originators to use the borrower's monthly gross income, as determined in accordance with the effective income standards set forth in the HUD Handbook, which have been incorporated into the Additional QRM Standards Appendix to the proposed rules. In addition, originators would be required to use the borrower's monthly housing debt in calculating the front-end ratio, and the

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[152] The Agencies' assessment of the available information suggested that the residual income method for assessing the borrowers' ability to repay is neither widely used nor consistently calculated. Therefore, the Agencies are not proposing to require the use of the residual income method for purposes of determining a borrower's ability to repay.

[153] See Appendix A to this Supplementary Information.

[154] See National Association of Realtors, "Financing the Home Purchase: The Real Estate Professional's Guide," Chicago: National Association of Realtors (1993), at 20.

borrower's total monthly debt in calculating the back-end ratio, as such debt amounts are defined in the HUD Handbook and incorporated into the Additional QRM Standards Appendix. The proposed rules, however, specifically provide that an originator must include in the borrower's monthly housing debt and total monthly debt any monthly pro rata payments for real estate taxes, insurance, ground rent, special assessments, and homeowner and condominium association dues. This requirement is intended to help ensure that the borrower has the capacity to meet these ongoing, housing-related monthly obligations, even where the borrower does not pay these obligations on a monthly basis.

The proposed rules also require that originators verify and document the borrower's monthly gross income, monthly housing debt, and monthly total debt in accordance with the verification and documentation standards of the HUD Handbook, as incorporated into the Additional QRM Standards Appendix.[155] The proposed rules also require the originator to determine the amount of the monthly first-lien mortgage payment and, in the case of refinancing transactions, the monthly payment for other debt secured by the property (including any open-end credit transaction as if fully drawn) that to the creditor's knowledge would exist at the closing of the refinancing transaction. These determinations would be based on the maximum interest rate chargeable during the first five years after the date on which the first regular periodic payment will be due and a payment schedule that fully amortizes the mortgage over the full term of the loan, which cannot exceed 30 years. These requirements are based on those that apply to QMs under section 129C of TILA.[156]

Request for Comment

123. The Agencies seek comment on the appropriateness of the proposed front-end ratio limit of 28 percent and the proposed back-end ratio limit of 36 percent.

8. Points and Fees

Section __.15(d)(7) of the proposed rules reflects the restriction on "points and fees" for QMs contained in section 129C(b)(2)(A)(vii) of TILA. As with other standards set forth in TILA for QMs, the Agencies have considered the statutory provisions governing points and fees for QMs and have sought to ensure that the standards applicable to QRMs would be no broader than those that may potentially apply to QMs.[157] Under the proposal, in order for a mortgage to

[155] Section 129C(b)(2)(A)(iii) of TILA requires that the originator of a QM verify and document the income and financial resources relied upon in qualifying the borrower for the loan.

[156] See section 129C(b)(2)(A)(iv) and (v) of TILA.

[157] Section 129C(b)(2)(C) of TILA defines the term "points and fees" with reference to the definition of "points and fees" in section 103(aa)(4) of TILA, which deals with "high-cost" mortgages. Under section 103(aa)(4) of TILA, as amended by the Dodd-Frank Act, points and fees include: (i) All items included in the "finance charge" under TILA, except interest or the time-price differential; (ii) All compensation paid directly or indirectly by a consumer or creditor to a mortgage originator (as defined in section 103(cc)(2) of TILA) from any source, including a mortgage originator that is also the creditor in a table-funded transaction; (iii) Each of the charges listed in section 106(e) of TILA (except an escrow for future payment of taxes) that are excluded from the definition of the "finance charge" (under section 106(e) of TILA, the following items when charged in connection with any extension of credit secured by an interest in real property are not included in the computation of the finance charge with respect to that transaction: fees or premiums for title examination, title insurance, or similar purposes; fees for preparation of loan-related documents; escrows for future payments of taxes and insurance; fees for notarizing deeds and other

be a QRM, the total points and fees payable by the borrower in connection with the mortgage transaction may not exceed three percent of the total loan amount, which would be calculated in the same manner as in Regulation Z.[158] Under Regulation Z, the "total loan amount" is calculated by taking the "amount financed," as defined in 12 CFR 226.18(b), and deducting any "points and fees" that are financed by the creditor and not otherwise deducted in calculating the amount financed. In this way, the three percent limit on points and fees for QRMs will be based on the amount of credit extended to the borrower without taking into account the financed points and fees themselves.

For QRMs, the proposed rules would define "points and fees" consistent with the current definition of "points and fees" under the Board's Regulation Z, but would include the additional items added to the TILA definition of "points and fees" by the Dodd-Frank Act. Specifically, the term "points and fees" would include: (1) All items required to be disclosed as "finance charges" under Regulation Z (12 CFR sections 226.4(a) and 226.4(b)), except interest or the time-price differential; (2) All compensation paid directly or indirectly by a consumer or creditor to a "mortgage originator" (as defined in section 103(cc)(2) of TILA) from any source,[159] including a mortgage originator that is also the creditor in a table-funded transaction;[160] (3) All items excluded from the "finance charge" under Regulation Z listed in 12 CFR section 226.4(c)(7) (other than amounts held for future payment of taxes), unless the charge is reasonable, the creditor and mortgage originator receive no direct or indirect compensation in connection with the charge, and the charge is not paid to an affiliate of the creditor or mortgage originator; (4) Premiums or other charges payable at or before closing for any credit life, credit disability, credit unemployment, or credit property insurance, or any other accident, loss-of-income, life or health insurance, or any payments made directly or indirectly for any debt cancellation or suspension

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documents; appraisal fees, including fees related to any pest infestation or flood hazard inspections conducted prior to closing; and fees or charges for credit reports), unless the charge is reasonable, the creditor receives no direct or indirect compensation, and the charge is paid to a third party unaffiliated with the creditor; (iv) Premiums or other charges payable at or before closing for any credit life, credit disability, credit unemployment, or credit property insurance, or any other accident, loss-of-income, life or health insurance, or any payments made directly or indirectly for any debt cancellation or suspension agreement or contract, except that insurance premiums or debt cancellation or suspension fees calculated and paid in full on a monthly basis are not considered financed by the creditor; (v) The maximum prepayment fees and penalties that may be charged or collected under the terms of the credit transaction; (vi) All prepayment fees or penalties that are incurred by the consumer if the consumer refinances a previous loan made or currently held by the same creditor or an affiliate of the creditor; and (vii) Such other charges as the Board determines to be appropriate.

For purposes of a "qualified mortgage," section 129C(b)(2)(C) of TILA provides some exceptions to the definition of "points and fees" under section 103(aa)(4) of TILA. In calculating points and fees for purposes of the three percent limit applicable to QMs, points and fees do not include bona fide third party charges not retained by the mortgage originator, creditor, or an affiliate of the creditor or mortgage originator. See section 129C(b)(2)(C)(i) of TILA. In addition, for purposes of computing the total points and fees for the three percent QM limit, the total points and fees excludes certain bona fide discount points if certain conditions are met. See section 129C(b)(2)(C)(ii)-(iv) of TILA.

[158] See 12 CFR 226.32(a)(1)(ii) and (b)(1).

[159] Under section 103(aa)(4)(B) of TILA, as amended by the Dodd-Frank Act, compensation paid to a mortgage originator "from any source" is included in "points and fees."

[160] For clarity, the proposal does not include the phrase "from any source" because the proposal would include all compensation paid directly or indirectly by a consumer or creditor to a mortgage originator, which would necessarily include compensation from any source.

agreement or contract;[161] and (5) All prepayment fees or penalties that are incurred by the consumer if the consumer refinances a previous loan made or currently held by the same creditor or an affiliate of the same creditor.[162]

Items excluded from the finance charge under 12 CFR sections 226.4(c), 226.4(d) and 226.4(e) would be excluded from the proposal's definition of "points and fees," unless those items are specifically included elsewhere in the definition of "points and fees." The proposed rules do not exclude "bona fide discount points" or certain bona fide third-party charges from "points and fees." The Agencies are also not proposing an adjustment to the limitation on points and fees for smaller loans as required for QMs under section 129C(b)(2)(D) of TILA.

Request for Comment

124(a). The Agencies request comment on all aspects of the proposed definition of "points and fees" for QRM purposes. In addition, the Agencies seek comment on the following matters. 124(b). Should the exclusion for "bona fide discount points" and certain bona fide third-party charges be included in the final rule? 124(c). If so, in what manner? 124(d) Would an adjustment to the limitation on points and fees for smaller loans, if implemented under section 129C(b)(2)(D) of TILA, be appropriate for QRMs?

9. Assumability Prohibition

Under the proposed rules, a QRM could not be assumable by any person who was not a borrower under the original mortgage transaction. If a mortgage were assumable after origination or its securitization, it is possible that the new borrower would not satisfy the QRM requirements, which could result in the credit quality of the mortgage being significantly and negatively affected. While the rule could require that the loan essentially be re-underwritten using the QRM standards in connection with an assumption to address these concerns, such a requirement could impose significant costs on the holder or servicer of the mortgage, and potentially increase the cost and reduce the liquidity of QRMs.

10. Default Mitigation

The proposed rules also would require that the originator of a QRM incorporate into the mortgage transaction documents certain requirements regarding servicing policies and procedures for the mortgage, including requirements regarding loss mitigation actions, subordinate liens, and responsibility for assumption of these requirements if servicing rights with respect to the QRM are sold or transferred. Timely initiation of loss mitigation activities often reduces the risk of subsequent default on mortgages backing the securitization transaction.

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[161] All such charges are included in "points and fees" under section 103(aa)(4)(D) of TILA and, thus, are included in points and fees under the proposal. Another amendment to TILA added by the Dodd-Frank Act (Section 129C(d) of TILA), restricts creditors from financing certain of these charges. This prohibition will be implemented when the Board or CFPB implements that section of TILA.

[162] Section 103(aa)(4) of TILA also includes in "points and fees" the maximum prepayment fees and penalties which may be charged or collected under the terms of the credit transaction. However, under the proposed rule, QRMs would not be permitted to have prepayment penalties.

Disclosure of the policies and procedures governing loss mitigation activities also will inform borrowers and provide clarity regarding the consequences of default.

Specifically, the proposed rules would require that the QRM mortgage transaction documents include a provision obliging the creditor of the QRM to have servicing policies and procedures to promptly initiate activities to mitigate risk of default on the mortgage loan (within 90 days after the mortgage loan becomes delinquent, if such delinquency has not been cured) and to take loss mitigation actions, such as engaging in loan modifications, in the event the estimated net present value of such action exceeds the estimated net present value of recovery through foreclosure, without regard to whether the particular loss mitigation action benefits the interests of a particular class of investors in a securitization. The loss mitigation policies and procedures must also take into account the borrower's ability to repay and other appropriate underwriting criteria. The policies and procedures must include servicing compensation arrangements that are consistent with the creditor's commitment to engage in loss mitigation activities.

In addition, under the proposal, the creditor's policies and procedures would be required to provide that the creditor will implement procedures for addressing any whole loan owned by the creditor (or any of its affiliates) and secured by a subordinate lien on the same property that secures a QRM if the borrower becomes more than 90 days past due on the QRM. If the QRM will collateralize any asset-backed securities, the creditor must disclose those procedures or require them to be disclosed to potential investors within a reasonable period of time prior to the sale of the asset-backed securities. The Agencies are proposing inclusion of this element in the policies and procedures because modification of the QRM could affect the status of subordinate mortgages, and the existence of a subordinate mortgage could affect the structuring of actions to mitigate losses on the QRM.

As proposed, the mortgage originator must provide disclosure of the foregoing default mitigation commitments to the borrower at or prior to the closing of the mortgage transaction. Also, the mortgage originator would be required to include terms in the mortgage transaction documents under which the creditor commits to include in its servicing policies and procedures that it will not sell transfer, or assign servicing rights for the mortgage loan unless the transfer agreement requires the purchaser, transferee or assignee servicer to abide by the default mitigation commitments of the creditor as if the purchaser, transferee or assignee were the creditor under this section of the proposed rule.[163]

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[163] As noted above, the policies and procedures prescribed under the proposed rule require the creditor's procedures with respect to subordinate liens held by the creditor or affiliates on the mortgaged property to be disclosed to potential investors if the creditor subsequently securitizes the QRM. In addition, the Agencies expect the creditor's commitments to have servicing policies and procedures as specified in the proposed rule would be reflected in the servicing agreement(s) for the securitization, which set forth the terms under which the servicer will service the securitized assets, and would thus be disclosed to potential investors in a securitization offering covered by the SEC's Regulation AB. If the servicing is transferred from the creditor to another entity who acts as securitization servicer, the Agencies expect these commitments would nevertheless be carried forward to the servicing agreements for the securitizations and disclosed pursuant to Regulation AB, because the policies and procedures prescribed under the proposed rule require the creditor not to transfer QRM servicing unless the agreement requires the transferee to abide by the same kind of default mitigation commitments as are required of the creditor.

It is noted that there is an ongoing interagency effort among certain Federal regulatory agencies, including some of the Agencies joining in this proposed rulemaking, to develop national mortgage servicing standards that would apply to servicers of residential mortgages, including bank and bank-affiliated servicers and servicers that are not affiliated with a bank.[164] These standards would apply to residential mortgages regardless of whether the mortgages are QRMs, are securitized or are held in portfolio by a financial institution. The primary objective of this separate interagency effort is to develop a comprehensive, consistent, and enforceable set of servicing standards for residential mortgages that servicers would have to meet. In addition to servicing matters covered in this proposal, the separate interagency effort on national mortgage servicing standards is taking into consideration a number of other aspects of servicing, including the quality of customer service provided throughout the life of a mortgage; the processing and handling of customer payments; foreclosure processing; operational and internal controls; and servicer compensation and payment obligations. The agencies participating in this separate effort currently anticipate requesting comment on proposed standards later this year, with the goal of having final standards issued shortly afterward. At this time, with respect to specific servicing standards, the Agencies are requesting comment only on those particular standards included in this proposed rulemaking.

<u>Request for comment</u>

125. The Agencies solicit comment on whether the definition of QRM should include servicing requirements.

126(a). Should the proposed servicing requirements be more or less robust? 126(b) If so, how should the proposed servicing requirements be changed?

127(a). Should servicers be required, as is proposed, to have policies and procedures that provide for loss mitigation activities if the borrower is 90 days delinquent, but default may not have occurred under the mortgage loan transaction documents? 127(b). Should the policies and procedures require, or at least not prohibit, initiation of loss mitigation activities, including loan modifications, when default is reasonably foreseeable? 127(c). What would be the practical implications of such an approach?

128(a). Should servicers be required, as is proposed, to have policies and procedures that provide for loss mitigation actions for QRMs (within 90 days after delinquency, unless the delinquency is cured) when the estimated net present value of the action would exceed the estimated net present value of recovery through foreclosure? 128(b). Should those policies and procedures be required to include specific actions, such as (i) restructuring the mortgage loan; (ii) reducing the borrower's payments through interest rate reduction, extension of loan maturity, or similar actions; (iii) making principal reductions, or (iv) taking other loss mitigation action in

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[164] Participating agencies in the effort include the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, the Federal Housing Finance Agency, the Department of Housing and Urban Development (including the Government National Mortgage Association (Ginnie Mae)), the Consumer Financial Protection Bureau, and the Department of the Treasury.

the event that the estimated net present value of that action would exceed the estimated net present value of recovery though loan foreclosure? 128(c). What would be the practical implications of such an approach?

129. The Agencies seek comment on whether other servicing standards should be included, consistent with the statute's authority.

130(a). What are the practical implications of the proposed QRM servicing standards? 130(b). Do commenters envision operational issues in implementing the standards? 130(c). If so, please describe. 130(d). Are the standards sufficiently clear? 130(e). If not, which should be clarified?

131. Would the proposed QRM servicing conditions restrict or impede the ability or willingness of certain classes of originators to originate QRMs?

132(a). Is the scope of the QRM servicing standards appropriate? 132(b). Are there alternatives to QRM servicing standards that would better address servicing issues?

133(a). Should the servicing requirements be part of the pooling and servicing agreement rather than part of the mortgage transaction documents? 133(b).Should they be included in both sets of documentation?

134(a). If a creditor or an affiliate has an ownership interest in a subordinate lien mortgage and the creditor services the first lien mortgage, should the creditor be required to implement pre-defined processes to address any potential conflicts of interest when the first lien loan becomes 90 days past due? 134(b).What types of processes should be required? 134(c).Would specification of a particular process unduly limit the ability of the creditor to address different circumstances that may arise?

135(a). Should the Agencies impose a standard requiring that a particular risk mitigation activity maximize the recovery based on net present value to avoid potential conflicts of interests between different classes of investors? 135(b). How would that be determined? 135(c). Would this approach improve the ability of servicers to best represent the interest of all investors? 135(d). What would be the practical implications under such an approach?

136(a). Are the proposed compensation requirements appropriate? 136(b). For example, should the compensation structure be more specific, depending on the type of risk mitigation action deemed appropriate? 136(c). If so, how?

137(a). Pursuant to servicers' obligations to investors under the terms of securitization transaction documents, servicers are generally required to advance scheduled payments of principal and interest to investors after a borrower has become past due for some period of time (with respect to private label securities, usually until foreclosure is started), to the extent that such monthly advances are expected to be reimbursed from future payments and collections or insurance payments or proceeds of liquidation of the related mortgage loan. These monthly advances are intended to maintain a regular flow of scheduled principal and interest payments on the certificates rather than to guarantee or insure against losses. Does funding of these delinquent payments create liquidity constraints for servicers that incent servicers to take action (e.g., start foreclosure) that may not be in the investors' best interest? 137(b). Should the Agencies put limits on servicers advancing delinquent mortgagors' payments of principal and interest to investors? 137(c). Would such a limitation harm investors' interests? 137(d). What are the practical implications of such an approach?

138(a). Should the Agencies require servicing standards for a broader class of securitized residential mortgages? 138(b). If so, how?

139. For commenters responding to any of the foregoing questions or with recommendations for different or additional approaches to servicing standards, are such approaches consistent with the statutory factors the Agencies are directed to take into account under the QRM exemption?

140. The Agencies are in the process of developing national mortgage servicing standards, which would cover all residential mortgage loans, including QRMs. In light of this, the Agencies seek comment on whether the establishment of national mortgage servicing standards is a more effective means to address the problems associated with servicing of all loans.

D. Repurchase of loans subsequently determined to be non-qualified after closing

As required by section 15G and discussed in greater detail in Part IV.B of this Supplementary Information, the proposed rules require that the depositor of the asset-backed security 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 QRMs and has concluded that such internal supervisory controls are effective. Nevertheless, the Agencies recognize that, despite the use of robust processes and procedures, it is possible that one or more loans included in a QRM securitization transaction may later be determined to have not met the QRM definition due to inadvertent error. For example, an originator conducting post-origination file reviews for compliance or internal audit purposes may find that some aspects of the documentation required to verify the borrower's monthly gross income were not obtained. If the discovery of such an error after closing of the securitization terminated the securitization's QRM exemption, then sponsors and investors may well be unwilling to participate in the securitization of QRMs. On the other hand, unless sponsors or depositors face some penalty for the inclusion in a QRM securitization transaction of loans that do not meet the QRM standards, sponsors and depositors may not have the proper incentives to use all reasonable efforts to ensure that securitizations relying on the QRM exemption are collateralized only by loans that meet all of the QRM standards.

The proposal seeks to balance these interests by providing that a sponsor that has relied on the QRM exemption with respect to a securitization transaction would not lose the exemption, with respect to the transaction, if, after closing of the securitization transaction, it is determined that one or more of the mortgages collateralizing the ABS do not meet all of the criteria to be a QRM, provided that certain conditions are met. First, the depositor must have certified that it evaluated the effectiveness of its internal supervisory controls with respect to the process for ensuring that all of the loans that collateralize the ABS are QRMs and concluded that its internal supervisory controls are effective, as required by §__.15(b)(4) of the proposed rules. Second, the sponsor must repurchase the loan(s) determined to not be QRMs from the issuing entity at a price at least equal to the remaining principal balance and accrued interest on the loan(s). The sponsor must complete this repurchase no later than ninety (90) days after the determination that the loan(s) does not satisfy the QRM requirements. Third, the sponsor must promptly notify (or cause to be notified) all investors of the ABS of any loan(s) that are required to be repurchased by the sponsor pursuant to this repurchase obligation, including the principal amount of the repurchased loan(s) and the cause for such repurchase.

These conditions are intended to provide a sponsor with the opportunity to correct inadvertent errors by promptly repurchasing any non-qualified loan(s) and removing such non-qualifying loan(s) from the pool, while protecting investors. Moreover, in light of this buy-back requirement, sponsors should continue to have a strong economic incentive to ensure that all loans backing a QRM securitization satisfy all of the conditions applicable to QRMs prior to closing of the transaction.

Request for Comment

141(a). Should the Agencies require, as a condition to qualify for the QRM exemption, that the sponsor repurchase the entire pool of loans collateralizing the ABS if the amount or percentage of the loans that are required to be repurchased due to the failure to meet the QRM standards reaches a certain threshold.? 141(b). If so, what threshold would be appropriate?

142(a). Should the Agencies permit a sponsor, within the first four months after the closing of a QRM securitization, to substitute a comparable QRM loan for a residential mortgage loan that is determined, post-closing, to not be a QRM (in lieu of purchasing the loan for cash)? 142(b). If so, is four months an appropriate period or should the rule allow more or less time?

E. Request for Comment on Possible Alternative Approach

As discussed previously, the approach taken by the proposal to implementing the exemption for QRMs within the broader context of section 15G is to limit QRMs to mortgages of very high credit quality, while providing sponsors considerable flexibility in how they meet the risk retention requirements for loans that do not qualify as QRMs (or for another exemption). An alternative approach to implementing the exemption for QRMs within the context of section 15G would be to create a broader definition of a QRM that includes a wider range of mortgages of potentially lower credit quality, and make the risk retention requirements stricter for non-QRM mortgages, such as by, for example, providing sponsors with less flexibility in how they retain risk (e.g., requiring vertical risk retention or increasing the base risk retention requirement), in order to provide additional incentives to originate QRM loans. Under this type of alternative approach, the proposed QRM standards could be modified as follows—

(a) If the mortgage transaction is a purchase transaction or rate and term refinancing, the combined LTV ratio of the mortgage transaction could not exceed 90 percent (with no restriction on the existence of a subordinate lien at closing of a purchase transaction);

(b) If the mortgage transaction is a cash-out refinancing, the combined LTV ratio of the mortgage transaction could not exceed 75 percent;

(c) The borrower's required cash down payment on a purchase mortgage could be reduced to—

(1) 10 percent (rather than the proposed 20 percent) of the lesser of the property's market value or purchase price, plus

(2) The closing costs payable by the borrower in connection with the mortgage transaction; and

(d) A borrower's maximum front-end DTI ratio could be increased to—

(1) 33 percent, if payments under the mortgage could not increase by more than 20 percent over the life of the mortgage; or

(2) 28 percent, if payments under the mortgage could increase by more than 20 percent over the life of the mortgage;

(e) A borrower's maximum back-end DTI ratio would be increased to—

(1) 41 percent, if payments under the mortgage could not increase by more than 20 percent over the life of the mortgage; or

(2) 38 percent, if payments under the mortgage could increase by more than 20 percent over the life of the mortgage; and

(f) Mortgage guarantee insurance or other types of insurance or credit enhancements provided by third parties could be taken into account in determining whether the borrower met the applicable combined LTV requirement, but such insurance or enhancements would not alter the 90 percent maximum combined LTV for purchase transactions and rate and term refinancings and 75 percent maximum combined LTV for cash-out refinancings.

<u>Request for Comment</u>

143. The Agencies seek comment on the potential benefits and costs of the alternative approach, with a broader QRM exemption combined with a stricter set of risk retention requirements for non-QRM mortgages.

144(a). If such an alternative approach were to be adopted, what stricter risk retention requirements would be appropriate in order to provide additional incentives to underwrite a greater share of origination volume within the QRM definition? 144(b). Should such stricter requirements involve the form of risk retention or a higher amount of risk retention? 144(c). Are there other changes that would achieve the same objective?

145. How would this approach help to ensure high quality loan underwriting standards and align the interests of investors?

146(a). Would this approach have the practical effect of exempting the securitization of most residential loans from the risk retention requirement? 146(b). If so, how would this positively and/or negatively affect investors in such securitizations? 146(c). Would an offering of an ABS backed by loans complying with the lower standards in the alternative approach adequately promote the necessary alignment of incentives among originators, sponsors, and investors?

147. What impact might a broader QRM definition have on the pricing, liquidity, and availability of loans that might fall outside the broader QRM boundary?

148. Would the lower QRM standards under the alternative approach be consistent with the requirement that QRMs be fully exempted from section 15G's risk retention requirements?

149. How could this type of alternative approach be designed to limit the likelihood that loans with significant credit risk are included in the pool and thus not subject to risk retention?

V. Reduced Risk Retention Requirements for ABS Backed by Qualifying Commercial Real Estate, Commercial or Automobile Loans

Under Section 15G, the regulations issued by the Agencies must include underwriting standards for residential mortgages, commercial real estate (CRE) loans, commercial loans, and automobile loans, as well as any other asset class that the Federal banking agencies and the Commission deem appropriate.[165] These underwriting standards, which are to be established by the Federal banking agencies, must specify terms, conditions, and characteristics of a loan within such asset class that indicate low credit risk with respect to the loan.[166] Section 15G provides that the Agencies must allow a securitizer to retain less than five percent of the credit risk of loans within an asset class that meet the underwriting standards set jointly by the Federal banking agencies if such loans are securitized through the issuance of an ABS.[167]

The following discussion addresses the underwriting standards established by the Federal banking agencies for CRE loans, commercial loans, and automobile loans.

A. Asset classes

As directed by section 15G, §__.18 to §__.20 of the proposed rules include underwriting standards for CRE loans, commercial loans, and automobile loans that would allow ABS backed exclusively by loans that meet these underwriting standards to qualify for a less than five percent risk retention requirement. As discussed in further detail in Part IV of this Supplementary Information, the proposed rules provide a complete exemption from the risk retention requirements for securitization transactions that are collateralized solely by residential mortgages that qualify as QRMs. Accordingly, the proposed rules do establish separate rules for securitizations of residential mortgages that have terms, conditions and characteristics that indicate a low credit risk as required by section 15G(c)(2)(B). The Agencies do not propose to establish additional underwriting standards for residential mortgages that would be different from those set forth in the QRM standards. In determining not to propose additional standards,

[165] See 15 U.S.C. § 78o-11(c)(2)(A).
[166] See id. at § 78o-11(c)(2)(B).
[167] See id. at § 78o-11(c)(1)(B)(ii).

the Agencies considered, among other things, whether requiring risk retention greater than zero percent but less than five percent would provide an adequate incentive to sponsors and originators to underwrite assets meeting those standards.

Although the Agencies recognize that securitization markets include securitizations collateralized by various subcategories of assets with unique characteristics, the Agencies believe that the asset classes specified in section 15G (e.g., residential mortgages, commercial mortgages, commercial loans and automobile loans) capture a predominance of all ABS issuances by dollar volume where the underlying pool is comprised of relatively homogeneous assets. Moreover, general information for ABS issuances collateralized exclusively by CRE, commercial, and automobile loans is widely available and, due to the homogeneity of the underlying pool, lends itself to the establishment of uniform underwriting standards establishing low credit risk for all of the assets within the pool. These characteristics also should facilitate the ability of investors and supervisors to monitor a sponsor's compliance with the proposed standards and disclosure requirements in a timely and comprehensive manner.

In contrast, many of the other types of ABS issuances are collateralized by assets that exhibit significant heterogeneity, or assets that by their nature exhibit relatively high credit risk. Such factors make it difficult to develop underwriting standards establishing low credit risk that can be, as a practical matter, applicable to an entire class of underlying assets in the manner described under section 15G. Accordingly, for purposes of the proposed rules, the Federal banking agencies and the Commission do not propose to establish asset classes in addition to those set forth in section 15G.

Request for Comment

150(a). Should underwriting standards be developed for residential mortgage loans that are different from those proposed for the QRM definition and under which a sponsor would be required to retain more than zero but less than five percent of the credit risk? 150(b). If so, what should those underwriting standards be and how should they differ from those established under the QRM provisions? 150(c). For example, should such underwriting standards allow for a loan-to-value ratio of up to 90 percent for purchase mortgage loans if there is mortgage insurance that would provide investors similar amounts of loss protection upon default as would be provided by a mortgage with a loan-to-value ratio of 80 percent? 150(d). If additional underwriting standards were established for residential mortgages, what amount of risk retention less than five percent should be required for loans meeting such standards, and should it be required to be held in a particular form?

151. If any new underwriting standards for residential mortgages were to be established and permit the inclusion of mortgage guarantee insurance or other types of insurance or credit enhancements, what financial eligibility standards should be incorporated for mortgage insurance or financial product providers?

152. Should additional asset classes beyond those specified in section 15G be established and, if so, how should the associated underwriting standards for such additional asset classes be defined? Commenters are encouraged to provide supporting data regarding the prevalence of each asset class in the ABS market, as well as loan-level performance data that

provides information on the characteristics, terms, and conditions of the underlying loans and that may be useful in developing standards that identify loans within such asset class that have low credit risk.

B. <u>ABS collateralized exclusively by qualifying CRE loans, commercial loans, or auto loans</u>

Section 15G(c)(1)(B)(ii) provides that a sponsor of an ABS issuance collateralized exclusively by loans that meet the underwriting standards prescribed by the Federal banking agencies under section 15G(c)(2)(B) shall be required to retain less than five percent of the credit risk of the securitized loans. The Agencies are proposing a zero percent risk retention requirement (that is, the sponsor would not be required to retain any portion of the credit risk) for ABS issuances collateralized exclusively by loans from one of the asset classes specified in the proposed rules, and which meet the proposed underwriting standards. In proposing a zero risk retention requirement for ABS backed by qualifying loans within these asset classes, the Agencies considered several factors. As discussed below, the underwriting standards the Agencies propose are, as is appropriate for a zero percent risk retention requirement, very conservative. In addition, the Agencies were concerned that establishing a risk retention requirement between zero and five percent for qualifying assets within these asset classes may not sufficiently incent securitizers to allocate the resources necessary to ensure that the collateral backing an ABS issuance satisfies the proposed underwriting standards, as there may be significant compliance costs to structure and maintain the retention piece of a securitization structure (irrespective of how it is calibrated) and provide required disclosures to investors.

Sections__.18 to __.20 of the proposed rules establish underwriting standards for CRE loans, commercial loans, and automobile loans that are designed to ensure that loans in these asset classes, which qualify for a zero risk retention requirement, are of very low credit risk. The proposed underwriting standards are based on the Federal banking agencies' expertise and supervisory experience with respect to the credit risk of the loans in each of the prescribed asset classes. Commercial, CRE and automobile loans that meet the conservative underwriting standards included in the proposed rules are referred to as "qualifying" commercial, CRE and automobile loans.

The Federal banking agencies have sought to make the standards for qualifying commercial loans, CRE loans and automobile loans, transparent to, and verifiable by, originators, securitizers, investors and supervisors. To facilitate compliance with the rule, as well as the supervision and enforcement of the rule, the proposed standards are generally prescriptive, rather than principle-based.

The Agencies recognize that many prudently underwritten CRE, commercial and automobile loans will not meet the underwriting standards set forth in §__.18 to §__.20 of the proposed rules. For example, the Agencies note that the proposed standards are significantly more prudent and conservative than those required to attain a "pass" credit under the Federal banking agencies' supervisory practices. Sponsors of ABS backed by loans that do not meet the underwriting standards will be required to retain some of the credit risk of the securitized loans in accordance with the proposed regulation (unless another exemption is available). However, as noted previously, the proposed rules provide sponsors with several options for complying with the risk retention requirements of section 15G so as to reduce the potential for these requirements to disrupt securitization markets or materially affect the flow or pricing of credit to borrowers and businesses. Moreover, the national pool of commercial loans, CRE loans and automobile loans that do not meet the standards set forth in §__.18 to §__.20 of the proposed rules should be sufficiently large, and include enough prudently underwritten loans, so that ABS backed by such loans will be routinely issued and purchased by a wide variety of investors. As a result, the market for such securities should be relatively liquid.

Request for Comment

153. The Agencies request comment on the appropriateness of a total exemption for sponsors of ABS issuances collateralized exclusively by qualifying CRE, commercial, or automobile loans that meet the underwriting standards set forth in §__.18 to §__.20 of the proposed rules. Commenters who support a partial exemption are encouraged to provide information regarding the methodology the Agencies should use to calibrate the retention requirement, in a manner that considers the relative risk of the securitization transaction, both within and across the proposed asset classes.

C. Qualifying commercial loans

For an ABS issuance collateralized exclusively by commercial loans to qualify for a zero percent risk retention requirement, the commercial loans must satisfy the underwriting standards set forth in §__.18 of the proposed rules. The proposed rules define a commercial loan as any secured or unsecured loan to a company or an individual for business purposes, other than a loan to purchase or refinance a one-to-four family residential property, a loan for the purpose of financing agricultural production, or a loan for which the primary source (that is, 50 percent or more) of repayment is expected to be derived from rents collected from persons or entities that are not affiliates of the borrower. Commercial loans encompass a wide variety of credit types and terms. However, these loans generally are similar in that the primary source of repayment is revenue from the business operations of the borrower. The standards for a qualifying commercial loan use measures that are consistent with, but more prudent and conservative than, industry standards for evaluating the financial condition and repayment capacity of a borrower.

1. Ability to repay

The historical performance of a borrower with respect to its outstanding loan obligations is, generally, a useful measure for evaluating whether the borrower will likely satisfy new debt obligations. However, even where a borrower has a consistent and documented record of satisfactory performance on prior debt obligations, the originator also must ensure that the borrower's financial condition has not changed in a way that could adversely affect its capacity to satisfy new loan obligations. Accordingly, under §__.18 of the proposed rules, the originator of a qualifying commercial loan must verify and document the financial condition of the borrower as of the end of the borrower's two most recently completed fiscal years. In addition, the originator must conduct an analysis of the borrower's ability to service its overall debt obligations during the next two years, based on reasonable projections. A commercial loan would meet the standards in the proposed rules only if the originator determines that, during the borrower's two most recently completed fiscal years and the two-year period after the closing of the commercial loan, the borrower had, or is expected to have: (1) a total liabilities ratio[168] of 50 percent or less; (2) a leverage ratio[169] of 3.0 or less; and (3) a debt service coverage (DSC) ratio[170] of 1.5 or greater.

Under the proposed rules, the loan payments under the commercial loan must be determined based on straight-line amortization of principal and interest that fully amortize the debt over a term that does not exceed five years from the closing date for the loan. In addition, the loan documentation must require payments no less frequently than quarterly over a term that does not exceed five years. The Federal banking agencies believe these proposed methods for assessing a borrower's financial condition and ability to repay are consistent with industry standards for evaluating the financial condition and repayment capacity of a borrower.

The proposal does not require that a commercial loan be secured by collateral in order to be a qualifying commercial loan. However, where the loan is made on a secured basis, the proposed rules include several conditions designed to ensure that the collateral is maintained and available to be used to satisfy the borrower's obligations under the loan, if necessary. For example, if the commercial loan is originated on a secured basis, the originator must obtain a first-lien security interest on the pledged property and include covenants in the loan agreement that require the borrower to maintain the condition of the collateral and permit the originator to inspect the collateral and the books and records of the borrower. The loan documentation for the commercial loan also must include covenants that require the borrower to: (a) pay all applicable taxes, fees, charges and claims where nonpayment could give rise to a lien against the collateral; (b) take any action necessary to perfect or defend the security interest (or priority of the security interest) of the originator (or any subsequent holder of the loan) in the collateral against claims adverse to the lender's interest; and (c) maintain insurance that protects against loss on the collateral at least up to the amount of the loan, and that names the originator (or any subsequent holder of the loan) as an additional insured or loss payee.

2. <u>Risk management and monitoring requirements</u>

To mitigate default risk during periods of economic stress or when the financial condition of the borrower otherwise deteriorates, the proposed rules require the loan documentation to include covenants that restrict the borrower's ability to incur additional debt or transfer or pledge its assets. Specifically, the proposed rules require the loan documentation to provide certain covenants, including a covenant to provide to the originator (or any subsequent holder) and the servicer financial information and supporting schedules on an ongoing basis, but not less frequently than quarterly. The covenants must also prohibit the borrower from retaining or entering into a debt arrangement that permits payments-in-kind, and place limitations on the

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[168] Total liabilities ratio equals the borrower's total liabilities, determined in accordance with GAAP divided by the sum of the borrower's total liabilities and equity, less the borrower's intangible assets, with each component determined in accordance with GAAP.

[169] The leverage ratio equals the borrower's total debt divided by the borrower's annual income before expenses for interest, tax, depreciation, and amortization (EBITDA), as determined in accordance with GAAP.

[170] The DSC ratio equals the borrower's EBITDA, as of the most recently completed fiscal year divided by the sum of the borrower's annual payments for principal and interest on any debt obligation.

transfer of any of the borrower's assets, on the borrower's ability to create other security interests with respect to any of its assets, and on any change to the name, location, or organizational structure of the borrower (or any other party that pledges collateral for the loan). The loan documentation must also include covenants designed to protect the value of any collateral pledged to secure the loan that require the borrower (and any other party that pledges collateral for the loan) to: (a) maintain insurance protecting against loss on any collateral at least up to the amount of the loan and names the originator (or any subsequent holder) as an additional insured, loss payee, or similar beneficiary; (b) pay any taxes, charges, claims and fees where nonpayment could give rise to a lien against any collateral securing the loan; (c) take any action necessary to perfect or defend the security interest of the originator or any subsequent holder of the loan in the collateral for the commercial loan or the priority thereof, and to defend the collateral against claims adverse to the lender's interest; (d) permit the originator or any subsequent holder of the loan, and the servicer of the loan, to inspect the collateral and the books and records of the borrower; and (e) maintain the physical condition of any collateral for the loan.

Request for Comment

154(a). Are the proposed standards appropriate for a qualifying commercial loan? 154(b) Are these standards sufficient and appropriate to ensure that qualifying commercial loans are of very low credit risk?

155. Are the metrics to measure a borrower's financial capacity, and the specified parameter for each metric, an appropriate standard?

D. Qualifying CRE loans

Section __.19 of the proposed rules provides the underwriting standards for qualifying CRE loans. Such standards focus predominately on the following criteria: the borrower's ability to repay the loan; the value of, and the originator's security interest in, the collateral; the LTV ratio; and whether the loan documentation includes the appropriate covenants to protect the collateral.

For purposes of the proposed rules, a CRE loan is defined as a loan secured by a property with five or more single-family units, or by nonfarm non-residential real property, the primary source (50 percent or more) of repayment for which is expected to be derived from: (a) the proceeds of the sale, refinancing, or permanent financing of the property; or (b) rental income associated with the property other than rental income that is derived from any affiliate of the borrower. However, under the proposal, a CRE loan does not include a land development and construction loan (including one-to-four family residential or commercial construction loans), loans on raw or unimproved land, a loan to a real estate investment trust (REIT), or an unsecured loan.

1. Ability to repay

The Federal banking agencies believe that prudent underwriting standards should require the originator to verify and document the capacity of the borrower, or income from the underlying collateral, to repay the loan. For qualifying CRE loans, the proposed underwriting standards focus on both the sufficiency of the CRE property's net operating income (NOI)[171] less replacement reserves to support the payment of principal and interest over the full term of the CRE loan, as well as the financial condition of the borrower (independent of the CRE property's NOI less replacement reserves) to repay other outstanding debt obligations. Specifically, the proposed rules generally require the borrower to have a DSC ratio[172] of 1.7 or greater. The proposed rules, however, would allow a CRE loan on properties with a demonstrated history of stable NOI to have a slightly lower (1.5) DSC ratio. To qualify for the lower DSC ratio requirement, the CRE loan must be secured by either (1) a residential property (other than a hotel, motel, inn, hospital, nursing home, or other similar facility where dwellings are not leased to residents) that consists of five or more dwelling units primarily for residential use, and where at least 75 percent of the CRE property's NOI is derived from residential rents and tenant amenities (such as a swimming pool, gym membership, or parking fees); or (2) commercial nonfarm real property (other than a multi-family property or a hotel, inn or similar property) that is occupied by, and derives at least 80 percent of its aggregate gross revenue from, one or more "qualified tenants." Under the proposed rules, a qualified tenant is defined as a tenant that (1) is subject to a triple net lease[173] that is current and performing with respect to the CRE property, or (2) was subject to a triple net lease that has expired, currently is leasing the property on a month-to-month basis, has occupied the property for at least three years prior to closing, and is current and performing with respect to all obligations associated with the CRE property. All outstanding triple net leases must have a remaining maturity of at least six months, unless the tenant leases the property on a month-to-month basis as described above.

Under the proposed rules, the originator of a qualifying CRE loan must also determine whether the borrower has the ability to service its other outstanding debt obligations, net of any income generated from the CRE (based on the NOI). This requirement is intended to ensure that the CRE remains a reliable source of repayment and security for the CRE loan, and not other debts of the borrower, over the full loan term. Accordingly, under the proposed rules, the originator must conduct an analysis of the borrower's ability, and determine that the borrower has the ability, to service all outstanding debt obligations over the two years following the origination date for the loan, based on reasonable projections and including the new debt obligation. A borrower's historical performance in satisfying debt obligations is often an indicator of whether the borrower will satisfy a new debt obligation. Accordingly, as part of this analysis, the originator also must document and verify that the borrower has satisfied all debt obligations over a look-back period of at least two years.

The proposed rules generally require that a qualifying CRE loan have a fixed stated interest rate to reduce the potential for the borrower to experience payment shock. However, the

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[171] Section __.16 of the proposed rules defines NOI as income generated by a CRE property, net of all expenses that have been deducted for federal income tax purposes (except depreciation, debt service expenses, and federal and state income taxes) and any unusual or nonrecurring income items.

[172] Under §__.16 of the proposed rules (definition of "Debt service coverage (DSC) ratio"), the DSC ratio for a CRE loan equals the CRE property's annual NOI less the annual replacement reserve of the CRE property at the time of origination divided by the sum of the borrower's annual payments for principal and interest on any debt obligation.

[173] For purposes of the proposed rules, a triple net lease means a lease pursuant to which the lessee is required to pay rent as well as taxes, insurance, and maintenance expenses associated with the property.

proposed rules allow the interest rate to be adjustable if the borrower obtains, prior to or concurrently with the origination date for the CRE loan, a derivative product that effectively results in the borrower paying a fixed interest rate on the CRE loan. Commercial borrowers often purchase a derivative (such as an interest rate swap) that effectively "convert" an adjustable rate into a fixed rate. In addition, the proposed standards for qualifying CRE loans would prohibit terms that (1) permit the borrower to defer principal or interest payments; (2) allow the originator to establish an interest reserve to fund all or part of a payment on the loan; or, (3) provide a maturity date that is earlier than ten years following the closing date for the loan. Further, the loan payment amount must be based on straight-line amortization of the debt over the term of the loan not to exceed twenty (20) years, with payments made no less frequently than monthly over a term of at least ten (10) years.

2. Loan-to-value requirement

The Agencies believe that prudent underwriting standards should limit the amount an originator may advance relative to the market value of the CRE property. Therefore, the Federal banking agencies are proposing to require a combined loan-to-value (CLTV) ratio of less than or equal to 65 percent for qualifying CRE loans. However, the recent crisis has demonstrated that the use of very low capitalization rates generally results in significantly higher market values for some CRE properties. Where the capitalization rate used in the appraisal is less than the 10-year interest rate swap rate[174] plus 300 basis points, the maximum CLTV ratio requirement will be 60 percent to mitigate the effect of an artificially low capitalization rate.

3. Valuation of the collateral

Because the credit risk of a CRE loan is closely linked with the commercial real estate collateralizing the loan, the proposed rules include several conditions relating to the collateral. For example, under §__.19(b) of the proposed rules, the originator of a qualifying CRE loan must determine whether the purchase price for the CRE property that secures the loan reflects the current market value of the property, so as to ensure that the collateral is sufficient to recover any unpaid principal in the event of default, and that the borrower has sufficient equity in the property to incent continued performance of all loan obligations during an economic downturn or when the CRE property's NOI may not be sufficient to cover loan payments. To determine the value of the CRE property, the proposed rules require the originator to obtain an appraisal prepared not more than six months before the origination date for the loan, in accordance with the Uniform Standards of Professional Appraisal Practice and the appraisal requirements of the Federal banking agencies for the CRE property securing the loan. The appraisal report must provide an "as is" opinion of the current market value of the CRE property, which includes an income approach that uses a discounted cash flow analysis based on the CRE property's actual NOI. These requirements are intended to help ensure that the appraisal is prepared by an independent third party with the experience, competence, and knowledge necessary to provide an accurate and objective valuation based on the CRE property's actual physical condition.

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[174] The 10-year interest rate swap rate is as reported on the previous day's Federal Reserve Statistical Release H.15: Selected Interest Rates.

Environmental hazards, such as ground water contamination and the presence of lead or other harmful chemicals or substances, may potentially jeopardize the value of CRE property as well as the borrower's ability to repay the loan. Accordingly, under the proposed rules, the originator also must conduct an environmental risk assessment of the CRE property securing a qualifying CRE loan and, based on this assessment, take appropriate measures to mitigate any risk of loss to the value of the CRE property. Appropriate measures may include a reduction in the loan amount sufficient to reflect potential losses; however, where the assessment reveals significant environmental hazards, originators are encouraged to reconsider the primary loan decision. The originator can have a qualified third party perform the assessment, but remains responsible for ensuring that appropriate measures are taken to mitigate any risk of loss due to environmental risks.

4. Risk management and monitoring requirements

Under §__.19(b) of the proposed rules, the CRE loan documentation must provide certain covenants that are generally designed to facilitate the ability of the originator to monitor and manage credit risk over the full term of the loan. In developing the proposed covenants, the Federal banking agencies reviewed the supporting loan documentation for several recent ABS issuances collateralized by CRE loans. The proposed covenants are generally consistent with those provided in such loan documentation and, therefore, should reflect current industry practice and impose minimal compliance burden.

As with the covenants required for commercial loans (as discussed in the previous section), the covenants for CRE loans require certain information be provided to the originator (or any subsequent holder) and the servicer financial on an ongoing basis. Additionally, with respect to CRE loans in particular, such information must include information on existing, maturing, and new leasing or rent-roll activity, as appropriate for the CRE property. This should assist the originator in monitoring volatility in the repayment capacity of the borrower, with respect to the CRE property's NOI and the borrower's financial condition.

The loan documentation for a qualifying CRE loan also must include covenants restricting the ability of the borrower to create additional security interests with respect to the CRE property and covenants designed to help maintain the value of, and protect the originator's (or any subsequent holder's) security interest in, the collateral. These covenants are substantially the same as the covenants required for commercial loans (as discussed above). Additionally, a covenant must be included that requires the borrower to comply with all legal or contractual obligations applicable to the collateral. Finally, the loan documentation must include a covenant that prohibits the borrower from pledging the CRE property as security for another loan, even where doing so results in the creation of a subordinate lien. The Agencies note, however, that the proposed rules provide an exception for loans that finance the purchase of machinery and equipment that is pledged as additional collateral for the CRE loan. This restriction is intended to ensure that the CRE property remains a reliable source of repayment and security for the CRE loan and the borrower does not become overleveraged, which could threaten the borrower's ability to repay the CRE loan. The proposed covenants must be applicable to the borrower as well as any other party who provides collateral for the loan.

Request for Comment

156(a). Are the proposed requirements for a qualifying CRE loan appropriate? 156(b). Are these standards sufficient to ensure that qualifying CRE loans have very low credit risk?

157. Are the DSC metrics employed for measuring a borrower's financial capacity, and the specified parameter for each type of CRE property, an appropriate standard?

158. The Agencies are proposing the same DSC ratio (1.5) for qualifying leased CRE loans and qualifying multifamily CRE loans, where the DSC analysis is based on at least two years of actual performance. The Agencies request comment whether the risk of default for qualifying non-Enterprise multifamily CRE loans is demonstrably lower as to justify a lower DSC ratio (such as 1.3). For example, the Agencies acknowledge that several highly-publicized defaults on large multifamily CRE loans had a much weaker structure (e.g., pro-forma underwritten DSC ratio or DSC ratio lower than 1.2) than what is contained in the proposed rules. Commenters should provide relevant criteria to be applied to qualify for a reduced DSC ratio and multifamily CRE loan performance data supporting the conclusion that multifamily loans meeting such criteria, as a class, have a correspondingly reduced risk of default to support a reduced DSC ratio for such loans.

D. Qualifying automobile loans

§__.20 of the proposed rules provides underwriting standards for qualifying automobile loans. Although automobile loans involve secured financing, the collateral represents a highly depreciable asset. Accordingly, in developing the proposed underwriting standards for qualifying automobile loans, the Federal banking agencies sought to establish conservative requirements that are consistent with underwriting standards commonly used by the industry for unsecured installment credits. The proposed rules define an automobile loan as a loan to an individual to finance the purchase of, and secured by a first lien on, a passenger car or other passenger vehicle, such as a minivan, van, sport-utility vehicle, pickup truck, or similar light truck for personal, family, or household use. Under the proposed rules, an automobile loan would not include: (a) any loan to finance fleet sales; (b) a personal cash loan secured by a previously purchased automobile; (c) a loan to finance the purchase of a commercial vehicle or farm equipment that is not used for personal, family, or household purposes; (d) any lease financing; or (e) a loan to finance the purchase of a vehicle with a salvage title.[175] A qualifying automobile loan may be for a new[176] or used vehicle.[177]

[175] Under the proposed rules, a new vehicle is one that is not a used vehicle and has not been previously sold to an end user. A used vehicle is any vehicle driven more than the limited use necessary in transporting or road testing the vehicle prior to the initial sale of the vehicle and does not include any vehicle sold only for scrap or parts (title documents surrendered to the State and a salvage certificate issued). Salvage title is a form of vehicle title branding by an insurance company paying a claim on the vehicle, where the vehicle title notes that the vehicle has been severely damaged and/or deemed a total loss and uneconomical to repair.
[176] A new vehicle is one that is not a used vehicle and has not been previously sold to an end user.
[177] A used vehicle is any vehicle driven more than the limited use necessary in transporting or road testing the vehicle prior to the initial sale of the vehicle and does not include any vehicle sold only for scrap or parts (title documents surrendered to the State and a salvage certificate issued).

1. Ability to repay

A borrower's ability to repay an automobile loan primarily hinges on the amount of the borrower's monthly total debt obligations in relation to the borrower's monthly income. The Agencies have sought to establish standards for the verification and documentation of a borrower's ability to repay an automobile loan that will help ensure that the loan is of very low credit risk. At the same time, the proposed standards seek to reflect the nature of automobile loans and allow originators to make qualifying automobile loans without undue burden or disruption to existing methods for making automobile loans. For example, originators of automobile loans typically do not verify all of a borrower's income and debt obligations prior to making an automobile loan and requiring an originator to do so could significantly limit any incentive an originator might otherwise have to underwrite loans in accordance with the standards for a qualifying automobile loan. The Federal banking agencies have sought to balance these considerations in developing the proposed underwriting standards.

Under the proposed rules, the borrower under a qualifying automobile loan must have a monthly DTI ratio of less than or equal to 36 percent, consistent with the proposed DTI ratio requirement for QRM loans. The originator must make this determination, and document the underlying analysis, upon origination of the loan.

Originators typically consider a borrower's income and debts in the credit approval process; however, the income history requirements of and the type of information considered by the originator vary widely across the industry. The Agencies believe that the use of consistent underwriting standards, to the extent practical and consistent with industry practice, should reduce implementation burden and ensure that all ABS issuances that qualify for an exemption from the risk retention requirement of the proposed rules are collateralized by high-quality, low credit risk loans. Based on the Federal banking agencies' supervisory experience in overseeing automobile lending, and in an effort to address these inconsistencies, the Federal banking agencies propose to require that originators verify and document the borrower's income using payroll stubs, tax returns, profit and loss statements, or other similar documentation, and that originators verify that all outstanding debts reported in a borrower's credit report are incorporated into the calculation of the borrower's ratio of total debt to monthly income (DTI ratio). For the borrower's monthly debt obligations, the Agencies propose to require the originator to obtain information from the borrower about all monthly housing payments (rent- or mortgage-related, including any property taxes, insurance, and home owners association fees), plus any of the following that are dependent on the borrower's income for payment: (1) monthly payments on all debt and lease obligations (such as installment loans or credit card loans), including the monthly amount due on the automobile loan; (2) estimated monthly amortizing payments for any term debt, debts with other than monthly payments, and debts not in repayment (for example, deferred student loans, interest-only loans); and (3) any required monthly alimony, child support, or court-ordered payments. These elements are generally consistent many of the elements taken into account for the DTI requirement for the QRM standards

2. Loan terms

The Federal banking agencies have found that, in supervising credit risk for such highly depreciable assets as automobiles, a fixed payment amount helps ensure that a borrower will have the ability to repay a loan over the life of the credit. Therefore, the proposed rules require qualifying automobile loans to provide for a fixed interest rate. In addition, under the proposal, the monthly payment must be calculated using straight-line amortization for the term of the loan, not to exceed five years, with the first payment due within 45 days of the closing date. The proposed rules also prohibit loan terms that permit a borrower to defer repayment of principal or interest.

If the loan is for a new vehicle, the proposal would require the loan agreement provide a maturity date for the loan that does not exceed 5 years from the date of closing. If the loan is for a used vehicle, the loan agreement must provide that the term of the loan, plus the difference between the current model year and the vehicle's model year, cannot exceed 5 years. In addition, under the proposed rules, the transaction documents must require that the originator, subsequent holder of the loan, or any agent of the originator or subsequent holder maintain physical possession of the vehicle title until the loan is repaid in full and the borrower has satisfied all obligations under the loan agreement.

3. <u>Reviewing credit history</u>

The supervisory experience of the Federal banking agencies has shown that the historical payment performance of a borrower often is indicative of the borrower's ability to manage debt and willingness to repay a new loan. Accordingly, the proposed rules require the originator to verify and document, within 30 days of the origination date for a qualifying automobile loan, that the borrower (1) is not currently 30 days or more past due, in whole or in part, on any debt obligation and (2) has not been 60 days or more past due on, in whole or in part, on any debt obligation within the past 24 months. Additionally, the originator must verify and document that, within the previous 36 months, the borrower was not a debtor in any bankruptcy proceeding, subject to a Federal or State judgment for collection of any unpaid debt or foreclosure, repossession, deed in lieu of foreclosure, or short sale, and has not had any personal property repossessed. These credit history standards are the same as those established for QRMs.

Similar to the safe harbor proposed in §__.15 of the proposed rules for the QRM requirements, the Federal banking agencies are proposing a safe harbor that would allow an originator to satisfy the documentation and verification requirements regarding a borrower's credit history. Under the proposal, an originator of a qualifying automobile loan will be deemed to have complied with the verification and documentation requirements related to the borrower's credit history (as described above) if, no more than 90 days before the automobile loan closing, the originator (1) obtains a credit report regarding the borrower from at least two consumer reporting agencies that compile and maintain files on consumers on a nationwide basis (within the meaning of 15 U.S.C. 1681a(p)); and (2) determines, based on the information in such credit reports, that the borrower meets the credit history requirements related described above. This safe harbor would not be available if the originator obtains a subsequent credit report before the closing of the automobile loan transaction that indicates that the borrower does not meet the credit history requirements.

4. <u>Loan-to-value</u>

Limitations relative to the amount financed are critical for automobile lending because the collateral is subject to such rapid depreciation. Therefore, under the proposed rules, an originator must document that, at the time of the closing of the automobile loan, the borrower tendered a minimum down payment from the borrower's personal funds and trade-in allowance,[178] if any, that is sufficient to pay (1) the full cost of vehicle title, tax, and registration fees, as well as any dealer-imposed fees, and (2) 20 percent of the purchase price of the automobile. Under §__.16 of the proposed rules, the purchase price of a new automobile is the net amount the consumer paid for the vehicle after any manufacturer, dealer, or financing incentive payments or cash rebates are applied. However, for a used automobile, the purchase price is the lesser of either the actual purchase price or the value of the automobile, as determined by a nationally recognized automobile pricing agency (for example, N.A.D.A. or Kelley Blue Book) based on the manufacturer, year, model, features, and condition of the vehicle.

An illustration of how to determine the minimum down payment is provided below.

Down Payment Determination

30,000	Invoice Purchase Price
2,000	Manufacturer Cash Rebate
1,000	Dealer Incentive
27,000	Purchase Price
5,400	20% of Purchase Price
2,700	Tax, Title, and License
8,100	Down Payment Requirement
$18,900	Maximum Loan Amount

Request for Comment

159(a). Are the proposed requirements for a qualifying automobile loan appropriate? 159(b). Are these standards sufficient and appropriate to ensure that qualifying automobile loans have very low credit risk?

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[178] Under §__.16 of the proposed rules, a trade-in allowance is the amount a vehicle purchaser is given as a credit at the purchase of a vehicle for the fair exchange of the borrower's existing vehicle to compensate the dealer for some portion of the vehicle purchase price, except that such amount shall not exceed the trade-in value of the used vehicle, as determined by a nationally recognized automobile pricing agency and based on the manufacturer, year, model, features, and condition of the vehicle.

160. Are the DTI ratios employed for measuring a borrower's financial capacity an appropriate standard?

E. Buy-back requirements for ABS issuances collateralized exclusively by qualifying commercial, CRE or automobile loans

Under the proposed rules, for a securitizer to qualify for a zero percent risk retention requirement under §__.18, §__.19 or §__.20, as applicable, the depositor must have (and certify that it has) effective internal supervisory controls with respect to its process for ensuring that all assets that collateralize the ABS meet the applicable underwriting standards set forth in §__.18, §__.19 or §__.20, as applicable, of the proposed rules. The Federal banking agencies recognize that, despite the use of reasonable processes and procedures by a depositor or sponsor, it is possible that one or more loans included in a securitization transaction may later be determined to have not met the underwriting standards set forth in §__.18, §__.19 or §__.20, as applicable, of the proposed rules due to inadvertent error. For example, an originator conducting post-origination file reviews for compliance or internal audit purposes may find that some aspects of the documentation required to verify the borrower's monthly income were not obtained. The Agencies are concerned that if an error that is discovered after closing of the securitization were to make the issuance ineligible for the proposed exemption, then sponsors and investors may well be less willing to participate in securitization transactions that are structured to meet the underwriting standards of §__.18, §__.19 or §__.20, as applicable, of the proposed rules. On the other hand, if there is no penalty for including in a securitization transaction a loan that does not meet such underwriting standards, sponsors and other participants in the securitization may not have the proper incentives to ensure that the issuance is collateralized exclusively by qualifying commercial, CRE, or automobile loans.

The proposal seeks to balance these interests by providing that a sponsor that has relied on an exemption from the retention requirement under §__.18, §__.19 or §__.20, as applicable, of the proposed rules would not lose the exemption, if, after closing of the securitization transaction, it is determined that one or more of the loans collateralizing the ABS do not meet all of the applicable criteria under §__.18, §__.19 or §__.20, as applicable, of the proposed rules provided that:

(a) The depositor certified the effectiveness of its internal supervisory controls for ensuring all of the loans backing the ABS are qualified loans under §__.18, §__.19 or §__.20, as applicable, of the proposed rules;

(b) The sponsor repurchases the loan(s) determined to not meet the underwriting standards set forth in §__.18, §__.19 or §__.20, as applicable, of the proposed rules from the issuing entity at a price at least equal to the remaining principal balance and accrued interest on the loan(s) no later than ninety (90) days after the determination that the loans do not satisfy the underwriting standards set forth in §__.18, §__.19 or §__.20, as applicable, of the proposed rules; and

(c) The sponsor discloses to the investors of the ABS any loan(s) that are repurchased by the sponsor, including the principal amount of such repurchased loan(s) and the cause for such repurchase.

These conditions, which are identical to those applicable to QRMs, are intended to provide the sponsor with the opportunity to correct inadvertent errors by repurchasing any non-qualified loan(s) and removing such non-qualifying loan(s) from the ABS, while protecting investors. Moreover, in light of the buy-back requirement, sponsors should continue to have a strong economic incentive to ensure that all loans backing a securitization subject to zero risk retention under §__.18, §__.19 or §__.20, as applicable, of the proposed rules satisfy all of the conditions applicable to such loans under §__.18, §__.19 or §__.20, as applicable, of the proposed rules.

Request for Comment

161(a). The Agencies seek comment on whether the sponsor should be required to repurchase the entire pool of loans collateralizing the ABS if the amount or percentage of the loans that are required to be repurchased due to the failure to meet the underwriting standards under §__.18, §__.19 or §__.20, as applicable, of the proposed rules reaches a certain threshold. 161(b). If so, what threshold would be appropriate?

VI. General Exemptions

Section 15G(c)(1)(G) and section 15G(e) of the Exchange Act require the Agencies to provide a total or partial exemption from the risk retention requirements for certain types of ABS or securitization transactions. In addition, section 15G(e)(1) permits the Federal banking agencies and the Commission jointly to adopt or issue additional exemptions, exceptions, or adjustments to the risk retention requirements of the rules, including exemptions, exceptions, or adjustments for classes of institutions or assets, if the exemption, exception, or adjustment would: (A) help ensure high quality underwriting standards for the securitizers and originators of assets that are securitized or available for securitization; and (B) encourage appropriate risk management practices by the securitizers and originators of assets, 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.[179]

Consistent with these provisions, section ___.21 of the proposed rules exempts certain types of ABS or securitization transactions from the credit risk retention requirements of the rule. Certain of these exemptions would appear in the rules of all Agencies, and others would appear only in the rules of certain Agencies, reflecting the different scope of the Agencies' rulewriting authority.

A. Exemption for federally insured or guaranteed residential, multifamily, and health care mortgage loan assets

Proposed § ___.21(a)(1) would implement section 15G(e)(3)(B) of the Exchange Act, which exempts from the risk retention requirements any residential, multifamily, or health care facility mortgage loan asset, or securitization based directly or indirectly on such an asset, that is

[179] See 15 U.S.C. § 78o-11(e)(1) and (2).

insured or guaranteed by the United States or an agency of the United States.[180] Section 15G expressly clarifies that Fannie Mae, Freddie Mac, and the Federal Home Loan Banks are not agencies of the United States,[181] and the proposed rules include a specific provision making clear that the exemptions that apply to ABS that is issued, guaranteed or insured by a U.S. government agency or that is backed by loans insured or guaranteed by a U.S. government agency do not apply where the issuer, insurer or guarantor is Fannie Mae, Freddie Mac, or a Federal Home Loan Bank.[182]

Proposed § ___.21(a)(1)(i) would exempt any securitization transaction that is collateralized solely (excluding cash and cash equivalents) by residential, multifamily, or health care facility mortgage loan assets if the assets are insured or guaranteed as to the payment of principal and interest by the United States or an agency of the United States. Currently, the federal government insures or guarantees residential, multifamily, and healthcare facility loans through a variety of programs. Some examples include FHA insurance on single family mortgage loans which insures the lender at approximately 100 percent of losses including advanced taxes, insurance and foreclosure costs. The Department of Veterans Administration also guarantees between 25 percent and 50 percent of lender losses in the event of residential borrower defaults. United States Department of Agriculture Rural Development also guarantees a sliding amount against loss of up to 90 percent of the original loan amount for single family loans. Each of the agencies sets underwriting and servicing standards, and in the case of some multifamily programs underwrites the mortgage itself. The agencies charge a fee or premium for the insurance/guaranty, and monitor the performance of participating lenders and borrowers.

Proposed § ___.21(a)(1)(ii) would exempt any securitization transaction that involves the issuance of ABS if the ABS are insured or guaranteed as to the payment of principal and interest by the United States or an agency of the United States and that are collateralized solely (excluding cash and cash equivalents) by residential, multifamily, or health care facility mortgage loan assets, or interests in such assets. Thus, proposed § __.21(a)(1)(ii) would exempt ABS the payment of principal and interest on which is guaranteed by the United States or an agency of the United States and that is collateralized by ABS that itself is backed by residential, multifamily, or health care facility mortgage loan assets. Examples of securitization transactions that would be exempted under § __.21(a)(1)(ii) include securities guaranteed by the Government National Mortgage Association (Ginnie Mae). Ginnie Mae guarantees the issuance of securities by approved lender/issuers. These mortgage-backed securities (MBS) are collateralized solely by federally insured or guaranteed loans. The insurance or guarantee protects the lender from some or all of the credit loss on the loan in the event of a borrower default. Upon issuance of the security, the issuer is obligated to advance from its own funds principal and interest to the investors if the borrower fails to pays the mortgage. Ginnie Mae guarantees to the investors that, in the event the issuer defaults on this obligation, Ginnie Mae will ensure the investors are paid.

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[180] See 15 U.S.C. 78o-11(e)(3)(B).
[181] See 15 U.S.C. 78o-11(c)(1)(G)(ii), (e)(3)(B).
[182] See section 15 U.S.C. 78o-11(c)(1)(G) and (e)(3)(B) and the proposed rules at § __.21(c). At this time, the Federal Home Loan Banks do not, and are not authorized to, issue or guarantee asset-backed securities. Similarly, neither Fannie Mae, Freddie Mac, nor the Federal Home Loan Banks insure or guarantee individual loans, and none is authorized to do so. These references are included in § ___.21(c) in order to conform the rule of construction to that which is required by section 15G(e)(3) of the Exchange Act.

Ginnie Mae provides a similar guarantee for Real Estate Mortgage Investment Conduits (REMICs) and Platinum Securities, which are collateralized by Ginnie Mae MBS.

Although, historically, federally insured/guaranteed loans have been securitized largely through Ginnie Mae, and Ginnie Mae is statutorily restricted to guaranteeing only securities collateralized by federally insured/guaranteed loans, this regulation would exempt a private securitization from risk retention to the extent it is collateralized solely by loans with federal insurance or guarantees. In addition, in cases where private securitization may be used the proposed rules do not limit the exemption based on the federal housing program involved or the nature of the government's insurance or guaranty coverage.

Request for Comments

162(a). Have the Agencies appropriately implemented the exemption in section 15G(e)(3)(B) of the Exchange Act? 162(b). Why or why not?

163. Are we correct in believing the federal department or agency issuing, insuring, or guaranteeing the ABS or collateral will monitor the quality of the assets securitized?

164(a). While it appears that Congress may have intended to exempt all existing federal insurance or guarantee programs for residential, multifamily, or health care facility mortgage loans, comments are requested on the proposed rules where private securitization may be used in the following areas. Are there risks in exempting assets or ABS that are not significantly insured or guaranteed by a federal agency? 164(b). If so, what level of federal guarantee or insurance should be required? 164(c). Would inclusion of additional requirements be appropriate in the public interest and for the protection of investors? 164(d). Why or why not? 164(e). Would inclusion of additional requirements be disruptive to any federal guarantee or insurance programs established or authorized by Congress? 164(f). If so, how and to what extent?

B. Other exemptions

Section 15G(c)(1)(G)(ii) of the Exchange Act separately requires the rules of the Agencies to provide for a total or partial exemption from risk retention requirements for securitizations of assets that are issued or guaranteed by the United States or an agency of the United States as the Federal banking agencies and the Commission jointly determine appropriate in the public interest and the protection of investors.[183] This exemptive authority is broader than the statutory exemption in section 15G(e)(3)(B) because it permits the exemption of any securitization of assets that are issued or guaranteed by the United States or any agency of the United States (and not just those based on residential, multifamily, or health care facility mortgage loan assets). Proposed § __.21(b)(1) fully exempts any securitization transaction if the asset-backed securities issued in the transaction are (i) collateralized solely (excluding cash and cash equivalents) by obligations issued by the United States or an agency of the United States; (ii) collateralized solely (excluding cash and cash equivalents) by assets that are fully insured or guaranteed as to the payment of principal and interest by the United States or an agency of the

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[183] See 15 U.S.C. 78o-11(c)(1)(G).

United States (other than those referred to in paragraph (a)(1)(i) of this section);[184] or (iii) fully guaranteed as to the timely payment of principal and interest by the United States or any agency of the United States.. This exemption is being proposed because payments of principal and interest on the ABS, or on the collateral backing the ABS, would be backed by the United States or an agency of the United States and, thus, the exemption should be appropriate in the public interest and for the protection of investors. The federal department or agency issuing, insuring or guaranteeing the ABS or collateral would monitor the quality of the assets securitized, consistent with the relevant statutory authority.[185]

Proposed § __.21(a)(2) provides an exemption from the risk retention requirements of the rules for any securitization transaction that is collateralized solely (excluding cash and cash equivalents) by loans or other assets made, insured, guaranteed, or purchased by any institution that is subject to the supervision of the Farm Credit Administration, including the Federal Agricultural Mortgage Corporation. This provision implements the exemption for these types of assets included in section 15G(e)(3)(A) of the Exchange Act.[186]

Section 15G(c)(1)(G)(iii) requires that the rules of the Agencies provide a total or partial exemption for an ABS if the security is (i) issued or guaranteed by any State of the United States, or by any political subdivision of a State or territory, or by any public instrumentality of a State or territory that is exempt from the registration requirements of the Securities Act by reason of section 3(a)(2) of the Securities Act[187] or (ii) defined as a qualified scholarship funding bond in section 150(d)(2) of the Internal Revenue Code of 1986.[188] In light of the special treatment afforded such securities by Congress, the directive in section 15G(c)(1)(G)(iii), and the role of the State or municipal entity in issuing, insuring, or guaranteeing the ABS or collateral, the Agencies are proposing to exempt such ABS form the risk retention requirements of the rule as an exemption that is appropriate in the public interest and for the protection of investors.[189]

Request for Comments

165(a). Have the Agencies appropriately implemented the exemption in section 15G(e)(3)(A) of the Exchange Act and the exemptive authority in section 15G(c)(1)(G)(ii) and (iii)? 165(b). Why or why not?

166(a). Is the proposed exemption for ABS issued or guaranteed by a State or municipal entity appropriate? 166(b). Is it under or over-inclusive? 166(c). There may be some ABS in which the sponsor is a municipal entity (i.e., a State or Territory of the United States, the District of Columbia, any political subdivision of any State, Territory or the District of Columbia, or any

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[184] To avoid confusion, the proposed rules provide that these assets do not include the types of federally insured or guaranteed residential, mortgage, and health care mortgage loan assets that are covered by the exemption in proposed § __.21(a).

[185] See 12 U.S.C. 78o-11(e)(2).

[186] See 15 U.S.C. 78o-11(e)(3)(A).

[187] 15 U.S.C. 77c(a)(2).

[188] See 26 U.S.C. 150(d)(2). Such bonds are those issued by a not-for-profit corporation established and operated exclusively for the purpose of acquiring student loans incurred under the Higher Education Act of 1965, and organized at the request of a State or a political subdivision of a State. See 10 U.S.C. chapter 28.

[189] See §§ ___.21(a)(3) and (4) of the proposed rules.

public instrumentality of one or more States, Territories or the District of Columbia), however, the ABS are issued by a special purpose entity, that is created at the direction of the municipal entity, but are not issued or guaranteed by the municipal entity. Should the rules also exempt from the risk retention requirements asset-backed securities where the sponsor is a municipal entity? 166(d). There are some municipal ABS that are issued by a municipal entity and exempt by reason of Section 3(a)(2) of the Securities Act but may include assets originated using the same underwriting criteria as private label securitizations. Should the rules, as proposed, exempt them?

167(a). Are there any ABS that are collateralized solely by obligations issued by the United States or an agency of the United States where the process of packaging and securitizing those obligations may raise issues that the risk retention requirement was designed to address? 167(b). For example, would a securitization by a non-governmental securitizer of debt issued by the Tennessee Valley Authority raise any issues such that the Agencies should provide only a partial exemption? 167(c). If so, what type of transactions and how should the Agencies determine the amount and form of risk retention to be required?

C. Exemption for certain resecuritization transactions

Section ___.21(a)(5) of the proposed rules would exempt from the credit risk retention requirements certain resecuritization transactions that meet two conditions.[190] First, the transaction must be collateralized solely by existing ABS issued in a securitization transaction for which credit risk was retained as required under the rule or which was exempted from the credit risk retention requirements of the rule (hereinafter 15G-compliant ABS). Second, the transaction must be structured so that it involves the issuance of only a single class of ABS interests and provides for the pass-through of all principal and interest payments received on the underlying ABS (net of expenses of the issuing entity) to the holders of such class. The holder of a resecuritization ABS structured as a single-class pass-through has a fractional undivided interest in the pool of underlying ABS and in the distributions of principal and interest (including prepayments) from these underlying ABS. Accordingly, the principal and interest payments allocated to each holder are identical (less any fees associated with the resecuritization) to those that would occur if that holder were to hold individual securities representing the same fractional interest in each of the underlying ABS.[191] Thus, a resecuritization ABS structured as a single-class pass-through would not alter the level or allocation of credit risk and interest rate risk on the underlying ABS.

The Agencies propose to adopt this exemption under the general exemption provisions of section 15G(e)(1) of the Exchange Act. Under that provision, the Agencies may jointly adopt or

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[190] In a resecuritization transaction, the asset pool underlying the ABS issued in the transaction comprises one or more asset-backed securities. In this section, we refer to the securities issued in a resecuritization transaction as "resecuritization ABS."
[191] According to the staff of the FHFA, Fannie Mae Mega Certificates are an example of a single-class pass-through resecuritization. FHFA staff have indicated that these certificates represent a fractional undivided beneficial ownership interest in the pool of underlying ABS (typically MBS, REMICs and other Mega Certificates) and in the principal and interest distributions from those underlying ABS. The proposed exemption in § __.21(a)(5) of the proposed rules would be available to any sponsor of a securitization transaction that is structured in accordance with the rule's requirements.

issue exemptions, exceptions, or adjustments to the risk retention rules, if such exemption, exception, or adjustment would: (A) help ensure high quality underwriting standards for the securitizers and originators of assets that are securitized or available for securitization; and (B) encourage appropriate risk management practices by the securitizers and originators of assets, 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.[192] As noted above, all of the ABS underlying a resecuritization that would be exempted under proposed § ___.21(a)(5) would already have been issued in a securitization transaction in which the sponsor has retained credit risk in accordance with the rule, or for which an exemption from the rule was available. Accordingly, the resecuritization of a single-class pass-through would neither increase nor reallocate the credit risk inherent in that underlying 15G-compliant ABS. Furthermore, because this type of resecuritization may be used to combine 15G-compliant ABS backed by smaller asset pools, the exemption for this type of resecuritization could improve the access of consumers and businesses to credit on reasonable terms by allowing for the creation of an additional investment vehicle for these smaller pools. The exemption would allow the creation of ABS that may be backed by more geographically diverse pools than those that can be achieved by the pooling of individual assets as part of the issuance of the underlying 15G-compliant ABS, which could also improve access to credit on reasonable terms.

Under the proposed rules, sponsors of resecuritizations that are not structured purely as single-class pass-through transactions would be required to meet the credit risk retention requirements with respect to such resecuritizations unless another exemption for the resecuritization is available, regardless of whether the sponsor of the initial securitization transaction retained credit risk under the rule or whether an exemption applied to the initial securitization transaction. Thus, resecuritizations that re-tranche the credit risk of the underlying ABS would be subject to separate risk retention requirements under the proposed rules.[193] Similarly, under the proposed rules, resecuritizations that re-tranche the prepayment risk of the underlying ABS, or that are structured to achieve a sequential paydown of tranches, would not be exempted. In these resecuritizations, although losses on the underlying ABS would be allocated to holders in the resecuritization on a pro rata basis, holders of longer duration classes in the resecuritization could be exposed to a higher level of credit risk than holders of shorter duration classes.

Section 15G does not apply to ABS issued before the effective date of the Agencies' final rules.[194] As a practical matter, private-label ABS issued before the effective date of the final

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[192] 15 U.S.C. § 78o-11(e)(1).

[193] For example, under the proposed rules, the sponsor of a collateralized debt obligation (CDO) would not meet the proposed conditions of the exemption and therefore would be required to retain risk in accordance with the rule with respect to the CDO, regardless of whether the underlying ABS have been drawn exclusively from 15G-compliant ABS. See 15 U.S.C. § 78o-11(c)(1)(F). In a typical CDO transaction, a securitizer pools interests in the mezzanine tranches from many existing ABS and uses that pool to collateralize the CDO. Repayments of principal on the underlying ABS interests are allocated so as to create a senior tranche, as well as supporting mezzanine and equity tranches of increasing credit risk. Specifically, as periodic principal payments on the underlying ABS are received, they are distributed first to the senior tranche of the CDO and then to the mezzanine and equity tranches in order of increasing credit risk, with any shortfalls being borne by the most subordinate tranche then outstanding.

[194] See 15 U.S.C. § 78o-11(i) (regulations become effective with respect to residential mortgage-backed ABS 1 year after publication of the final rules in the Federal Register, and 2 years for all other ABS).

rules will typically not be 15G-compliant ABS, because such ABS will not have been structured to meet the rule's risk retention requirements. ABS issued before the effective date that meets the terms of an exemption of the type proposed under __.21 (General exemptions) or __.11 (Fannie Mae and Freddie Mac ABS) could serve as 15G-compliant ABS.

Request for Comment

168(a). Are there other types of resecuritization transactions backed solely by 15G-compliant ABS that should be exempt from the risk retention requirements? 168(b). If so, what principles and factors should the Agencies use in considering whether other types of resecuritizations backed by 15G-compliant ABS should be exempted from the risk retention requirements of section 15G? 168(c). Should the Agencies consider granting an exemption only if it is clear that the resecuritization transaction does not expose investors in the resecuritization to different levels or types of credit risk in the securitized assets than the underlying 15G-compliant ABS?

169(a). Should the rule provide an exemption for a sequential-pay resecuritization that is collateralized only by 15G-compliant ABS? In this type of resecuritization, the rights to principal repayment of the holders of the different classes differ solely with respect to the timing of such repayments. Longer duration classes receive no payments of principal until shorter duration classes have been paid off in full and principal shortfalls are allocated on a pro-rata basis based upon the unpaid principal balance of each class. As the shorter duration classes are paid off, the unpaid principal balances of the longer duration classes begin to represent a larger portion of the total unpaid principal balances of the underlying ABS and, therefore, the longer duration classes are allocated an ever-increasing percentage of credit losses as the ABS matures. 169(b). If an exemption for sequential-pay resecuritizations backed by 15G-compliant ABS is appropriate, how could such an exemption be written to ensure the exemption is limited to this particular structure?

170(a). Should the Agencies provide an exemption for prepayment-tranched resecuritizations that are backed solely by 15G-compliant ABS? This form of resecuritization involves the sponsor of the resecuritization creating tranches based on the prepayments of the underlying ABS (i.e.., prepayments received by the ABS in the first-level ABS securitization). One type of prepayment-tranched resecuritization is a planned amortization class (PAC) resecuritization. PAC bonds receive principal payments based on the level of prepayments and will have their expected duration if the actual speed of prepayments on the underlying ABS falls within a designated range. In order to create a PAC bond with greater certainty of cash flow than the underlying ABS, one or more support (SUP) classes that are highly sensitive to varying levels of prepayment are created as part of the same transaction. If the rate of prepayments is faster than that assumed in the creation of the PAC, the SUPs receive more principal in order to prevent an overpayment of principal on the PAC. If the rate of prepayment is slower, principal is redirected from the SUPs in order to achieve the specified repayment schedule on the PAC. In either case, credit losses are allocated on a pro rata basis based on the unpaid principal balance attributable to each class. Accordingly, the effect of faster-than-expected rates of prepayment will tend to expose holders of the PAC bonds to relatively greater losses than the holders of the SUPs, while slower-than-expected rates of prepayment will tend to have the opposite effect. Moreover, in transactions where more than one PAC bond is created, the distribution of principal repayments to the PACs are based on priority and, therefore, the holders of the PACs are exposed to levels of credit risk that differ from that of the underlying ABS. 170(b). If an exemption of prepayment-tranched resecuritizations or certain types of such resecuritizations (such as PAC structures) is appropriate, how could an exemption be written to ensure that the exemption does not extend to other resecuritizations?

171. As noted above, the proposed exemptions require the underlying ABS be 15G-compliant ABS. In practice, initially this may mean that only resecuritizations based on ABS guaranteed by Fannie Mae and Freddie Mac will qualify for this exemption. Does this raise any competitive or other issues and if so, how can they be mitigated without eliminating the requirement there be risk retention on the underlying ABS?

172(a). Is the proposed language for this exemption appropriate? 172(b). Does any portion of the exemption cause an ambiguity that should be addressed?

D. Additional exemptions

Consistent with section15G of the Exchange Act, § __.23(b) of the proposed rules provides that the Federal banking agencies and the Commission, in consultation with FHFA and HUD, may jointly adopt or issue additional exemptions, exceptions or adjustments to the credit risk retention requirements, including exemptions, exceptions or adjustments for classes of institutions or assets in accordance with section 15G(e).[195] In addition, § __.23(a) of the proposed rules recognizes that the Agencies with rulewriting authority under section 15G(b)[196] with respect to the type of assets involved may jointly provide a total or partial exemption of any individual securitization transaction, as such Agencies determine may be appropriate in the public interest and for the protection of investors, as permitted by section 15G(c)(1)(G)(i).[197] The Agencies expect to coordinate with each other to facilitate the processing, review and action on requests for such written interpretations or guidance, or additional exemptions, exceptions or adjustments.

Request for Comments

173(a). Are there securitization transactions that would not be covered by the exemptions in the proposed rules that should be exempted from risk retention requirements pursuant to section 15G(e)(3) of the Exchange Act? 173(b). If so, what are the features and characteristics of such securitization transactions that would properly exempt them from risk retention requirements pursuant to section 15G(e)(3)?

E. Safe harbor for certain foreign-related transactions

The proposed rules include a safe harbor provision for certain predominantly foreign transactions based on the limited nature of the transactions' connections with the United States and U.S. investors. The proposed safe harbor is intended solely to provide clarity that the

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[195] 15 U.S.C. § 78o-11(e).
[196] 15 U.S.C. § 78o-11(b).
[197] 15 U.S.C. § 78o-11(c)(1)(G)(i).

Agencies would not apply the requirements of the proposed rules to transactions that meet all of the conditions of the safe harbor. The proposed safe harbor should not be interpreted as reflecting the views of any Agency as to the potential scope of transactions or persons subject to section 15G or the proposed rules.

As set forth in section ___.23 of the proposed rules, the safe harbor provides that the rule's risk retention requirements would not apply to a securitization transaction if certain conditions are met, including: (i) the securitization transaction is not required to be and is not registered under the Securities Act; (ii) no more than 10 percent of the dollar value by proceeds (or equivalent if sold in a foreign currency) of all classes of ABS interests sold in the securitization transaction are sold to U.S. persons or for the account or benefit of U.S. persons;[198] (iii) neither the sponsor of the securitization transaction nor the issuing entity is (A) chartered, incorporated, or organized under the laws of the U.S., or a U.S. State or Territory or (B) the unincorporated branch or office located in the U.S. of an entity not chartered, incorporated, or organized under the laws of the U.S., or a U.S. State or Territory (collectively, a U.S.-located entity); (iv) no more than 25 percent of the assets collateralizing the ABS sold in the securitization transaction were acquired by the sponsor, directly or indirectly, from a consolidated affiliate of the sponsor or issuing entity that is a U.S.-located entity.[199]

The safe harbor is intended to exclude from the proposed risk retention requirements transactions in which the effects on U.S. interests are sufficiently remote so as not to significantly impact underwriting standards and risk management practices in the United States or the interests of U.S. investors. Accordingly, the conditions for use of the safe harbor limit involvement by persons in the U.S. with respect to both assets being securitized in a transaction and the ABS sold in connection with the transaction. The safe harbor would not be available for any transaction or series of transactions that, although in technical compliance with the conditions of the safe harbor, is part of a plan or scheme to evade the requirements of section 15G and the proposed rules.

<u>Request for Comment</u>

174(a). Are there any extra or special considerations relating to these circumstances that we should take into account? 174(b). Should the more than 10 percent proceeds trigger be higher or lower (<u>e.g.</u>, 0 percent, 5 percent, 15 percent, or 20 percent)?

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[198] The proposed rules include a definition of "U.S. person" that is substantially the same as the definition of "U.S. person" in the Commission's Regulation S, although Regulation S relates solely to the application of section 5 of the Securities Act (12 U.S.C. § 77e). <u>See</u> proposed rules at § ___.23 and 17 CFR 203.902(k). Additionally, 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. <u>See</u> Securities Act Rules 801 and 802 (17 CFR 230.801 and 802).

[199] <u>See</u> proposed rules at § ____.23.

Appendix A

The tables below show the estimated effects of the proposed QRM standards based on data for all residential mortgage loans purchased or securitized by the Enterprises between 1997 and 2009. The first set of results shows rates of serious delinquency (SDQ), that is, loans that are 90 days or more delinquent, or are in the process of foreclosure. The second set of results shows volume, in dollars of unpaid principal balance (UPB).

Because the data that FHFA routinely receives from the Enterprises does not include all the factors needed to identify QRM eligible loans, the universe of loans within the data set that would qualify as a QRM under the proposed standards was estimated based on four of the most significant QRM elements: (i) product type (i.e. excluding non-owner occupied loans, low or no documentation loans, interest-only or negative amortization loans, loans with balloon payments, and ARM loans that permit payment shocks in excess of the range permitted by the proposed QRM standards); (ii) front-end and back-end DTI ratios; (iii) LTV ratios; and (iv) credit history.

Because of data limitations, proxies were used for certain of these QRM standards. FHFA does not have individual credit items in the data set used for analysis, such as previous bankruptcies or foreclosures involving the borrower, or current or recent borrower delinquencies on other debt obligations. However, borrowers with such credit issues would tend to have much lower credit scores than other borrowers (all else being equal). To proxy the credit history restrictions in the proposed QRM definition, borrowers with FICO scores below 690 were deemed to not satisfy the proposed QRM credit history standards for purposes of the analysis.

In addition, the analysis uses first-lien LTV ratios as a proxy for combined LTV when relevant. The Agencies do not believe that this proxy would produce a large discrepancy for analysis of loans originated before 2002 or after 2007, but it may understate the proposed QRM definition’s effects, both on volume and on rates of SDQ, for originations from 2002 to 2007, as second liens were increasingly used during this period. (That is, the proposed QRM definition would likely cause a greater decrease in SDQ rates and loan volumes than estimated through the use of this proxy.)

Other proposed QRM factors may differ somewhat for this analysis. The QRM proposal is based on current FHA definitions of income, and standards for full documentation of income and full appraisals. The data used in this analysis for purposes of estimating whether a loan would meet the DTI and LTV ratios in the proposed QRM standards, however, is based on Enterprise definitions of income, and Enterprise documentation and appraisal requirements that prevailed at the time the loans were originated. While there may be some circumstances in which the different standards and definitions would have led to a different QRM eligibility estimate, the Agencies do not believe that these differences would have a material impact on the analysis. For example, the Enterprises did not always require an interior appraisal in cases where the default risk was judged to be low and the down payment was substantial. While loans originated to these standards would not be QRM eligible under this proposal, it is likely that the QRM standard would induce originators to require full appraisals going forward, and thus cause these loans to be QRM eligible.

For the first set of results concerning SDQ rates, the first column shows the "QRM qualifying" population. This is the SDQ rate for all loans that are estimated as meeting the proposed QRM standards. The last column in the first set of results shows the SDQ rate for all loans purchased or securitized by the Enterprises in that year. Thus, the difference between the first and last column show the cumulative estimated effect of the set of proposed QRM standards on SDQ for that cohort of loans. The intermediate columns show the SDQ rate for the population of loans in the relevant year that are estimated to meet every QRM standard other than the standard(s) indicated at the top of the column. For example, the second column, headed Product Type, shows the estimated effect of allowing low or no documentation loans, interest-only or negative amortization loans, loans with balloon payments, or ARM loans that permit payment shocks in excess of the range permitted by the proposed QRM standards, while still prohibiting loans with credit history (as proxied through the use of credit scores), an LTV ratio, or debt-to-income ratios that would disqualify them for QRM status. These columns show the differences between the base QRM SDQ rate and the higher risk population within each column. The analysis is shown separately for all loans, for purchases, for rate and term refinances, and for cash out refinances.

The second set of results shows the volume of Enterprise mortgages purchased or securitized that are estimated to have met the proposed QRM standards. The last column shows total dollar originations purchased or securitized by the Enterprises for each year. The first column shows the percent of that volume estimated to be QRM eligible. The intermediate columns show the estimated effect on that volume for the population of loans that are estimated to meet the proposed QRM standards other than the one identified at the top of the column. For example, the second column, headed Product Type, shows the estimated effect on the percentage of Enterprise volume that would be QRM eligible by allowing loans that do not conform to the Product Type standards for QRMs,[200] while still prohibiting loans with a credit history (as proxied by credit scores), an LTV ratio, or debt-to-income ratios that would disqualify the loan for QRM status. These columns show the differences between the base QRM qualifying percentage and the higher risk population.

<u>All Loans</u>

Ever-to-Date Serious Delinquency Rates for QRMs and the Difference in Rates for Mortgages that Do Not Meet One of the Qualification Requirements

Year	QRM	Product Type	PTI/DTI	LTV	FICO	All Loans
1997	0.42%	+0.05%	+0.39%	+0.61%	+3.08%	+2.30%
1998	0.39%	+0.10%	+0.31%	+0.52%	+2.34%	+1.68%

[200] That is, low or no documentation loans, interest-only or negative amortization loans, loans with a balloon payment, or ARM loans that permit payment shocks in excess of the range permitted by the proposed QRM standards.

1999	0.44%	+0.13%	+0.34%	+0.78%	+3.12%	+2.31%
2000	0.32%	+0.43%	+0.20%	+0.83%	+2.94%	+2.77%
2001	0.31%	+0.35%	+0.27%	+0.59%	+2.52%	+2.27%
2002	0.33%	+0.41%	+0.32%	+0.73%	+2.34%	+2.09%
2003	0.55%	+0.64%	+0.66%	+1.06%	+2.95%	+2.40%
2004	0.95%	+1.72%	+1.16%	+1.58%	+4.27%	+4.33%
2005	1.86%	+5.30%	+2.36%	+2.31%	+6.46%	+8.13%
2006	2.72%	+7.49%	+3.35%	+3.73%	+7.90%	+13.93%
2007	2.37%	+6.34%	+3.59%	+4.39%	+8.66%	+17.12%
2008	0.68%	+1.48%	+1.64%	+1.68%	+5.15%	+5.94%
2009	0.04%	+0.06%	+0.11%	+0.09%	+0.50%	+0.24%
Total	0.69%	+2.99%	+1.38%	+0.99%	+3.73%	+5.27%

Percent of Total Dollar Volume for QRMs and Mortgages that Do Not Meet One of the Qualification Requirements

Year	QRM	Product Type	PTI/DTI	LTV	FICO	All Loans
1997	20.44%	+3.75%	+13.04%	+13.74%	+5.81%	$ 286,497,878,371
1998	23.29%	+2.17%	+13.30%	+17.10%	+6.24%	$ 691,033,994,509
1999	19.48%	+3.16%	+14.83%	+12.95%	+5.37%	$ 481,450,519,442
2000	16.44%	+3.70%	+17.00%	+8.40%	+4.53%	$ 356,779,731,420
2001	19.37%	+3.01%	+14.33%	+13.11%	+4.62%	$ 1,039,412,013,403
2002	22.37%	+4.28%	+15.35%	+10.72%	+4.62%	$ 1,385,056,256,240
2003	24.57%	+4.55%	+16.68%	+10.02%	+4.98%	$ 1,924,265,340,603
2004	17.03%	+6.35%	+17.68%	+6.25%	+4.34%	$ 937,643,914,289
2005	14.41%	+6.74%	+18.78%	+5.45%	+3.36%	$ 939,069,358,457

2006	11.52%	+7.11%	+17.59%	+3.91%	+2.73%	$ 887,443,942,464
2007	10.72%	+5.44%	+16.14%	+4.95%	+2.24%	$ 1,027,460,511,244
2008	17.39%	+4.64%	+22.01%	+9.22%	+2.12%	$ 793,136,249,487
2009	30.52%	+3.38%	+24.47%	+15.26%	+1.74%	$ 1,176,445,135,548
Total	19.79%	+4.62%	+17.36%	+9.86%	+3.91%	$11,925,694,845,477

<u>Purchase Loans</u>

Ever-to-Date Serious Delinquency Rates for QRMs and the Difference in Rates for Mortgages that Do Not Meet One of the Qualification Requirements

Year	QRM	Product Type	PTI/DTI	LTV	FICO	All Loans
1997	0.42%	+0.03%	+0.36%	+0.80%	+3.13%	+2.44%
1998	0.46%	+0.04%	+0.30%	+0.90%	+2.70%	+2.13%
1999	0.40%	+0.12%	+0.30%	+0.98%	+3.05%	+2.23%
2000	0.29%	+0.38%	+0.17%	+0.83%	+2.51%	+2.29%
2001	0.38%	+0.35%	+0.28%	+0.97%	+2.72%	+2.59%
2002	0.48%	+0.50%	+0.32%	+1.28%	+2.61%	+2.70%
2003	0.93%	+0.72%	+0.78%	+1.84%	+3.29%	+3.50%
2004	1.16%	+1.97%	+1.24%	+2.53%	+3.93%	+4.71%
2005	2.13%	+6.18%	+2.49%	+2.87%	+5.94%	+8.61%
2006	2.76%	+8.69%	+3.28%	+3.29%	+6.78%	+13.63%
2007	2.33%	+6.76%	+3.31%	+4.33%	+6.79%	+16.51%
2008	0.64%	+1.36%	+1.42%	+2.10%	+4.73%	+5.62%
2009	0.07%	+0.09%	+0.09%	+0.07%	+0.63%	+0.23%
Total	1.01%	+3.84%	+1.56%	+1.28%	+3.69%	+6.39%

Percent of Total Dollar Volume for QRMs and Mortgages that Do Not Meet One of the Qualification Requirements

Year	QRM	Product Type	PTI/DTI	LTV	FICO	All Loans
1997	20.74%	+4.40%	+14.02%	+12.11%	+5.55%	$ 171,316,168,314
1998	22.08%	+2.99%	+15.33%	+13.09%	+6.23%	$ 243,827,154,269
1999	19.86%	+4.02%	+17.29%	+10.39%	+4.93%	$ 252,736,885,540
2000	18.17%	+4.21%	+19.37%	+7.56%	+4.45%	$ 259,462,348,244
2001	19.57%	+4.20%	+18.76%	+7.94%	+4.92%	$ 334,671,388,428
2002	18.43%	+5.80%	+18.86%	+6.12%	+4.51%	$ 378,648,800,742
2003	18.03%	+6.81%	+19.38%	+5.32%	+4.42%	$ 428,404,858,343
2004	16.71%	+9.21%	+20.88%	+3.25%	+3.78%	$ 397,943,548,815
2005	15.67%	+10.22%	+22.25%	+2.51%	+2.92%	$ 433,917,427,310
2006	13.57%	+9.37%	+21.75%	+2.02%	+2.48%	$ 459,040,004,449
2007	12.39%	+6.88%	+19.94%	+3.27%	+1.95%	$ 504,879,485,500
2008	17.33%	+6.08%	+26.06%	+6.40%	+1.86%	$ 321,485,446,505
2009	27.06%	+7.02%	+33.83%	+8.18%	+1.89%	$ 225,983,942,704
Total	17.57%	+6.69%	+20.69%	+5.89%	+3.63%	$ 4,412,317,459,162

No Cash-Out Refinancings

Ever-to-Date Serious Delinquency Rates for QRMs and the Difference in Rates for Mortgages that Do Not Meet One of the Qualification Requirements

Year	QRM	Product Type	PTI/DTI	LTV	FICO	All Loans
1997	0.37%	+0.06%	+0.43%	+0.32%	+2.94%	+2.00%
1998	0.33%	+0.11%	+0.27%	+0.36%	+2.15%	+1.41%
1999	0.46%	+0.17%	+0.43%	+0.66%	+3.26%	+2.47%
2000	0.40%	+0.66%	+0.31%	+0.70%	+3.69%	+4.11%
2001	0.27%	+0.32%	+0.24%	+0.50%	+2.21%	+1.97%
2002	0.28%	+0.27%	+0.28%	+0.65%	+2.01%	+1.63%
2003	0.46%	+0.42%	+0.54%	+0.88%	+2.69%	+1.71%
2004	0.77%	+1.01%	+0.97%	+1.25%	+4.09%	+3.36%
2005	1.43%	+3.09%	+1.92%	+1.96%	+6.46%	+6.54%
2006	2.74%	+6.44%	+3.70%	+3.72%	+8.57%	+13.99%
2007	2.86%	+7.94%	+5.20%	+5.39%	+10.27%	+19.45%
2008	0.70%	+1.80%	+1.94%	+1.55%	+5.25%	+5.78%
2009	0.04%	+0.03%	+0.11%	+0.10%	+0.48%	+0.24%
Total	0.44%	+1.65%	+0.90%	+0.82%	+3.11%	+3.47%

Percent of Total Dollar Volume for QRMs and Mortgages that Do Not Meet One of the Qualification Requirements

Year	QRM	Product Type	PTI/DTI	LTV	FICO	All Loans
1997	21.04%	+3.12%	+11.92%	+15.76%	+6.12%	$ 72,883,400,278

1998	25.24%	+1.92%	+12.34%	+18.72%	+6.40%	$ 302,723,323,315
1999	20.34%	+2.44%	+12.42%	+14.98%	+6.23%	$ 140,480,199,806
2000	13.66%	+2.31%	+11.72%	+10.37%	+5.06%	$ 48,878,241,470
2001	22.56%	+2.89%	+13.21%	+15.14%	+4.72%	$ 390,566,245,690
2002	28.69%	+4.46%	+15.27%	+11.65%	+4.90%	$ 584,998,514,202
2003	31.06%	+4.48%	+16.76%	+11.22%	+5.22%	$ 920,098,549,172
2004	22.37%	+5.15%	+16.81%	+8.76%	+5.07%	$ 269,562,391,201
2005	16.42%	+4.93%	+16.06%	+8.46%	+3.82%	$ 169,162,254,192
2006	10.24%	+6.22%	+13.03%	+6.20%	+2.73%	$ 131,792,837,483
2007	9.41%	+5.15%	+12.27%	+6.36%	+2.16%	$ 196,852,210,903
2008	20.16%	+4.61%	+20.18%	+10.87%	+2.06%	$ 231,714,054,542
2009	32.80%	+3.01%	+22.10%	+16.44%	+1.63%	$ 637,544,819,174
Total	25.50%	+3.95%	+16.25%	+12.53%	+4.23%	$ 4,097,257,041,427

Cash-Out Refinancings

Ever-to-Date Serious Delinquency Rates for QRMs and the Difference in Rates for Mortgages that Do Not Meet One of the Qualification Requirements

Year	QRM	Product Type	PTI/DTI	LTV	FICO	All Loans
1997	0.51%	+0.18%	+0.48%	+0.54%	+3.12%	+2.20%
1998	0.39%	+0.20%	+0.37%	+0.42%	+2.09%	+1.44%
1999	0.52%	+0.23%	+0.42%	+0.56%	+3.05%	+2.27%
2000	0.51%	+0.70%	+0.41%	+0.81%	+4.26%	+3.88%
2001	0.31%	+0.33%	+0.23%	+0.52%	+2.67%	+2.30%
2002	0.31%	+0.40%	+0.28%	+0.61%	+2.57%	+2.15%
2003	0.51%	+0.64%	+0.60%	+1.12%	+3.11%	+2.57%
2004	0.89%	+1.29%	+1.08%	+1.51%	+4.92%	+4.71%
2005	1.70%	+2.71%	+2.22%	+2.55%	+7.11%	+8.34%
2006	2.61%	+3.77%	+3.34%	+4.05%	+9.06%	+14.42%
2007	2.14%	+3.46%	+3.37%	+3.84%	+9.99%	+16.66%
2008	0.72%	+1.39%	+1.73%	+1.44%	+5.47%	+6.52%
2009	0.03%	+0.05%	+0.10%	+0.07%	+0.44%	+0.24%
Total	0.70%	+2.01%	+1.40%	+1.12%	+4.50%	+5.85%

Percent of Total Dollar Volume for QRMs and Mortgages that Do Not Meet One of the Qualification Requirements

Year	QRM	Product Type	PTI/DTI	LTV	FICO	All Loans
1997	18.17%	+2.23%	+10.98%	+16.86%	+6.32%	$ 42,298,309,778
1998	21.25%	+1.30%	+11.88%	+20.45%	+5.91%	$ 144,483,516,925
1999	17.05%	+1.84%	+11.63%	+17.04%	+5.28%	$ 88,233,434,096

2000	10.03%	+2.40%	+9.66%	+10.90%	+4.46%	$ 48,439,141,706
2001	15.19%	+1.90%	+11.01%	+16.10%	+4.18%	$ 314,174,379,286
2002	17.13%	+2.67%	+12.30%	+13.58%	+4.33%	$ 421,408,941,296
2003	19.05%	+2.99%	+14.53%	+11.60%	+5.00%	$ 575,761,933,088
2004	12.16%	+3.34%	+13.83%	+8.15%	+4.43%	$ 270,137,974,274
2005	11.77%	+3.14%	+15.67%	+7.74%	+3.71%	$ 335,989,676,955
2006	8.93%	+4.00%	+13.17%	+5.81%	+3.12%	$ 296,611,100,532
2007	8.93%	+3.39%	+12.61%	+6.70%	+2.75%	$ 325,728,814,842
2008	14.78%	+2.75%	+18.34%	+11.41%	+2.52%	$ 239,936,748,440
2009	28.36%	+1.52%	+22.56%	+17.99%	+1.87%	$ 312,916,373,670
Total	15.81%	+2.75%	+14.39%	+11.78%	+3.89%	$ 3,416,120,344,887

VII. Solicitation of Comments on Use of Plain Language

Section 722 of the Gramm-Leach-Bliley Act, Pub. L. 106-102, sec. 722, 113 Stat. 1338, 1471 (Nov. 12, 1999), requires the Federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. The Federal banking agencies invite your comments on how to make this proposal easier to understand. For example:

• Have we organized the material to suit your needs? If not, how could this material be better organized?

• Are the requirements in the proposed regulation clearly stated? If not, how could the regulation be more clearly stated?

• Does the proposed regulation contain language or jargon that is not clear? If so, which language requires clarification?

• Would a different format (grouping and order of sections, use of headings, paragraphing) make the regulation easier to understand? If so, what changes to the format would make the regulation easier to understand?

• What else could we do to make the regulation easier to understand?

VIII. ADMINISTRATIVE LAW MATTERS

A. Regulatory Flexibility Act

OCC: The Regulatory Flexibility Act (RFA) generally requires that, in connection with a notice of proposed rulemaking, an agency prepare and make available for public comment an initial regulatory flexibility analysis that describes the impact of a proposed rule on small entities.[201] However, the regulatory flexibility analysis otherwise required under the RFA is not required if an agency certifies that the rule will not have a significant economic impact on a substantial number of small entities (defined in regulations promulgated by the Small Business Administration to include banking organizations with total assets of less than or equal to $175 million) and publishes its certification and a short, explanatory statement in the Federal Register together with the rule.

As of September 30, 2010, there were approximately 590 small national banks. For the reasons provided below, the OCC certifies that the proposed rule, if adopted in final form, would not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not required.

As discussed in the "Supplementary Information" above, section 941 of the Dodd-Frank Act[202] generally requires the Federal banking agencies and the Commission, and, in the case of the securitization of any residential mortgage asset, together with HUD and FHFA, to jointly prescribe regulations, that (i) require a securitizer to retain not less than 5 percent of the credit risk of any asset that the securitizer, through the issuance of an asset-backed security (ABS), transfers, sells, or conveys to a third party; and (ii) prohibit a securitizer from directly or indirectly hedging or otherwise transferring the credit risk that the securitizer is required to retain under section 15G. Although the proposed rule would apply directly only to securitizers, subject to a certain considerations, section 15G authorizes the Agencies to permit securitizers to allocate at least a portion of the risk retention requirement to the originator(s) of the securitized assets.

Section 15G provides a total exemption from the risk retention requirements for securitizers of certain securitization transactions, such as an ABS issuance collateralized exclusively by "qualified residential mortgage" (QRM) loans, and further authorizes the Agencies to establish a lower risk retention requirement for securitizers of ABS issuances collateralized by other asset types, such as commercial, commercial real estate (CRE), and

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[201] See 5 U.S.C. 601 et seq.

[202] Codified at section 15G of the Exchange Act, 17 U.S.C. 78o-11

automobile loans, which satisfy underwriting standards established by the Federal banking agencies.

The risk retention requirements of section 15G apply generally to a “securitizer” of ABS, where securitizer is defined to mean (i) an issuer of an ABS; or (ii) a person who organizes and initiates an asset-backed transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuer. Section 15G also defines an “originator” as a person who (i) through the extension of credit or otherwise, creates a financial asset that collateralizes an asset-backed security; and (ii) sells an asset directly or indirectly to a securitizer.

The proposed rule implements the credit risk retention requirements of section 15G. Section 15G requires the Agencies to establish risk retention requirements for “securitizers”. The proposal would, as a general matter, require that a “sponsor” of a securitization transaction retain the credit risk of the securitized assets in the form and amount required by the proposed rule. The Agencies believe that imposing the risk retention requirement on the sponsor of the ABS—as permitted by section 15G—is appropriate in light of the active and direct role that a sponsor typically has in arranging a securitization transaction and selecting the assets to be securitized. The OCC is aware of only six small banking organizations that currently sponsor securitizations (one of which is a national bank, two are state member banks, and three are state nonmember banks based on September 30, 2010 information) and, therefore, the risk retention requirements of the proposed rule, as generally applicable to sponsors, would not have a significant economic impact on a substantial number of small national banks.

Under the proposed rule a sponsor may offset the risk retention requirement by the amount of any vertical risk retention ABS interests or eligible horizontal residual interest acquired by an originator of one or more securitized assets if certain requirements are satisfied, including, the originator must originate at least 20 percent of the securitized assets, as measured by the aggregate unpaid principal balance of the asset pool. In determining whether the allocation provisions of the proposal would have a significant economic impact on a substantial number of small banking organizations, the Federal banking agencies reviewed September 30, 2010 Call Report data to evaluate the securitization activity and approximate the number of small banking organizations that potentially could retain credit risk under allocation provisions of the proposal.[203]

The Call Report data indicates that approximately 329 small banking organizations, 54 of which are national banks, originate loans for securitization, namely ABS issuances collateralized by one-to-four family residential mortgages. The majority of these originators sell their loans either to Fannie Mae or Freddie Mac, which retain credit risk through agency guarantees and would not be able to allocate credit risk to originators under this proposed rule. Additionally, based on publicly-available market data, it appears that most residential mortgage-backed securities offerings are collateralized by a pool of mortgages with an unpaid aggregate principal

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[203] Call Report Schedule RC-S provides information on the servicing, securitization, and asset sale activities of banking organizations. For purposes of the RFA analysis, the Agencies gathered and evaluated data regarding (1) net securitization income, (2) the outstanding principal balance of assets sold and securitized by the reporting entity with servicing retained or with recourse or other seller-provided credit enhancements, and (3) assets sold with recourse or other seller-provided credit enhancements and not securitized by the reporting bank.

balance of at least $500 million.[204] Accordingly, under the proposed rule a sponsor could potentially allocate a portion of the risk retention requirement to a small banking organization only if such organization originated at least 20 percent ($100 million) of the securitized mortgages. As of September 30, 2010, only one small banking organization reported an outstanding principal balance of assets sold and securitized of $100 million or more.[205]

The OCC seeks comments on whether the proposed rule, if adopted in final form, would impose undue burdens, or have unintended consequences for, small national banks and whether there are ways such potential burdens or consequences could be minimized in a manner consistent with section 15G of the Exchange Act.

Board: The Regulatory Flexibility Act (5 U.S.C. § 603(b)) generally requires that, in connection with a notice of proposed rulemaking, an agency prepare and make available for public comment an initial regulatory flexibility analysis that describes the impact of a proposed rule on small entities.[206] Under regulations promulgated by the Small Business Administration, a small entity includes a commercial bank or bank holding company with assets of $175 million or less (each, a small banking organization).[207] The Board has considered the potential impact of the proposed rules on small banking organizations supervised by the Board in accordance with the Regulatory Flexibility Act.

For the reasons discussed in Part II of this Supplementary Information, the proposed rules define a securitizer as a "sponsor" in a manner consistent with the definition of that term in the Commission's Regulation AB and provide that the sponsor of a securitization transaction is generally responsible for complying with the risk retention requirements established under section 15G. The Board is unaware of any small banking organization under the supervision of the Board that has acted as a sponsor of an ABS transaction[208] (based on September 30, 2010 data).[209] As of September 30, 2010, there were approximately 2861 small banking organizations supervised by the Board, which includes 2412 bank holding companies, 398 state member banks, 9 Edge and agreement corporations and 42 U.S. offices of foreign banking organizations.

The proposed rules permit, but do not require, a sponsor to allocate a portion of its risk retention requirement to one or more originators of the securitized assets, subject to certain conditions being met. In particular, a sponsor may offset the risk retention requirement by the

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204 Based on the data provided in Table 1, page 29 of the Board's "Report to the Congress on Risk Retention", it appears that the average MBS issuance is collateralized by a pool of approximately $620 million in mortgage loans (for prime MBS issuances) or approximately $690 million in mortgage loans (for subprime MBS issuances). For purposes of the RFA analysis, the agencies used an average asset pool size $500 million to account for reductions in mortgage securitization activity following 2007, and to add an element of conservatism to the analysis.

205 The OCC notes that this finding assumes that no portion of the assets originated by small banking organizations were sold to securitizations that qualify for an exemption from the risk retention requirements under the proposed rule.

206 See 5 U.S.C. 601 et seq.

207 13 CFR 121.201.

208 For purposes of the proposed rules, this would include a small bank holding company; state member bank; Edge corporation; agreement corporation; foreign banking organization; and any subsidiary of the foregoing.

209 Call Report Schedule RC-S; Data based on the Reporting Form FR 2866b; Structure Data for the U.S. Offices of Foreign Banking Organizations; and Aggregate Data on Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks based on the quarterly form FFIEC 002.

amount of any vertical risk retention ABS interests or eligible horizontal residual interest acquired by an originator of one or more securitized assets if certain requirements are satisfied, including, the originator must originate at least 20 percent of the securitized assets, as measured by the aggregate unpaid principal balance of the asset pool. A sponsor using this risk retention option remains responsible for ensuring that the originator has satisfied the risk retention requirements. In light of this option, the Board has considered the impact of the proposed rules on originators that are small banking organizations.

The September 30, 2010 regulatory report data[210] indicates that approximately 329 small banking organizations, 37 of which are small banking organizations that are supervised by the Board, originate loans for securitization, namely ABS issuances collateralized by one-to-four family residential mortgages. The majority of these originators sell their loans either to Fannie Mae or Freddie Mac, which retain credit risk through agency guarantees and would not be able to allocate credit risk to originators under this proposed rule. Additionally, based on publicly-available market data, it appears that most residential mortgage-backed securities offerings are collateralized by a pool of mortgages with an unpaid aggregate principal balance of at least $500 million.[211] Accordingly, under the proposed rule a sponsor could potentially allocate a portion of the risk retention requirement to a small banking organization only if such organization originated at least 20 percent ($100 million) of the securitized mortgages. As of September 30, 2010, only one small banking organization supervised by the Board reported an outstanding principal balance of assets sold and securitized of $100 million or more.[212]

In light of the foregoing, the proposed rules would not appear to have a significant economic impact on sponsors or originators supervised by the Board. The Board seeks comment on whether the proposed rules would impose undue burdens on, or have unintended consequences for, small banking organizations, and whether there are ways such potential burdens or consequences could be minimized in a manner consistent with section 15G of the Exchange Act.

FDIC: The Regulatory Flexibility Act (RFA) generally requires that, in connection with a notice of proposed rulemaking, an agency prepare and make available for public comment an initial regulatory flexibility analysis that describes the impact of a proposed rule on small entities.[213] However, a regulatory flexibility analysis is not required if the agency certifies that

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[210] Call Report Schedule RC-S provides information on the servicing, securitization, and asset sale activities of banking organizations. For purposes of the RFA analysis, the Agencies gathered and evaluated data regarding (1) net securitization income, (2) the outstanding principal balance of assets sold and securitized by the reporting entity with servicing retained or with recourse or other seller-provided credit enhancements, and (3) assets sold with recourse or other seller-provided credit enhancements and not securitized by the reporting bank.

[211] Based on the data provided in Table 1, page 29 of the Board's "Report to the Congress on Risk Retention", it appears that the average MBS issuance is collateralized by a pool of approximately $620 million in mortgage loans (for prime MBS issuances) or approximately $690 million in mortgage loans (for subprime MBS issuances). For purposes of the RFA analysis, the agencies used an average asset pool size $500 million to account for reductions in mortgage securitization activity following 2007, and to add an element of conservatism to the analysis.

[212] The FDIC notes that this finding assumes that no portion of the assets originated by small banking organizations were sold to securitizations that qualify for an exemption from the risk retention requirements under the proposed rule.

[213] See 5 U.S.C. 601 et seq.

the rule will not have a significant economic impact on a substantial number of small entities (defined in regulations promulgated by the Small Business Administration to include banking organizations with total assets of less than or equal to $175 million) and publishes its certification and a short, explanatory statement in the Federal Register together with the rule.

As of September 30, 2010, there were approximately 2,768 small FDIC-supervised institutions, which includes 2,639 state nonmember banks and 129 state chartered savings banks. For the reasons provided below, the FDIC certifies that the proposed rule, if adopted in final form, would not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not required.

As discussed in the "Supplementary Information" above, section 941 of the Dodd-Frank Act[214] generally requires the Federal banking agencies and the Commission, and, in the case of the securitization of any residential mortgage asset, together with HUD and FHFA, to jointly prescribe regulations, that (i) require a securitizer to retain not less than 5 percent of the credit risk of any asset that the securitizer, through the issuance of an asset-backed security (ABS), transfers, sells, or conveys to a third party; and (ii) prohibit a securitizer from directly or indirectly hedging or otherwise transferring the credit risk that the securitizer is required to retain under section 15G. Although the proposed rule would apply directly only to securitizers, subject to a certain considerations, section 15G authorizes the Agencies to permit securitizers to allocate at least a portion of the risk retention requirement to the originator(s) of the securitized assets.

Section 15G provides a total exemption from the risk retention requirements for securitizers of certain securitization transactions, such as an ABS issuance collateralized exclusively by "qualified residential mortgage" (QRM) loans, and further authorizes the Agencies to establish a lower risk retention requirement for securitizers of ABS issuances collateralized by other asset types, such as commercial, commercial real estate (CRE), and automobile loans, which satisfy underwriting standards established by the Federal banking agencies.

The risk retention requirements of section 15G apply generally to a "securitizer" of ABS, where securitizer is defined to mean (i) an issuer of an ABS; or (ii) a person who organizes and initiates an asset-backed transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuer. Section 15G also defines an "originator" as a person who (i) through the extension of credit or otherwise, creates a financial asset that collateralizes an asset-backed security; and (ii) sells an asset directly or indirectly to a securitizer.

The proposed rule implements the credit risk retention requirements of section 15G. The proposal would, as a general matter, require that a "sponsor" of a securitization transaction retain the credit risk of the securitized assets in the form and amount required by the proposed rule. The Agencies believe that imposing the risk retention requirement on the sponsor of the ABS—as permitted by section 15G—is appropriate in view of the active and direct role that a sponsor typically has in arranging a securitization transaction and selecting the assets to be securitized. The FDIC is aware of only six small banking organizations that currently sponsor securitizations

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[214] Codified at section 15G of the Exchange Act, 17 U.S.C. 78o-11.

(one of which is a national bank, two are state member banks, and three are state nonmember banks based on September 30, 2010 information) and, therefore, the risk retention requirements of the proposed rule, as generally applicable to sponsors, would not have a significant economic impact on a substantial number of small state nonmember banks.

Under the proposed rule a sponsor may offset the risk retention requirement by the amount of any vertical risk retention ABS interests or eligible horizontal residual interest acquired by an originator of one or more securitized assets if certain requirements are satisfied, including, the originator must originate at least 20 percent of the securitized assets, as measured by the aggregate unpaid principal balance of the asset pool. In determining whether the allocation provisions of the proposal would have a significant economic impact on a substantial number of small banking organizations, the Federal banking agencies reviewed September 30, 2010 Call Report data to evaluate the securitization activity and approximate the number of small banking organizations that potentially could retain credit risk under allocation provisions of the proposal.[215]

The Call Report data indicates that approximately 329 small banking organizations, 241 of which are state nonmember banks, originate loans for securitization, namely ABS issuances collateralized by one-to-four family residential mortgages. The majority of these originators sell their loans either to Fannie Mae or Freddie Mac, which retain credit risk through agency guarantees, and therefore would not be allocated credit risk under the proposed rule. Additionally, based on publicly-available market data, it appears that most residential mortgage-backed securities offerings are collateralized by a pool of mortgages with an unpaid aggregate principal balance of at least $500 million.[216] Accordingly, under the proposed rule a sponsor could potentially allocate a portion of the risk retention requirement to a small banking organization only if such organization originated at least 20 percent ($100 million) of the securitized mortgages. As of September 30, 2010, only one small banking organization reported an outstanding principal balance of assets sold and securitized of $100 million or more.[217]

The FDIC seeks comment on whether the proposed rule, if adopted in final form, would impose undue burdens, or have unintended consequences for, small state nonmember banks and whether there are ways such potential burdens or consequences could be minimized in a manner consistent with section 15G of the Exchange Act.

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[215] Call Report Schedule RC-S provides information on the servicing, securitization, and asset sale activities of banking organizations. For purposes of the RFA analysis, the Agencies gathered and evaluated data regarding (1) net securitization income, (2) the outstanding principal balance of assets sold and securitized by the reporting entity with servicing retained or with recourse or other seller-provided credit enhancements, and (3) assets sold with recourse or other seller-provided credit enhancements and not securitized by the reporting bank.

[216] Based on the data provided in Table 1, page 29 of the Board's "Report to the Congress on Risk Retention", it appears that the average MBS issuance is collateralized by a pool of approximately $620 million in mortgage loans (for prime MBS issuances) or approximately $690 million in mortgage loans (for subprime MBS issuances). For purposes of the RFA analysis, the agencies used an average asset pool size $500 million to account for reductions in mortgage securitization activity following 2007, and to add an element of conservatism to the analysis.

[217] The FDIC notes that this finding assumes that no portion of the assets originated by small banking organizations were sold to securitizations that qualify for an exemption from the risk retention requirements under the proposed rule.

SEC: The Commission hereby certifies, pursuant to 5 U.S.C. 605(b), that the proposed rule, if adopted, would not have a significant economic impact on a substantial number of small entities. The proposed rule implements the risk retention requirements of section 15G of the Exchange Act, which, in general, requires the securitizer of a asset-backed securities (ABS) to retain not less than five percent of the credit risk of the assets collateralizing the ABS.[218] Under the proposed rule, the risk retention requirements would apply to "sponsors", as defined in the proposed rule. Based on our data, we found only one sponsor that would meet the definition of a small broker-dealer for purposes of the Regulatory Flexibility Act.[219] Accordingly, the Commission does not believe that the proposed rule, if adopted, would not have a significant economic impact on a substantial number of small entities.

FHFA: Pursuant to section 605(b) of the Regulatory Flexibility Act, FHFA hereby certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities.

B. Paperwork Reduction Act

1. Request for Comment on Proposed Information Collection

Certain provisions of the proposed rule contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA"), 44 U.S.C. 3501-3521. In accordance with the requirements of the PRA, the Agencies may not conduct or sponsor, and the respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. The information collection requirements contained in this joint notice of proposed rulemaking have been submitted by the FDIC, OCC, and the Commission to OMB for approval under section 3506 of the PRA and section 1320.11 of OMB's implementing regulations (5 CFR part 1320). The Board reviewed the proposed rule under the authority delegated to the Board by OMB.

Comments are invited on:

(a) Whether the collections of information are necessary for the proper performance of the agencies' functions, including whether the information has practical utility;

(b) The accuracy of the estimates of the burden of the information collections, including the validity of the methodology and assumptions used;

(c) Ways to enhance the quality, utility, and clarity of the information to be collected;

(d) Ways to minimize the burden of the information collections on respondents, including through the use of automated collection techniques or other forms of information technology; and

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[218] See 17 U.S.C. 78o-11.

[219] 5 U.S.C. 601 et seq.

(e) Estimates of capital or start up costs and costs of operation, maintenance, and purchase of services to provide information.

All comments will become a matter of public record. Commenters may submit comments on aspects of this notice that may affect disclosure requirements and burden estimates at the addresses listed in the ADDRESSES section of this Supplementary Information. A copy of the comments may also be submitted to the OMB desk officer for the agencies: By mail to U.S. Office of Management and Budget, 725 17th Street, NW, #10235, Washington, DC 20503 or by facsimile to 202-395-6974, Attention, Commission and Federal Banking Agency Desk Officer.

2. Proposed Information Collection

Title of Information Collection: Credit Risk Retention.

Frequency of response: Event generated.

Affected Public:[220]

FDIC: Insured state non-member banks, insured state branches of foreign banks, and certain subsidiaries of these entities.

OCC: National banks, Federal savings associations, Federal branches or agencies of foreign banks, or any operating subsidiary thereof.

Board: FDIC-insured state member banks. For §__.15(d)(13) the Board's respondents also include bank holding companies, foreign banking organizations, Edge or agreement corporations, any nonbank financial company (as defined in §__.1(c)(5)), savings and loan holding companies, (as defined in 12 U.S.C. 1467a, on and after the transfer date established under section 311 of the Dodd-Frank Act (12 U.S.C. 5411)), or any subsidiary of the foregoing. *SEC*: All entities other than those assigned to the FDIC, OCC, or Board.

Abstract: The notice sets forth permissible forms of risk retention for securitizations that involve issuance of asset-backed securities. The information requirements in joint regulations proposed by the three Federal banking agencies and the Commission are found in §§__.4, __.5, __.6, __.7, __.8, __.9, __.10, __.12, __.13, __.15, __.18, __.19, and __.20. The Agencies believe that the disclosure and recordkeeping requirements associated with the various forms of risk retention will enhance market discipline, help ensure the quality of the assets underlying a securitization transaction, and assist investors in evaluating transactions. Compliance with the information collections would be mandatory. Responses to the information collections would

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[220] The affected public of the FDIC, OCC, and Board is assigned generally in accordance with the entities covered by the scope and authority section of their respective proposed rule. The affected public of the Commission is based on those entities not already accounted for by the FDIC, OCC, and Board.

not be kept confidential and, except as provided below, there would be no mandatory retention period for proposed collections of information.

Section-by-Section Analysis

Section __.4 sets forth the conditions that must be met by sponsors electing to use the vertical risk retention option. Section __.4(b)(1) requires disclosure of the amount of each class of ABS interests retained and required to be retained by the sponsor and § __.4(b)(2) requires disclosure of material assumptions used to determine the aggregate dollar amount of ABS interests issued in the transaction.

Section __.5 specifies the conditions that must be met by sponsors using the horizontal risk retention option, including disclosure of the amount of the eligible horizontal residual interest retained by the sponsor and the amount required to be retained (§__.5(c)(1)(i)); disclosure of the material terms of the eligible horizontal residual interest (§__.5(c)(1)(ii)); disclosure of the dollar amount to be placed in a cash reserve account and the amount required to be placed in the account (§__.5(c)(2)(i)), if applicable; disclosure of the material terms governing the cash reserve account (§__.5(c)(2)(ii)), if applicable; and disclosure of material assumptions and methodology used in determining the aggregate dollar amount of ABS interests issued in the transaction (§__.5(c)(3)).

Section __.6 identifies the requirements for sponsors opting to use the hybrid L-shaped risk retention method, including disclosures in compliance with those set forth for the vertical and horizontal risk retention methods (§__.6(b)).

Section __.7 requires sponsors using a revolving master trust structure for securitizations to disclose the amount of seller's interest retained by the sponsor and the amount the sponsor is required to retain (§__.7(b)(1)); the material terms of the seller's interest retained by the sponsor (§__.7(b)(2)); and the material assumptions and methodology used in determining the aggregate dollar amount of ABS issued in the transaction (§__.7(b)(3)).

Section __.8 discusses the representative sample method of risk retention and requires that the sponsor adopt and adhere to policies and procedures to, among other things, document the material characteristics used to identify the designated pool and randomly select assets using a process that does not take account of any asset characteristic other than the unpaid balance (§__.8(c)); maintaining, until all ABS interests are paid in full, documentation that clearly identifies the assets included in the representative sample (§__.8(c)); obtaining an agreed upon procedures report from an independent public accounting firm (§__.8(d)(1)); disclose the amount of assets included in the representative sample and retained by the sponsor and the amount of assets required to be retained by the sponsor (§__.8(g)(1)(i)); disclose prior to sale a description of the material characteristics of the designated pool (§__.8(g)(1)(ii)); disclose prior to sale a description of the policies and procedures used by the sponsor to ensure compliance with random selection and equivalent risk determination requirements (§__.8(g)(1)(iii)); confirm prior to sale that the required agreed upon procedures report was obtained (§__.8(g)(1)(iv)); disclose the material assumptions and methodology used in determining the aggregate dollar amount of ABS interests issued in the transaction (§__.8(g)(1)(v)); and disclose after sale the performance of the pool of assets in the securitization transaction as compared to performance of assets in the representative sample (§__.8(g)(2)); and disclose to holders of the asset-backed securities information concerning the assets in the representative sample (§__.8(g)(3)).

Section __.9 addresses the requirements for sponsors utilizing the ABCP conduit risk retention approach. The requirements for the ABCP conduit risk retention approach include disclosure of each originator-seller with a retained eligible horizontal residual interest and the form, amount, and nature of the interest (§__.9(b)(1)); disclosure of each regulated liquidity provider providing liquidity support to the ABCP conduit and the form, amount, and nature of the support (§__.9(b)(2)); maintenance of policies and procedures that are reasonably designed to monitor regulatory compliance by each originator-seller of the eligible ABCP conduit (§__.9(c)(2)(i)); and notice to holders of the ABS interests issued in the transaction in the event of originator-seller regulatory non-compliance (§__.9(c)(2)(ii)).

Section __.10 sets forth the requirements for sponsors utilizing the commercial mortgage-backed securities risk retention option, and includes disclosures of the name and form of organization of the third-party purchaser (§__.10(a)(5)(i)), the third-party purchaser's experience (§__.10(a)(5)(ii)), other material information (§__.10(a)(5)(iii)), the amount and purchase price of eligible horizontal residual interest retained by the third-party purchaser and the amount that the sponsor would have been required to retain (§__.10(a)(5)(iv) and (v)), a description of the material terms of the eligible residual horizontal interest retained by the third-party purchaser (§__.10(a)(5)(vi)), the material assumptions and methodology used to determine the aggregate amount of ABS interests issued by the issuing entity (§__.10(a)(5)(vii)), representations and warranties concerning the securitized assets and factors used to determine the assets should be included in the pool (§__.10(a)(5)(viii)); sponsor maintenance of policies and procedures to monitor third-party compliance with regulatory requirements (§__.10(b)(2)(A)); and sponsor notice to holders of ABS interests in the event of third-party non-compliance with regulatory requirements (§__.10(b)(2)(B)).

Section __.12 requires the establishment of a premium cash reserve account, in addition to the sponsor's base risk retention requirement, in instances where the sponsor structures a securitization to monetize excess spread on the underlying assets. The premium cash reserve account would be used to "capture" the premium received on sale of such tranches for purposes of covering losses on the underlying assets and would require the sponsor to make disclosures regarding the dollar amount required by regulation to be placed in the account and any other amounts placed in the account by the sponsor (§__.12(d)(1)) and the material assumptions and methodology used in determining fair value of any ABS interest that does not have a par value and that was used in calculating the amount required for the premium capture cash reserve account (§__.12(d)(2)).

Section __.13 sets forth the conditions that apply when the sponsor of a securitization allocates to originators of securitized assets a portion of the credit risk it is required to retain, including disclosure of the name and form of organization of any originator with an acquired and retained interest (§__.13(a)(2)); maintenance of policies and procedures that are reasonably designed to monitor originator compliance with retention amount and hedging, transferring and pledging requirements (§__.13(b)(2)(A)); and notice to holders of ABS interests in the transaction in the event of originator non-compliance with regulatory requirements (§__.13(b)(2)(B)).

Section __.15 provides an exemption from the risk retention requirements for qualified residential mortgages that meet certain specified criteria including certification by the depositor of the asset-backed security that it has evaluated the effectiveness of its internal supervisory controls and concluded that the controls are effective (§__.15(b)(4)(i)), and sponsor disclosure prior to sale of asset-backed securities in the issuing entity of a copy of the certification to potential investors (§__.15(b)(4)(iii)). In addition §__.15(e)(3) provides that a sponsor that has relied upon the exemption shall not lose the exemption if it complies with certain specified requirements, including prompt notice to the holders of the asset-backed securities of any loan repurchased by the sponsor. Section _.15 also contains additional information collection requirements on the mortgage originator to include terms in the mortgage transaction documents under which the creditor commits to having servicing policies and procedures (§__.15(d)(13)(i)) and to provide disclosure of the foregoing default mitigation commitments to the borrower at or prior to the closing of the mortgage transaction (§__.15(d)(13)(ii)).

Sections __.18, __.19, and ___.20 provide exemptions from the risk retention requirements for qualifying commercial real estate loans, commercial mortgages, and auto loans that meet specified criteria. Each section requires that the depositor of the asset-backed security certify that it has evaluated the effectiveness of its internal supervisory controls and concluded that its controls are effective (§§__.18(b)(7)(i), __.19(b)(10)(i), and __.20(b)(9)(i)); that the sponsor provide a copy of the certification to potential investors prior to the sale of asset-backed securities (§§__.18(b)(7)(iii), __.19(b)(10)(iii), and __.20(b)(9)(iii)); and that the sponsor promptly notify the holders of the securities of any loan included in the transaction that is required to be repurchased by the sponsor (§§__.18(c)(3), __.19(c)(3), and __.20(c)(3)).

Estimated Paperwork Burden

Estimated Burden Per Response:

§__.4 - Vertical risk retention: disclosures – 2 hours.

§__.5 - Horizontal risk retention: disclosures – 2.5 hours.

§__.6 – L-Shaped risk retention: disclosures – 3 hours.

§__.7 – Revolving master trusts: disclosures 2.5 hours.

§__.8 – Representative sample: recordkeeping – 120 hours; disclosures – 23.25 hours.

§__.9 – Eligible ABCP conduits: recordkeeping – 20 hours; disclosures – 3 hours.

§__.10 – Commercial mortgage-backed securities: recordkeeping – 20 hours; disclosures – 19.75 hours.

§__.12 – Premium capture cash reserve account: disclosures – 1.75 hours.

§__.13 – Allocation of risk retention: recordkeeping 20 hours; disclosures 2.5 hours.

§__.15 – Exemption for qualified residential mortgages: recordkeeping – 40 hours; disclosures 9.25 hours.

§__.18 – Exemption for qualifying CRE loans: recordkeeping – 40 hours; disclosures – 1.25 hours.

§__.19 – Exemption for qualifying commercial mortgages: recordkeeping – 40 hours; disclosures – 1.25 hours.

§__.20 – Exemption for qualifying auto loans: recordkeeping – 40 hours; disclosures – 1.25 hours.

FDIC

Number of Respondents: 90 sponsors and 4,715 creditors.

Total Estimated Annual Burden: 59,463 hours.

OCC

Number of Respondents: 30 sponsors and 1,650 creditors.

Total Estimated Annual Burden: 20,483 hours.

Board

Number of Respondents: 20 sponsors and 7,636 creditors.

Total Estimated Annual Burden: 70,430 hours.

Commission

Number of Respondents: 104 sponsors and 1,500 creditors.

Total Estimated Annual Burden: 37,166 hours.

Commission's explanation of the calculation:

To determine the total paperwork burden for the requirements contained in this proposed rule the Agencies first estimated the universe of sponsors that would be required to comply with the proposed disclosure and recordkeeping requirements. The Agencies estimate that approximately 243 unique sponsors conduct ABS offerings per year. This estimate was based on 2010 data reported on the commercial bank Call Report (FFIEC 031 and 041) and from the ABS database AB Alert. Of the 243 sponsors, the Agencies have assigned 8 percent of these sponsors to the Board, 12 percent to the OCC, 37 percent to the FDIC, and 43 percent to the Commission.

Next, the Agencies estimated the burden per response that would be associated with each disclosure and recordkeeping requirement. In some cases, the proposed rule is estimated to incur only an incremental burden on respondents. For example, in the representative sample option, the proposed rule requires that the sponsor cause to be disclosed information regarding the securitized assets, but the Agencies believe similar information regarding the securitized assets are already being made to investors, and therefore the proposed rule would only incur an incremental burden on sponsors.

Next, the Agencies estimated how frequent the entities would make the required disclosure by estimating the proportionate amount of offerings per year for each agency. In making this determination, the estimate was based on the average number of ABS offerings from 2004 through 2009, and therefore, we estimate the total number of annual offerings per year to be 1,700.[221] We also made the following additional estimates:

- 12 offerings per year will be subject to disclosure and recordkeeping requirements under sections §__.12 and §__.13, which are divided equally among the four agencies (i.e., 3 offering per year per agency);
- 100 offerings per year will be subject to disclosure and recordkeeping requirements under section §__.15, which are divided proportionately among the agencies based on the entity percentages described above (i.e., 8 offerings per year subject to §__.15 for the Board; 12 offerings per year subject to §__.15 for the OCC; 37 offerings per year subject to §__.15 for the FDIC; and 43 offerings per year subject to §__.15 for the Commission); and
- 40 offerings per year will be subject to disclosure and recordkeeping requirements under §__.18, §__.19, and §__.20, respectively, which are divided proportionately among the agencies based on the entity percentages described above (i.e., 3 offerings per year subject to each section for the Board, 5 offerings per year subject to each section for the OCC; 15 offerings per year subject to each section for the FDIC, and 17 offerings per year subject to each section for the Commission).

To obtain the estimated number of responses (equal to the number of offerings) for each option in Part B of the proposed rule, the Agencies multiplied the number of offerings estimated to be subject to the base risk retention requirements (i.e., 1,480)[222] by the sponsor percentages described above. The result was the number of base risk retention offerings per year per agency. For the Commission, this was calculated by multiplying 1,480 offerings per year by 43 percent, which equals 636 offerings per year. This number was then divided by the number of base risk retention options (7) to arrive at the estimate of the number of offerings per year per agency per base risk retention option. For the Commission, this was calculated by dividing 636 offerings per year by 7 options, resulting in 91 offerings per year per base risk retention option.

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[221] We use the ABS issuance data from Asset-Backed Alert on the initial terms of offerings, and we supplement that data with information from Securities Data Corporation (SDC). This estimate includes registered offerings and offerings made under Securities Act Rule 144A. We also note that this estimate is for offerings that are not exempted under §§ _.21 and _.22 of the proposed rule.

[222] Estimate of 1,700 offerings per year minus the estimate of the number of offerings qualifying for an exemption under §__.15, §__.18, §__.19, and §__.20 (220 total).

The total estimated annual burden for each Agency was then calculated by multiplying the number of offerings per year per section for such Agency (except with respect to the recordkeeping burden hours under §__.8 and §_.15(d)(13) as described below) by the number of burden hours estimated for the respective section, then adding these subtotals together. For example, under §__.4, the Commission multiplied the estimated number of offerings per year per §__.4 (i.e., 91 offerings per year) by the disclosure burden hour estimate for §__.4 of 2.0 hours. Thus, the estimated annual burden hours for respondents to which the Commission accounts for the burden hours under §__.4 is 182 hours (91 * 2.0 hours = 182 hours). For the recordkeeping burden estimate under §§__.8(c) and__.8(d)(2), instead of using the number of offerings per year per base risk retention option, the Agencies multiplied the number of recordkeeping burden hours by the number of unique sponsors assigned to such Agency per year (i.e., 104 in the case of the Commission).[223] The reason for this is that the Agencies considered it possible that sponsors may establish these policies and procedures during the year independent on whether an offering was conducted, with a corresponding agreed upon procedures report obtained from a public accounting firm each time such policies and procedures are established.

To obtain an estimate for the number of burden hours required by § _.15(d)(13), the Agencies multiplied the estimate of the number of creditors assigned to such Agency for purposes of this risk retention rule by an estimate of the number of hours that it will take creditors to perform a one-time update to their systems to account for the requirements of this section, which we estimate to be 8 hours.[224] This estimate was added to the other disclosure and recordkeeping burden estimates as described above to achieve a total estimated annual burden for respondents assigned to the Commission.

For disclosures made at the time of the securitization transaction,[225] the Commission allocates 25 percent of these hours (1,009 hours) to internal burden for all sponsors. For the remaining 75 percent of these hours, (3,028 hours), the Commission uses an estimate of $400 per hour for external costs for retaining outside professionals totaling $1,211,200. For disclosures made after the time of sale in a securitization transaction,[226] the Commission allocated 75 percent of the total estimated burden hours (892 hours) to internal burden for all sponsors. For the remaining 25 percent of these hours (297 hours), the Commission uses an estimate of $400 per hour for external costs for retaining outside professionals totaling $118,800. With respect to the agreed upon procedures report by an independent public accounting firm under the representative sample option, the Commission allocated 100 percent of the total estimated burden hours (4,160 hours[227]) to retaining outside professionals at an estimate of $400 per hour, for a total cost of $1,664,000.

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[223] 243 * 43% = 104.

[224] 1,500 creditors * 8 hours = 12,000 hours

[225] These are the disclosures required by §§_.4(b)(1)-(2); _.5(c)(1)(i)-(ii), (2)(i)-(ii), and (3); _.6(b); _.7(b)(1)-(3); _.8(g)(1)(i)-(iv) and (g)(3); _.9(b)(1)-(2); _.10(a)(5)(i)-(viii); _.12(d)(1)-(3); _.13(a)(2); _.15(b)(4)(iii); _.18(b)(7)(iii); _.19(b)(10)(iii); and _.20(b)(9)(iii).

[226] These are the disclosures required by §§_.8(g)(2); _.9(c)(2)(ii); _.10(b)(2)(B); _.13(b)(2)(B); _15(e)(3); _.18(c)(3); _19(c)(3); and _.20(c)(3).

[227] 40 * 104 = 4,160 hours.

FHFA: The proposed regulation does not contain any FHFA information collection requirement that requires the approval of OMB under the Paperwork Reduction Act.

HUD: The proposed regulation does not contain any HUD information collection requirement that requires the approval of OMB under the Paperwork Reduction Act

C. Commission Economic Analysis

1. Introduction

As discussed above, Section 15G of the Exchange Act, as added by section 941(b) of the Dodd-Frank Act, generally requires the Agencies to jointly prescribe regulations, that (i) require a sponsor to retain not less than five percent of the credit risk of any asset that the sponsor, through the issuance of an ABS, transfers, sells, or conveys to a third party, and (ii) prohibit a sponsor from directly or indirectly hedging or otherwise transferring the credit risk that the sponsor is required to retain under section 15G and the Agencies' implementing rules.[228]

Section 15G of the Exchange Act exempts certain types of securitization transactions from these risk retention requirements and authorizes the Agencies to exempt or establish a lower risk retention requirement for other types of securitization transactions. For example, section 15G specifically provides that a sponsor shall not be required to retain any part of the credit risk for an asset that is transferred, sold, or conveyed through the issuance of ABS by the sponsor, if all of the assets that collateralize the ABS are qualified residential mortgages (QRMs), as that term is jointly defined by the Agencies.[229] In addition, section 15G states that the Agencies must permit a sponsor to retain less than five percent of the credit risk of commercial mortgages, commercial loans, and automobile loans that are transferred, sold, or conveyed through the issuance of ABS by the sponsor if the loans meet underwriting standards established by the Federal banking agencies.[230]

Section 15G requires the Agencies to prescribe risk retention requirements for "securitizers," which the Agencies interpret are depositors or sponsors of ABS. The proposal would require that a "sponsor" of a securitization transaction to retain the credit risk of the securitized assets in the form and amount required by the proposed rule. The Agencies believe that imposing the risk retention requirement on the sponsor of the ABS is appropriate in light of the active and direct role that a sponsor typically has in arranging a securitization transaction and selecting the assets to be securitized.

In developing the proposed rules, the Agencies have taken into account the diversity of assets that are securitized, the structures historically used in securitizations, and the manner in which sponsors may have retained exposure to the credit risk of the assets they securitize. The proposed rules provide several options sponsors may choose from in meeting the risk retention requirements of section 15G, including, but not limited to, retention of a five percent "vertical" slice of each class of interests issued in the securitization or retention of a five percent

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[228] See 15 U.S.C. §78o-11(b), (c)(1)(A) and (c)(1)(B)(ii).
[229] See 15 U.S.C. § 78o-11(c)(1)(C)(iii), (4)(A) and (B).
[230] See id. at § 78o-11(c)(1)(B)(ii) and (2).

"horizontal" first-loss interest in the securitization, as well as other risk retention options that take into account the manners in which risk retention often has occurred in credit card receivable and automobile loan and lease securitizations and in connection with the issuance of asset-backed commercial paper. The proposed rules also include a special "premium capture" mechanism designed to prevent a sponsor from structuring an ABS transaction in a manner that would allow the sponsor to effectively negate or reduce its retained economic exposure to the securitized assets by immediately monetizing the excess spread created by the securitization transaction. In designing these options and the proposed rules in general, the Agencies have sought to ensure that the amount of credit risk retained is meaningful—consistent with the purposes of section 15G—while reducing the potential for the proposed rules to negatively affect the availability and costs of credit to consumers and businesses.

As required by section 15G, the proposed rules provide a complete exemption from the risk retention requirements for ABS that is collateralized solely by QRMs and establish the terms and conditions under which a residential mortgage would qualify as a QRM. In developing the proposed definition of a QRM, the Agencies carefully considered the terms and purposes of section 15G, public input, and the potential impact of a broad or narrow definition of QRMs on the housing and housing finance markets.

As discussed in greater detail in Part IV of this Supplementary Information, the proposed rule would generally prohibit QRMs from having product features that contributed significantly to the high levels of delinquencies and foreclosures since 2007—such as terms permitting negative amortization, interest-only payments, or significant interest rate increases—and also would establish underwriting standards designed to ensure that QRMs are of very high credit quality consistent with their exemption from risk retention requirements. These underwriting standards include, among other things, maximum front-end and back-end debt-to-income ratios of 28 percent and 36 percent, respectively; a maximum loan-to-value ratio of 80 percent in the case of a purchase transaction (with a lesser combined LTV permitted for refinance transactions); a 20 percent down payment requirement in the case of a purchase transaction; and credit history restrictions.

The proposed rules also would not require a sponsor to retain any portion of the credit risk associated with a securitization transaction if the ABS issued are exclusively collateralized by qualified assets (QAs) -- commercial loans, commercial mortgages, or automobile loans that meet underwriting standards included in the proposed rule for the individual asset class.

The Commission is sensitive to the costs and benefits imposed by its rules. The discussion below focuses on the costs and benefits of the decisions made by the Commission, together with the other Agencies, to fulfill the mandates of the Dodd-Frank Act within its permitted discretion, rather than the costs and benefits of the mandates of the Dodd-Frank Act itself. For instance, the analysis below assumes as a baseline that a standard for QRM is in place, since such a standard is mandated by statute. Rather than assessing the economic costs and benefits of implementing such a standard, the analysis below focuses on the relative costs and benefits of alternative QRM standards. Similarly, the analysis assumes the following: a risk retention requirement of at least 5 percent for non-qualified mortgages and non-qualified assets, 0% for QRMs and less than 5 percent for qualified assets. Thus, our analysis below examines the costs and benefits of alternative implementations of a risk retention requirement meeting the mandates of the Dodd-Frank Act, rather than the existence of a risk retention requirement. Although our intent is to limit the economic analysis of this rule to decisions made by the Commission, to the extent that the Commission's discretion is exercised to further the benefits intended by the Dodd-Frank Act, the two types of benefits might not be entirely separable.

Section 23(a)(2) of the Exchange Act requires the Commission, when making rules under the Exchange Act, to consider the impact on competition that the rules would have, and prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the Exchange Act.[231] Further, Section 2(b) of the Securities Act of 1933[81] and Section 3(f) of the Exchange Act requires the Commission,[232] when engaging in rulemaking where we are required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation. The Commission has considered and discussed below the effects of the proposed rules on efficiency, competition, and capital formation, as well as the benefits and costs associated with the Commission's decisions in the proposed rulemaking.

2. Risk Retention Methods for non-QRMs and non-qualifying assets ("QAs")

The proposed rules require not less than 5 percent risk retention for all non-QRMs and non-QAs. The form of the retention is to be chosen from a menu of options, which should provide flexibility to sponsors in meeting the risk retention requirement mandated by Section 15G, as added by the Dodd-Frank Act. Section 15G directs the Agencies to set appropriate risk retention rules, which will require the retention of no less than 5 percent of the credit risk in the securitized assets for all ABS classes not exempt from the requirement. Section 15G provides for a risk retention exemption for sponsors of ABS backed solely by QRMs and for certain other sponsors or ABS asset classes as discussed below and a less than five percent risk retention requirement for QAs.

Empirical evidence points to a significant heterogeneity of securitization structures, practices and risk characteristics across ABS asset classes.[233] Accordingly, allowing sponsors to choose a form of risk retention from a menu of options provides them with the flexibility of choosing the form that best suits their operational and financing preferences. By including most of the risk retention forms currently observed in the marketplace, the Agencies' proposal benefits sponsors, originators, and investors alike by limiting disruption to current securitization practices to the extent possible. Historically, most sponsors have been exposed to some level of credit risk by retaining an economic interest in the pools they securitize in the form of first-loss or pro-rata positions.[234] Thus, the proposed rule allows sponsors that have existing risk retention programs to minimize their compliance costs resultant from the statute's mandate. Without the flexibility

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[231] 15 U.S.C. 78w(a)..
[232] 17 U.S.C. 78c(f).
[233] See Board of Governors of the Federal Reserve System, Report to the Congress on Risk Retention, October 2010 available at http://federalreserve.gov/boarddocs/rptcongress/securitization/riskretention.pdf.
[234] For example, Chen, Liu, and Ryan (2008) show that banks retain more risk when loans have higher or less externally verifiable credit risk. See *Characteristics of Securitizations that Determine Issuers' Retention of the Risks of the Securitized*, Weitzu Chen, Chi-Chun Liu, and Stephen Ryan (2008), The Accounting Review, 2008.83.5.1181.

allowed by a broad menu-of-options approach, there likely would be an increase in borrowing costs to sponsors and to the borrowers whose loans are in the securitized pools. In some cases, this increase could be large enough to make certain types of securitizations economically unfeasible.

It is possible that the flexibility allowed by the proposed approach to implementing the risk retention mandate of Section 15G might result in some sponsors choosing risk retention methods that do not align fully their incentives with those of investors. In such cases, underwriting standards and pool selection procedures may not improve. If investors are reluctant to invest in ABS where a sponsor has selected such a suboptimal risk retention method, risk retention might not have the effect of facilitating capital formation. To the extent that such reluctance on part of investors provides sponsors with the incentive to choose risk retention methods that investors demand, this effect on capital formation is mitigated.

An integral part of the proposed rules are new risk retention disclosure requirements specifically tailored to each of the permissible forms of risk retention. The required disclosure would provide investors with information on the sponsor's retained interest in an ABS transaction, such as the amount and form of the interest retained and the assumptions used in determining the aggregate value of ABS to be issued. This information would benefit investors by providing them with an efficient mechanism to monitor compliance with the proposed rules and make informed investment decisions. However, compliance costs to sponsors would increase, since sponsors would now have to prepare and provide these disclosures to investors.

Therefore, the Commission believes that the proposed menu-of-options approach and the accompanying disclosures will have no competitive effects, and will implement the mandates of Section 15G without causing economic inefficiencies or hindering capital formation.[235]

Vertical Risk Retention Method

By requiring the retention of five percent of each interest backed by the securitized asset pool, regardless of whether the interest is certificated or not, the vertical risk retention method is the most straightforward method to implement. The transparency and ease of verification of this method will likely benefit investors to the extent that they view their ability to discern a sponsor's risk retention important. This provides the sponsor an interest in the entire structure of the securitization transaction. However, the vertical risk retention method requires a sponsor to bear only a small fraction of the losses incurred by the pool, thus possibly failing to align sufficiently originators' and sponsors' interests with those of investors when it comes to the origination and underwriting of riskier asset classes. Since 5 percent is a lower bound on the risk required to be retained, it is possible some sponsors may hold more if it were economically optimal.

Horizontal Risk Retention Method

[235] As discussed in the introduction, this statement refers to the choice made by the Commission and other agencies by having proposed a menu of options rather than the statutory mandate to require risk retention.

This method exposes a sponsor to the first 5 percent of all pool-asset losses and thus results in the sponsor retaining substantially more than five percent of the credit risk in a securitization. That is, a sponsor will be exposed to 100 percent of all losses as long as those losses are up to 5 percent. Therefore, this method imposes a significant disincentive on sponsors of poorly underwritten assets. As a result, the horizontal method of risk retention should benefit investors by aligning their incentives with those of originators and sponsors when originating and underwriting riskier asset classes.

Since the retention of a horizontal first-loss position in securitizations leaves the sponsor holding a significant amount of risk, it is possible that for less risky asset classes a 5 percent risk retention might be unnecessarily high. For such asset classes, a sponsor might be constrained to raising external financing for only 95 percent of the asset pool, while the market might have allowed for a smaller equity interest. As a result, the sponsor might have to incur additional financing costs which would have the effect of impeding capital formation.

The retention of a first-loss position has been a common market practice for many asset classes, so this method should not be unnecessarily disruptive and should therefore impose limited additional costs on sponsors. The effect would be that of no decrease in efficiency and no new impediment to capital formation.

Premium Capture Cash Reserve Account

Securitization transactions often contain pools of assets that are expected to earn substantially higher returns compared to the financing rates on the ABS issued in the securitization. This is generally referred to as excess spread. In situations where there is substantial excess spread, the sponsor can obtain significant economic income by selling an interest based on the excess spread. If the sponsor is able to recover more than 5 percent of the balance of the pool in a short period of time, then the sponsor would be left with limited economic interest in the securitization. This is particularly true if defaults occur later in the life of pool assets. For this reason, the proposed rules prohibit the cash flows from the excess spread (or cash proceeds from selling it) to be distributed to the sponsor. This benefits investors by helping to ensure that the incentive-alignment objectives of the proposed rules are achieved. However, this may reduce the flexibility of sponsors in structuring their deals, thus imposing a cost.

L-Shaped Method

Another risk retention option in the proposed rules would allow a sponsor, subject to certain conditions, to use an equal combination of a vertical risk retention and horizontal risk retention as a means of retaining the required five percent exposure to the credit risk of the securitized assets. This form of risk retention is referred to as an "L-Shaped" form of risk retention because it combines both vertical and horizontal forms. Overall, this has the benefits and costs associated with the two approaches as described above. Also, the proposed requirement that the sponsor retain 50 percent vertical and 50 percent horizontal facilitates the monitoring of the risk retention compliance by investors, Agencies and other market participants.

Representative Sample Method

The representative sample method requires risk retention of a randomly selected loan pool that is "similar" in risk attributes to the securitized loans *prior to* a securitization. Since it may be costly to ensure the true "randomness" of the selection or "representativeness" of the sample, and since sponsors' prior knowledge of the sample selection bias might alter their incentives to put well-underwritten assets into the pool, this method may not fulfill its incentive-alignment benefits without mechanisms in place to ensure there is no selection bias. Thus, the proposed rules require that sponsors have plans and procedures in place, maintain documentation, and have the sampling procedures agreed upon by an independent auditing firm. In addition, the proposed rules would require ongoing disclosures about the performance of the assets in the representative sample in the same form, level, and manner as is provided concerning the securitized assets. Although this will increase sponsors' compliance costs, the Commission believes that it will also further the incentive-alignment benefits contemplated in Section 15G of the Exchange Act.

For some asset classes, such as automobile loans, retaining a portion of the loans that would ordinarily be securitized has been used as a method of risk retention. Therefore, permitting a representative sample risk retention option with the appropriate safeguards will likely benefit sponsors of such asset classes, whose compliance costs – other than reporting costs – will not increase as a result of the proposed rules. Furthermore, the borrowers whose loans back such securitizations will also likely experience no increase in their borrowing costs.

Seller's Interest Method

Securitizations of revolving lines of credit, such as credit card accounts or dealer floorplan loans, are typically structured using a revolving master trust, which issues more than one series of ABS backed by a single pool of revolving assets. The proposed rule would allow a sponsor of a revolving asset master trust that is collateralized by revolving loans or other extensions of revolving credit to meet its risk retention requirement by retaining a seller's interest in an amount not less than 5 percent of the unpaid principal balance of the pool assets held by the issuer. The definitions of a seller's interest and a revolving asset master trust are intended to be consistent with market practices and, with respect to seller's interest, designed to help ensure that any seller's interest retained by a sponsor under the proposal would expose the sponsor to the credit risk of the underlying assets. This should benefit all parties to the securitization by balancing implementation costs for sponsors utilizing the master trust structure with incentive-alignment benefits for investors.

3. Definition of Qualified Residential Mortgages

Section 15G requires the Commission, along with the other Agencies, to jointly specify underwriting standards for QRMs that take into consideration underwriting and product features that historical loan performance data indicate result in lower risk of default. Section 15G exempts ABS entirely backed by QRMs from the risk retention mandated by Section 15G. In defining QRMs, the Agencies examined data on mortgage performance supplied by Lender Processing Services' ("LPS") Applied Analytics division (formerly McDash Analytics). To minimize performance differences arising from unobservable changes across products, and to focus on loan performance through stressful environments, the analysis generally used prime fixed-rate loans originated from 2005 to 2008. Since the LPS data do not include detailed borrower information, the Agencies also analyzed data from the triennial Survey of Consumer Finances ("SCF") for the 1992-2007 period. To isolate the borrower characteristics closest in time to the mortgage origination, the analysis was limited to the approximately 1,500 families, who purchased their homes in the year prior to or of the survey. The Agencies also examined a combined data set of loans purchased or securitized by the Enterprises from 1997 to 2009. This data set consisted of more than 78 million mortgages, and included data on loan products and terms, borrower characteristics (e.g., income and credit score), and performance data through the third quarter of 2010.

The analysis of the data described above and the conclusions of numerous academic studies support a definition of QRM that takes into account the following underwriting and product features: the borrower's ability to repay the mortgage (as captured the borrower's debt-to-income ratio); the borrower's credit history; the borrower's down payment amount and sources; the loan-to-value ratio for the loan; the form of valuation used in underwriting the loan; the type of mortgage involved; and the owner-occupancy status of the property securing the mortgage.[236] The Commission believes that selecting this subset of features will be beneficial to loan originators, because these are the features typically considered in the mortgage underwriting process. Although there might be factors among those listed above that loan originators had not previously used in their lending decisions, the Commission believes that this is unlikely. Thus, the Commission expects that loan originators would not have to incur significant new or additional costs to collect information on these specific underwriting and product features, which should have the effect of not unnecessarily disrupting existing lending practices. As a result, the Commission expects that mortgage rates would not be adversely impacted by the Agencies' choice of the features used to define QRMs and therefore this choice would not have a negative effect on efficiency and capital formation.

The Agencies also have sought to make the standards applicable to QRMs transparent to, and verifiable by, originators, securitizers, investors and supervisors. The Commission believes that investors will also benefit from the proposed approach to defining QRMs using the above subset of mortgage features, since these include the factors most commonly considered by the market as determinants of loan quality and expected mortgage default. Therefore, investors will likely be familiar with them, which will have the effect of facilitating investors' interpretation and understanding of the QRM standard as proposed.

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[236] See Demyanyk, Yuliya, and Otto Van Hemert, "Understanding the Subprime Crisis," Working paper. St. Louis, Missouri: Federal Reserve Bank of St. Louis (2008); Quercia, Roberto, Michael Stegman, and Walter R. Davis, "Residential Mortgage Default: A Review of the Literature," Journal of Housing Research 3(2): 341-379 (2005); Ambrose, Brent W., Michael LaCour-Little, and Zsuzsa Huszar, "A Note on Hybrid Mortgages," Real Estate Economics 33(4): 765-782 (2005); Anderson, Dennis Capozza and Robert Van Order, "Deconstructing the Mortgage Meltdown: A Methodology for Decomposing Underwriting Quality," Social Science Research Network. http://ssrn. com/abstract=1411782 (2009); Gerardi, Kristopher, Andreas Lehnert, Shane Sherlund, and Paul Willen "Making Sense of the Subprime Crisis," Brookings Papers on Economic Activity (Fall 2008), 59-145; Austin Kelly, "Skin in the Game: Zero Down Payment Mortgage Default," Federal Housing Finance Agency, Journal of Housing Research, Vol. 19, No. 2 (2008); Neil Bhutta, Jane Dokko and Hui Shan, "The Depth of Negative Equity and Mortgage Default Decisions," Finance and Economics Discussion Series, Federal Reserve Board, 2010-35 (2010); Deng, Yongheng, John M. Quigley and Robert van Order (2000), "Mortgage Terminations, Heterogeneity and the Exercise of Mortgage Options," Econometrica, Vol. 68, No. 2 (2000), pp. 275-307.

When considering the underwriting and product features to be used in the QRM definition, the Agencies selected features that are transparent or verifiable. The Commission believes that this will benefit all entities involved in the securitization process. Loan originators will be able to easily discern whether a mortgage is a QRM during the underwriting process. Sponsors will be able to unambiguously determine whether an ABS is backed by QRMs alone and therefore qualifies for the risk retention exemption. And finally, investors will be able to assess without difficulty whether they are investing in a QRM ABS or not. Thus, the Commission expects that as a result of the transparency and verifiability of the mortgage features used to define QRMs, there will be no reduction in efficiency or impediment to capital formation.

Some of the QRM standards proposed by the Agencies rely on definitions and calculations which may be defined in multiple ways. To provide clarity, the Agencies are proposing the use of definitions of key terms as established in the U.S. Department of Housing and Urban Development (HUD) Handbook 4155.1 (New Version), Mortgage Credit Analysis for Mortgage Insurance, as in effect on December 31, 2010. Since the HUD definitions have been time-tested and are well understood by the market, the Commission believes this approach will be efficient and beneficial to both investors and sponsors. On the other hand, loan originators and sponsors who have been using alternative definitions might incur adjustment costs, if they have to modify their loan origination systems and processes. These new lending costs might be passed onto borrowers in the form of higher mortgage rates or fees, thus impeding capital formation.

The QRM standards that the Agencies are proposing prescribe fixed thresholds for several borrower and loan features. For instance, a QRM cannot have a front-end debt-to-income ratio higher than 28 percent or a loan-to-value ratio higher than 80 percent. The thresholds chosen in the proposed rule reflect a balance between setting standards that are over- or under-conservative with regard to mortgage default risk. If the Agencies had been more conservative in their choices of thresholds such that fewer mortgages were QRMs, more sponsors would have incurred compliance costs for risk retention for non-QRMs. These additional costs would likely be passed on to borrowers whose loans comprise the securitized pool, which would have the effect of increasing mortgage rates for a larger proportion of home buyers. On the other hand, QRM standards that are more restrictive and that result in more non-QRMs would likely create a larger and therefore more liquid secondary market for non-QRMs, and thus reduce the liquidity premium for non-QRM ABS. The reduced liquidity premium, which would decrease non-QRM rates, might counteract the possible increase in non-QRM rates resulting from risk retention compliance costs.

The opposite would also have been true. If the Agencies had been less conservative in their choices of thresholds such that a larger fraction of mortgages would have qualified as QRMs, then non-QRMs might face illiquidity in the secondary market. However, fewer borrowers would have had to face increased mortgage rates resulting from compliance costs for risk retention.

4. Risk Retention Allocation for Non-QRMs and Non-QAs

Many securitization transactions are brought to the market by aggregators who purchase assets from one or many originators, combine these assets in a pool, and then issue securities backed by the assets to investors. This securitization chain allows for the possibility of implementing risk retention at either the originator or the sponsor level. Risk retention imposed directly on originators may be more effective in improving underwriting standards than if imposed on sponsors. On the other hand, many of the risk retention forms discussed earlier would be unfeasible to implement due to the complexity introduced by the two-stage nature of a securitization by an aggregator. Nonetheless, the Agencies believe that the imposition of risk retention on sponsors should still have the effect of improving underwriting standards. Sponsors would have strong incentives to monitor the lending practices of originators and consider these practices when acquiring pool assets. This likely will align originators' interests with those of sponsors, whose interests would now be aligned with those of investors through risk retention.

The proposed rules allow sponsors to allocate some of their risk retention responsibilities to originators, which would provide additional flexibility in complying with the requirements. However, the proposed rules do not allow the allocation of risk to an originator contributing a small share of assets to the securitized pool. Thus, the proposed allocation of risk retention is likely to benefit small loan originators by not allowing sponsors to pass onto them their own risk retention costs.

The Agencies are also proposing to allow risk retention allocation to a third-party purchaser in the securitization of commercial real estate loans. It has been a common market practice for a third-party purchaser to retain the first-loss position in commercial mortgage-backed transactions. This third-party buyer, also known as "B-piece buyer," is typically involved in the securitization early on and thus can significantly affect pool asset selection. The B-piece buyer reviews the loans and corresponding mortgage properties, and may ask for loans to be removed from the pool if underwriting issues are uncovered. Thus, the Agencies' decision to allow a B-piece buyer to meet a sponsor's risk retention obligations under Section 15G of the Exchange Act, will likely benefit both sponsors and investors. It accommodates existing market practices, thus minimizing sponsors' compliance costs while aligning the interests of investors with those of parties performing due diligence on the pool assets. In this way, the proposal should provide incentives for good underwriting and origination practices. Since a sponsor's risk retention obligation can be met by a B-piece buyer only under certain conditions described earlier, these conditions may increase B-piece buyers' cost of participating in CMBS transactions. B-piece buyers may be able to pass these costs to borrowers with an adverse effect on capital formation. However, the Commission preliminary believes that the conditions help ensure that the B-piece buyer's risk retention is consistent with the intent of Section 15G and would benefit investors, and ultimately facilitating capital formation.

As noted earlier, the B-piece buyer in CMBS transactions often acts in the capacity of a special servicer, which can create conflicts of interest between the B-piece buyer and senior tranche holders. To mitigate these conflicts of interest, the Agencies are proposing to have an operating adviser oversee the servicing activities of the B-piece buyer when the B-piece buyer acts in a capacity of a special servicer. While such a requirement would increase compliance costs, it should have the benefit of minimizing B-piece buyers' ability to manipulate cash flows through special servicing and by limiting B-piece buyers' ability to offset the consequences of poor underwriting through special servicing. In addition, it should incentivize B-piece buyers to avoid adding into the pool poorly underwritten or originated assets. This would be consistent with the purpose of Section 15G and would benefit investors, thus facilitating capital formation.

The Agencies are proposing yet another option for risk retention allocation, which is specifically designed for asset-backed commercial paper ("ABCP") conduits. This option takes into account the special structures through which this type of ABS is typically issued, as well as the manner in which exposure to the credit risk of the underlying assets is typically retained.

Although the proposal would allow the originator-sellers (rather than the sponsor) to retain the required eligible horizontal residual interest, the proposal also imposes certain obligations directly on the sponsor in recognition of the key role the sponsor plays in organizing and operating an eligible ABCP conduit. Most importantly, the proposal provides that the sponsor of an eligible ABCP conduit that issues ABCP in reliance on this option would be the securitization party ultimately responsible for compliance with the risk retention requirements of Section 15G of the Exchange Act. The proposal allows for an ABCP sponsor to be in compliance if each originator-seller retains a five-percent horizontal residual interest in each intermediate SPV established by or on behalf of that originator-seller for purposes of issuing interests to an eligible ABCP conduit. Since eligible ABCP conduits also provide full liquidity guarantees to commercial-paper investors by regulated liquidity providers, the flexibility allowed by the proposed rule benefits ABCP sponsors by allowing them to avoid costly duplicative risk retention and should have the effect of promoting capital formation in this important segment of the securitization market.

Further, the proposed rule avoids an outcome in which one originator-seller would have to be exposed to risks underwritten by other originator-sellers. Each originator-seller would be required to retain credit exposure only to its own receivables, thus properly aligning its incentives with those of ABCP investors.

5. Hedging Prohibitions

Hedging helps sponsors manage and mitigate their exposure to unwanted risks. For example, a securitizer may want to mitigate the interest rate risk of its ABS portfolio. Hedging is also a beneficial activity from a systemic risk perspective because it helps market participants redistribute risk. Given the benefits from hedging, the proposed rule aims to implement the risk retention mandate of Section 15G without unduly limiting a sponsor's risk management activities. This is accomplished by prohibiting hedging only to the extent that hedging would result in a sponsor no longer being exposed to the risk required to be retained by Section 15G of the Exchange Act.

The ability to hedge interest rate risk and similar risks increases economic efficiency and facilitates capital formation, because it allows securitizers to direct their capital and efforts towards activities of comparative advantage. For instance, a securitizer might have a superior ability of assessing the credit risk of residential mortgages, but be less skilled in forecasting interest-rate changes. Such a securitizer might find it more efficient to hedge the interest-rate risk of the residential mortgages collateralizing an RMBS rather than invest resources in improving its ability to understand and price this interest-rate risk. Furthermore, since interest-rate fluctuations are unrelated to underwriting deficiencies in the loan origination process, allowing a securitizer to hedge interest-rate risk will not compromise the incentive alignment contemplated by the Act. The ability to hedge also may help competition, because by hedging less diversified companies may be able to compete with more diversified companies that have weaker hedging incentives. Therefore, the proposed rules are designed to promote efficiency, competition and capital formation.

6. Treatment of Government-Sponsored Enterprises

The proposed rules, which allows the guarantees of Fannie Mae and Freddie Mac to satisfy the risk retention requirements while they are operating under the conservatorship or receivership of FHFA with capital support from the United States, as well as for any limited-life regulated entity succeeding to the charter and also operating with such capital support, avoid unnecessary costs to be incurred by sponsors until the statutory and regulatory framework for the Enterprises becomes clearer. The Commission believes that the capital support provided by the United States government makes additional risk retention unnecessary because as a result of the support investors in GSE ABS are not exposed to any credit losses. Thus, there would be no incremental benefit to be gained by requiring GSEs to retain risk.

7. Resecuritization Transactions

The Agencies have identified certain resecuritizations where duplicative risk retention requirements would provide no added benefit. Resecuritizations collateralized only by existing 15G-compliant ABS and financed through the issuance of a single class of securities so that all principal and interest payments received are evenly distributed to all security holders, are a unique category of resecuritizations. For them, the resecuritization process would neither increase nor reallocate the credit risk of the underlying ABS. Therefore, there would be no cost to investors from incentive misalignment with the securitizing sponsor. Furthermore, because this type of resecuritization may be used to aggregate 15G-compliant ABS backed by small asset pools, the exemption for this type of resecuritization could improve access to credit at reasonable terms to consumers and businesses by allowing for the creation of an additional investment vehicle for these smaller asset pools. The exemption would allow the creation of ABS that may be backed by more geographically diverse pools than those that can be achieved by the pooling of individual assets as part of the issuance of the underlying 15G-compliant ABS. Again, this will likely improve access to credit on reasonable terms.

Under the proposed rule, sponsors of resecuritizations that do not have the structure described above would not be exempted from risk retention. Resecuritization transactions, which re-tranche the credit risk of the underlying ABS, would be subject to risk retention requirements in addition to the risk retention requirement imposed on the underlying ABS. In such transactions, there is the possibility of incentive misalignment between investors and sponsors just as when structuring the underlying ABS. For such resecuritizations, the proposed rule seeks to ensure that this misalignment is addressed by not granting these resecuritizations with an exemption from risk retention. However, the proposed rules may have an adverse impact on capital formation and efficiency if they make some types of resecuritization transactions costlier or infeasible to conduct as a result of risk retention costs.

D. Executive Order 12866 Determination

The Office of Management and Budget (OMB) reviewed this proposed rule as it relates to programs and activities of the Department of Housing and Urban Development (HUD) under Executive Order 12866 (entitled "Regulatory Planning and Review"), and determined the rule as it relates to HUD to be an economically significant regulatory action, as provided in section 3(f)(1) of the Order. The docket file is available for public inspection in the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street, SW, Room 10276 Washington, DC 20410-0500. Due to security measures at the HUD Headquarters building, please schedule an appointment to review the docket file by calling the Regulations Division at 202-402-3055 (this is not a toll-free number). Individuals with speech or hearing impairments may access this number via TTY by calling the Federal Information Relay Service at 800-877-8339.

E. OCC Unfunded Mandates Reform Act of 1995 Determination

Section 202 of the Unfunded Mandates Reform Act of 1995, Public Law 104-4 (Unfunded Mandates Act) requires that an agency prepare a budgetary impact statement before promulgating a rule that includes a Federal mandate that may result in expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of $100 million (adjusted for inflation) or more in any one year. The current inflation-adjusted expenditure threshold is $126.4 million. If a budgetary impact statement is required, section 205 of the UMRA also requires an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a rule.

Based on current and historical supervisory data on national bank securitization activity, the OCC estimates that, pursuant to the proposed rule, national banks would be required to retain approximately $2.8 billion of credit risk, after taking into consideration the proposed exemptions for qualified residential mortgages and other qualified assets. The cost of retaining this risk amount has two components. The first is the loss of origination and servicing fees on the reduced amount of origination activity necessitated by the need to hold the $2.8 billion retention amount on the bank's balance sheet. Typical origination fees are 1 percent and typical servicing fees are another half of a percentage point. To capture any additional lost fees, the OCC conservatively estimated that the total cost of lost fees to be two percent of the retained amount, or approximately $56 million. The second component of the retention cost is the opportunity cost of earning the return on these retained assets versus the return that the bank would earn if these funds were put to other use. Because of the variety of assets and returns on the securitized assets, the OCC assumes that this interest opportunity cost nets to zero. In addition to the cost of retaining the assets under the proposed rule, the overall cost of the proposed rule includes the administrative costs associated with implementing the rule and providing required disclosures. The OCC estimates that implementation and disclosure will require approximately 480 hours per institution, or at $100 per hour, approximately $48,000 per institution. The OCC estimates that the rule will apply to approximately 25 national banking organizations. Thus, the estimate of the total administrative cost of the proposed rule is approximately $1.2 million. Thus, the estimated total cost of the proposed rule applied to ABS is $57.2 million.

The OCC has determined that its portion of the final rules will not result in expenditures by State, local, and tribal governments, or by the private sector, of $126.4 million or more. Accordingly, the OCC has not prepared a budgetary impact statement or specifically addressed the regulatory alternatives considered

F. Commission: Small Business Regulatory Enforcement Fairness Act

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or "SBREFA,"[237] the Commission solicits data to determine whether the proposal constitutes a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results or is likely to result in:

- An annual effect on the economy of $100 million or more (either in the form of an increase or a decrease);

- A major increase in costs or prices for consumers or individual industries; or

- Significant adverse effects on competition, investment or innovation.

We request comment on the potential impact of the proposal on the U.S. economy on an annual basis, any potential increase in costs or prices for consumers or individual industries, and any potential effect on competition, investment or innovation. Commenters are requested to provide empirical data and other factual support for their views if possible.

G. FHFA: Considerations of Differences between the Federal Home Loan Banks and the Enterprises

Section 1313 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 requires the Director of FHFA, when promulgating regulations relating to the Federal Home Loan Banks (Banks), to consider the following differences between the Banks and the Enterprises (Fannie Mae and Freddie Mac): cooperative ownership structure; mission of providing liquidity to members; affordable housing and community development mission; capital structure; and joint and several liability.[238] The Director also may consider any other differences that are deemed appropriate. In preparing the portions of this proposed rule over which FHFA has joint rulemaking authority, the Director considered the differences between the Banks and the Enterprises as they relate to the above factors. FHFA requests comments from the public about whether differences related to these factors should result in any revisions to the proposal.

Text of the Proposed Common Rules

(All Agencies)

The text of the proposed common rules appears below:

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[237] 5 U.S.C. 603.
[238] See 12 U.S.C. 4513.

PART [ ]—CREDIT RISK RETENTION

Subpart A	Authority, Purpose, Scope and Definitions	
	Section 1	Authority, purpose, and scope
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Subpart D	Exceptions and Exemptions	
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	Section 17	Exceptions for qualifying commercial loans, commercial mortgages, and auto loans
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SUBPART A—AUTHORITY, PURPOSE, SCOPE AND DEFINITIONS

§ __.1 Authority, purpose, and scope

[Reserved]

§ __.2 Definitions.

For purposes of this part, the following definitions apply:

ABCP means asset-backed commercial paper that has a maturity at the time of issuance not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

ABS interest:

(1) Includes any type of interest or obligation issued by an issuing entity, whether or not in certificated form, including a security, obligation, beneficial interest or residual interest, payments on which are primarily dependent on the cash flows of the collateral owned or held by the issuing entity; and

(2) Does not include common or preferred stock, limited liability interests, partnership interests, trust certificates, or similar interests that:

(i) Are issued primarily to evidence ownership of the issuing entity; and

(ii) The payments, if any, on which are not primarily dependent on the cash flows of the collateral held by the issuing entity.

An affiliate of, or a person affiliated with, a specified person means a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified.

Asset means a self-liquidating financial asset (including but not limited to a loan, lease, mortgage, or receivable).

Asset-backed security has the same meaning as in section 3(a)(77) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(77)).

Appropriate Federal banking agency has the same meaning as in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813).

Collateral with respect to any issuance of ABS interests means the assets or other property that provide the cash flow (including cash flow from the foreclosure or sale of the assets or property) for the ABS interests irrespective of the legal structure of issuance, including security interests in assets or other property of the issuing entity, fractional undivided property interests in the assets or other property of the issuing entity, or any other property interest in such assets or other property.

Assets or other property collateralize an issuance of ABS interests if the assets or property serve as collateral for such issuance.

Commercial real estate loan has the same meaning as in § __.16 of this part.

Commission means the Securities and Exchange Commission.

Consolidated affiliate means, with respect to a sponsor, an entity (other than the issuing entity) the financial statements of which are consolidated with those of:

(1) The sponsor under applicable accounting standards; or

(2) Another entity the financial statements of which are consolidated with those of the sponsor under applicable accounting standards.

Control including the terms “controlling,” “controlled by” and “under common control with”

(1) Means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.

(2) Without limiting the foregoing, a person shall be considered to control a company if the person:

(i) Owns, controls or holds with power to vote 25 percent or more of any class of voting securities of the company; or

(ii) Controls in any manner the election of a majority of the directors, trustees or persons performing similar functions of the company.

Credit risk means:

(1) The risk of loss that could result from the failure of the borrower in the case of a securitized asset, or the issuing entity in the case of an ABS interest in the issuing entity, to make required payments of principal or interest on the asset or ABS interest on a timely basis;

(2) The risk of loss that could result from bankruptcy, insolvency, or a similar proceeding with respect to the borrower or issuing entity, as appropriate; or

(3) The effect that significant changes in the underlying credit quality of the asset or ABS interest may have on the market value of the asset or ABS interest.

Depositor means:

(1) The person that receives or purchases and transfers or sells the securitized assets to the issuing entity;

(2) The sponsor, in the case of a securitization transaction where there is not an intermediate transfer of the assets from the sponsor to the issuing entity; or

(3) The person that receives or purchases and transfers or sells the securitized assets to the issuing entity in the case of a securitization transaction where the person transferring or selling the securitized assets directly to the issuing entity is itself a trust.

Eligible ABCP conduit means an issuing entity that issues ABCP provided that:

(1) The issuing entity is bankruptcy remote or otherwise isolated for insolvency purposes from the sponsor of the issuing entity and from any intermediate SPV;

(2) The interests issued by an intermediate SPV to the issuing entity are collateralized solely by the assets originated by a single originator-seller;

(3) All of the interests issued by an intermediate SPV are transferred to one or more ABCP conduits or retained by the originator-seller; and

(4) A regulated liquidity provider has entered into a legally binding commitment to provide 100 percent liquidity coverage (in the form of a lending facility, an asset purchase agreement, a repurchase agreement, or other similar arrangement) to all the ABCP issued by the issuing entity by lending to, or purchasing assets from, the issuing entity in the event that funds are required to repay maturing ABCP issued by the issuing entity.

Eligible horizontal residual interest means, with respect to any securitization transaction, an ABS interest in the issuing entity that:

(1) Is allocated all losses on the securitized assets (other than losses that are first absorbed through the release of funds from a premium capture cash reserve account, if such an account is required to be established under § __.12 of this part) until the par value of such ABS interest is reduced to zero;

(2) Has the most subordinated claim to payments of both principal and interest by the issuing entity; and

(3) Until all other ABS interests in the issuing entity are paid in full, is not entitled to receive any payments of principal made on a securitized asset, provided, however, an eligible horizontal residual interest may receive its current proportionate share of scheduled payments of principal received on the securitized assets in accordance with the transaction documents.

Federal banking agencies means the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation.

Intermediate SPV means, with respect to an originator-seller, a special purpose vehicle that:

(1) Is bankruptcy remote or otherwise isolated for insolvency purposes from the originator-seller;

(2) Purchases assets from the originator-seller; and

(3) Issues interests collateralized by such assets to one or more ABCP conduits.

Issuing entity means, with respect to a securitization transaction, the trust or other entity:

(1) That is created at the direction of the sponsor;

(2) That owns or holds the pool of assets to be securitized; and

(3) In whose name the asset-backed securities are issued.

Originator means a person who:

(1) Through an extension of credit or otherwise, creates an asset that collateralizes an asset-backed security; and

(2) Sells the asset directly or indirectly to a securitizer.

Originator-seller means an entity that creates assets through one or more extensions of credit and sells those assets (and no other assets) to an intermediate SPV, which in turn sells interests collateralized by those assets to one or more ABCP conduits.

Regulated liquidity provider means:

(1) A depository institution (as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813));

(2) A bank holding company (as defined in 12 U.S.C. 1841), or a subsidiary thereof;

(3) A savings and loan holding company (as defined in 12 U.S.C. 1467a), provided all or substantially all of the holding company's activities are permissible for a financial holding company under 12 U.S.C. 1843(k), or a subsidiary thereof; or

(4) A foreign bank whose home country supervisor (as defined in § 211.21 of the Federal Reserve Board's Regulation K (12 CFR 211.21)) has adopted capital standards consistent with the Capital Accord of the Basel Committee on Banking Supervision, as amended, and that is subject to such standards, or a subsidiary thereof.

Retaining sponsor means, with respect to a securitization transaction, the sponsor that has retained or caused to be retained an economic interest in the credit risk of the securitized assets pursuant to subpart B of this part.

Revolving asset master trust means an issuing entity that is:

(1) A master trust; and

(2) Established to issue more than one series of asset-backed securities all of which are collateralized by a single pool of revolving securitized assets that are expected to change in composition over time.

Securitization transaction means a transaction involving the offer and sale of asset-backed securities by an issuing entity.

Securitized asset means an asset that:

(1) Is transferred, sold, or conveyed to an issuing entity; and

(2) Collateralizes the ABS interests issued by the issuing entity.

Securitizer with respect to a securitization transaction shall mean either:

(1) The depositor of the asset-backed securities; or

(2) A sponsor of the asset-backed securities.

Seller's interest means an ABS interest:

(1) In all of the assets that:

(i) Are owned or held by the issuing entity; and

(ii) Do not collateralize any other ABS interests issued by the issuing entity;

(2) That is pari passu with all other ABS interests issued by the issuing entity with respect to the allocation of all payments and losses prior to an early amortization event (as defined in the transaction documents); and

(3) That adjusts for fluctuations in the outstanding principal balances of the securitized assets.

Servicer means any person responsible for the management or collection of the securitized assets or making allocations or distributions to holders of the ABS interests, but does not include a trustee for the issuing entity or the asset-backed securities that makes allocations or distributions to holders of the ABS interests if the trustee receives such allocations or distributions from a servicer and the trustee does not otherwise perform the functions of a servicer.

Sponsor means a person who organizes and initiates a securitization transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuing entity.

U.S. person:

(1) Means—

(i) Any natural person resident in the United States;

(ii) Any partnership, corporation, limited liability company, or other organization or entity organized or incorporated under the laws of the United States;

(iii) Any estate of which any executor or administrator is a U.S. person;

(iv) Any trust of which any trustee is a U.S. person;

(v) Any agency or branch of a foreign entity located in the United States;

(vi) Any non-discretionary account or similar account (other than an estate or trust) held by a dealer or other fiduciary for the benefit or account of a U.S. person;

(vii) Any discretionary account or similar account (other than an estate or trust) held by a dealer or other fiduciary organized, incorporated, or (if an individual) resident in the United States; and

(viii) Any partnership, corporation, limited liability company, or other organization or entity if:

(A) Organized or incorporated under the laws of any foreign jurisdiction; and

(B) Formed by a U.S. person principally for the purpose of investing in securities not registered under the Act.

(2) Does not include—

(i) Any discretionary account or similar account (other than an estate or trust) held for the benefit or account of a non-U.S. person by a dealer or other professional fiduciary organized, incorporated, or (if an individual) resident in the United States;

(ii) Any estate of which any professional fiduciary acting as executor or administrator is a U.S. person if:

(A) An executor or administrator of the estate who is not a U.S. person has sole or shared investment discretion with respect to the assets of the estate; and

(B) The estate is governed by foreign law;

(iii) Any trust of which any professional fiduciary acting as trustee is a U.S. person, if a trustee who is not a U.S. person has sole or shared investment discretion with respect to the trust assets, and no beneficiary of the trust (and no settlor if the trust is revocable) is a U.S. person;

(iv) An employee benefit plan established and administered in accordance with the law of a country other than the United States and customary practices and documentation of such country;

(v) Any agency or branch of a U.S. person located outside the United States if:

(A) The agency or branch operates for valid business reasons; and

(B) The agency or branch is engaged in the business of insurance or banking and is subject to substantive insurance or banking regulation, respectively, in the jurisdiction where located;

(vi) The International Monetary Fund, the International Bank for Reconstruction and Development, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the United Nations, and their agencies, affiliates and pension plans, and any other similar international organizations, their agencies, affiliates and pension plans.

(3) For purposes of the definition of a U.S. person, the term <u>United States</u> means the United States of America, its territories and possessions, any State of the United States, and the District of Columbia.

SUBPART B—CREDIT RISK RETENTION

<u>§ __.3 Base risk retention requirement</u>.

(a) <u>Base risk retention requirement</u>. Except as otherwise provided in this part, the sponsor of a securitization transaction shall retain an economic interest in the credit risk of the securitized assets in accordance with any one of § __.4 through § __.11 of this part.

(b) <u>Multiple sponsors</u>. If there is more than one sponsor of a securitization transaction, it shall be the responsibility of each sponsor to ensure that at least one of the sponsors of the securitization transaction retains an economic interest in the credit risk of the securitized assets in accordance with any one of § __.4 through § __.11 of this part.

<u>§ __.4 Vertical risk retention</u>.

(a) In general. At the closing of the securitization transaction, the sponsor retains not less than five percent of each class of ABS interests in the issuing entity issued as part of the securitization transaction.

(b) Disclosures. A sponsor utilizing this section shall provide, or cause to be provided, to potential investors a reasonable period of time prior to the sale of the asset-backed securities in the securitization transaction and, upon request, to the Commission and to its appropriate Federal banking agency, if any, the following disclosure in written form under the caption "Credit Risk Retention":

(1) The amount (expressed as a percentage and dollar amount) of each class of ABS interests in the issuing entity that the sponsor will retain (or did retain) at the closing of the securitization transaction and the amount (expressed as a percentage and dollar amount) of each class of ABS interests in the issuing entity that the sponsor is required to retain under this section; and

(2) The material assumptions and methodology used in determining the aggregate dollar amount of ABS interests issued by the issuing entity in the securitization transaction, including those pertaining to any estimated cash flows and the discount rate used.

§ __.5 Horizontal risk retention.

(a) General requirement. At the closing of the securitization transaction, the sponsor retains an eligible horizontal residual interest in an amount that is equal to at least five percent of the par value of all ABS interests in the issuing entity issued as part of the securitization transaction.

(b) Option to hold base amount in horizontal cash reserve account. In lieu of retaining an eligible horizontal residual interest in the amount required by paragraph (a) of this section, the sponsor may, at closing of the securitization transaction, cause to be established and funded, in cash, a horizontal cash reserve account in the amount specified in paragraph (a), provided that the account meets all of the following conditions:

(1) The account is held by the trustee (or person performing similar functions) in the name and for the benefit of the issuing entity;

(2) Amounts in the account are invested only in:

(i) United States Treasury securities with maturities of 1 year or less; or

(ii) Deposits in one or more insured depository institutions (as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813)) that are fully insured by federal deposit insurance; and

(3) Until all ABS interests in the issuing entity are paid in full or the issuing entity is dissolved:

(i) Amounts in the account shall be released to satisfy payments on ABS interests in the issuing entity on any payment date on which the issuing entity has insufficient funds from any source (including any premium capture cash reserve account established pursuant to § __.12 of this part) to satisfy an amount due on any ABS interest; and

(ii) No other amounts may be withdrawn or distributed from the account except that:

(A) Amounts in the account may be released to the sponsor or any other person due to the receipt by the issuing entity of scheduled payments of principal on the securitized assets, provided that, the issuing entity distributes such payments of principal in accordance with the transaction documents and the amount released from the account on any date does not exceed the product of:

(1) The amount of scheduled payments of principal received by the issuing entity and for which the release is being made; and

(2) The ratio of the current balance in the horizontal cash reserve account to the aggregate remaining principal balance of all ABS interests in the issuing entity; and

(B) Interest on investments made in accordance with paragraph (b)(2) may be released once received by the account.

(c) Disclosures. A sponsor utilizing this section shall provide, or cause to be provided, to potential investors a reasonable period of time prior to the sale of the asset-backed securities in the securitization transaction and, upon request, to the Commission and its appropriate Federal banking agency, if any, the following disclosure in written form under the caption "Credit Risk Retention":

(1) If the sponsor retains risk through an eligible horizontal residual interest:

(i) The amount (expressed as a percentage and dollar amount) of the eligible horizontal residual interest the sponsor will retain (or did retain) at the closing of the securitization transaction, and the amount (expressed as a percentage and dollar amount) of the eligible horizontal residual interest that the sponsor is required to retain under this section; and

(ii) A description of the material terms of the eligible horizontal residual interest to be retained by the sponsor;

(2) If the sponsor retains risk through the funding of a horizontal cash reserve account:

(i) The dollar amount to be placed (or placed) by the sponsor in the horizontal cash reserve account and the dollar amount the sponsor is required to place in such an account pursuant to this section; and

(ii) A description of the material terms of the horizontal cash reserve account; and

(3) The material assumptions and methodology used in determining the aggregate dollar amount of ABS interests issued by the issuing entity in the securitization transaction, including those pertaining to any estimated cash flows and the discount rate used.

§ __.6 L-Shaped risk retention.

(a) General requirement. At the closing of the securitization transaction, the sponsor:

(1) Retains not less than 2.5 percent of each class of ABS interests in the issuing entity issued as part of the securitization transaction; and

(2) Retains an eligible horizontal residual interest in the issuing entity, or establishes and funds in cash a horizontal cash reserve account that meets all of the requirements of § __.5(b) of this part, in an amount that in either case is equal to at least 2.564 percent of the par value of all ABS interests in the issuing entity issued as part of the securitization transaction other than any portion of such ABS interests that the sponsor is required to retain pursuant to paragraph (a)(1) of this section.

(b) Disclosure requirements. A sponsor utilizing this section shall comply with all of the disclosure requirements set forth in § __.4(b) and § __.5(c) of this part.

§ __.7 Revolving asset master trusts.

(a) General requirement. At the closing of the securitization transaction and until all ABS interests in the issuing entity are paid in full, the sponsor retains a seller's interest of not less than five percent of the unpaid principal balance of all the assets owned or held by the issuing entity provided that:

(1) The issuing entity is a revolving asset master trust; and

(2) All of the securitized assets are loans or other extensions of credit that arise under revolving accounts.

(b) Disclosures. A sponsor utilizing this section shall provide, or cause to be provided, to potential investors a reasonable period of time prior to the sale of the asset-backed securities in the securitization transaction and, upon request, to the Commission and its appropriate Federal banking agency, if any, the following disclosure in written form under the caption "Credit Risk Retention":

(1) The amount (expressed as a percentage and dollar amount) of the seller's interest that the sponsor will retain (or did retain) at the closing of the securitization transaction and the amount (expressed as a percentage and dollar amount) that the sponsor is required to retain pursuant to this section;

(2) A description of the material terms of the seller's interest; and

(3) The material assumptions and methodology used in determining the aggregate dollar amount of ABS interests issued by the issuing entity in the securitization transaction, including those pertaining to any estimated cash flows and the discount rate used.

§ __.8 Representative sample.

(a) In general. At the closing of the securitization transaction, the sponsor retains ownership of a representative sample of the pool of assets that are designated for securitization in the securitization transaction and draws from such pool all of the securitized assets for the securitization transaction, provided that:

(1) At the time of issuance of asset-backed securities by the issuing entity, the unpaid principal balance of the assets comprising the representative sample retained by the sponsor is equal to at least 5.264 percent of the unpaid principal balance of all the securitized assets in the securitization transaction; and

(2) The sponsor complies with paragraphs (b) through (g) of this section.

(b) Construction of representative sample.

(1) Designated pool. Prior to the sale of the asset-backed securities as part of the securitization transaction, the sponsor identifies a designated pool (the “designated pool”) of assets:

(i) That consists of a minimum of 1000 separate assets;

(ii) From which the securitized assets and the assets comprising the representative sample are exclusively drawn; and

(iii) That contains no assets other than those described in paragraph (b)(1)(ii) of this section.

(2) Random selection from designated pool. (i) Prior to the sale of the asset-backed securities as part of the securitization transaction, the sponsor selects from the assets that comprise the designated pool a sample of such assets using a random selection process that does not take account of any characteristic of the assets other than the unpaid principal balance of the assets.

(ii) The unpaid principal balance of the assets selected through the random selection process described in paragraph (b)(2)(i) must represent at least 5 percent of the aggregate unpaid principal balance of all the assets that comprise the designated pool.

(3) Equivalent risk determination. Prior to the sale of the asset-backed securities as part of the securitization transaction, the sponsor determines, using a statistically valid methodology, that for each material characteristic of the assets in the designated pool, including the average unpaid principal balance of all the assets, that the mean of any quantitative characteristic, and the proportion of any characteristic that is categorical in nature, of the sample of assets randomly selected from the designated pool pursuant to paragraph (b)(2) of this section is within a 95

percent two-tailed confidence interval of the mean or proportion, respectively, of the same characteristic of the assets in the designated pool.

(c) Sponsor policies, procedures and documentation.

(1) The sponsor has in place, and adheres to, policies and procedures for:

(i) Identifying and documenting the material characteristics of assets included in the designated pool;

(ii) Selecting assets randomly in accordance with paragraph (b)(2) of this section;

(iii) Testing the randomly-selected sample of assets for compliance with paragraph (b)(3) of this section;

(iv) Maintaining, until all ABS interests are paid in full, documentation that clearly identifies the assets included in the representative sample established under paragraphs (b)(2) and (3) of this section; and

(v) Prohibiting, until all ABS interests are paid in full, assets in the representative sample from being included in the designated pool of any other securitization transaction.

(2) The sponsor maintains documentation that clearly identifies the assets in the representative sample established under paragraphs (b)(2) and (3) of this section.

(d) Agreed upon procedures report.

(1) Prior to the sale of the asset-backed securities as part of the securitization transaction, the sponsor has obtained an agreed upon procedures report that satisfies the requirements of paragraph (d)(2) of this section from an independent public accounting firm.

(2) The independent public accounting firm providing the agreed upon procedures report required by paragraph (d)(1) of this section must at a minimum report on whether the sponsor has:

(i) Policies and procedures that require the sponsor to identify and document the material characteristics of assets included in a designated pool of assets that meets the requirements of paragraph (b)(1) of this section;

(ii) Policies and procedures that require the sponsor to select assets randomly in accordance with paragraph (b)(2) of this section;

(iii) Policies and procedures that require the sponsor to test the randomly-selected sample of assets in accordance with paragraph (b)(3) of this section;

(iv) Policies and procedures that require the sponsor to maintain, until all ABS interests are paid in full, documentation that identifies the assets in the representative sample established under paragraphs (b)(2) and (3) of this section; and

(v) Policies and procedures that require the sponsor to prohibit, until all ABS interests are paid in full, assets in the representative sample from being included in the designated pool of any other securitization transaction.

(e) Servicing. Until such time as all ABS interests in the issuing entity have been fully paid or the issuing entity has been dissolved:

(1) Servicing of the assets included in the representative sample must be conducted by the same entity and under the same contractual standards as the servicing of the securitized assets; and

(2) The individuals responsible for servicing the assets included in the representative sample or the securitized assets must not be able to determine whether an asset is owned or held by the sponsor or owned or held by the issuing entity.

(f) Sale, hedging or pledging prohibited. Until such time as all ABS interests in the issuing entity have been fully paid or the issuing entity has been dissolved, the sponsor:

(1) Shall comply with the restrictions in § __.14 of this part with respect to the assets in the representative sample;

(2) Shall not remove any assets from the representative sample; and

(3) Shall not cause or permit any assets in the representative sample to be included in any designated pool or representative sample established in connection with any other issuance of asset-backed securities.

(g) Disclosures.

(1) Disclosure prior to sale. A sponsor utilizing this section shall provide, or cause to be provided, to potential investors a reasonable period of time prior to the sale of the asset-backed securities as part of the securitization transaction and, upon request, to the Commission and its appropriate Federal banking agency, if any, the following disclosure with respect to the securitization transaction in written form under the caption “Credit Risk Retention”:

(i) The amount (expressed as a percentage of the designated pool and dollar amount) of assets included in the representative sample and to be retained (or retained) by the sponsor, and the amount (expressed as a percentage of the designated pool and dollar amount) of assets required to be included in the representative sample and retained by the sponsor pursuant to this section;

(ii) A description of the material characteristics of the designated pool, including, but not limited to, the average unpaid principal balance of all the assets, the means of the quantitative characteristics and the proportions of categorical characteristics of the assets, appropriate introductory and explanatory information to introduce the characteristics, the methodology used in determining or calculating the characteristics, and any terms or abbreviations used;

(iii) A description of the policies and procedures that the sponsor used for ensuring that the process for identifying the representative sample complies with paragraph (b)(2) of this section and that the representative sample has equivalent material characteristics as required by paragraph (b)(3) of this section;

(iv) Confirmation that an agreed upon procedures report was obtained pursuant to paragraph (d) of this section; and

(v) The material assumptions and methodology used in determining the aggregate dollar amount of ABS interests issued by the issuing entity in the securitization transaction, including those pertaining to any estimated cash flows and the discount rate used.

(2) Disclosure after sale. A sponsor utilizing this section shall provide, or cause to be provided, to the holders of the asset-backed securities issued as part of the securitization transaction and, upon request, provide, or cause to be provided, to the Commission and its appropriate Federal banking agency, if any, at the end of each distribution period, as specified in the governing documents for such asset-backed securities, a comparison of the performance of the pool of securitized assets included in the securitization transaction for the related distribution period with the performance of the assets in the representative sample for the related distribution period.

(3) Conforming disclosure of representative sample. A sponsor utilizing this section shall provide, or cause to be provided, to holders of the asset-backed securities issued as part of the securitization transaction and, upon request, provide to the Commission and its appropriate Federal banking agency, if any, disclosure concerning the assets in the representative sample in the same form, level, and manner as it provides, pursuant to rule or otherwise, concerning the securitized assets.

§ __.9 Eligible ABCP conduits.

(a) In general. A sponsor satisfies the risk retention requirement of § __.3 of this part with respect to the issuance of ABCP by an eligible ABCP conduit in a securitization transaction if:

(1) Each originator-seller of the ABCP conduit:

(i) Retains an eligible horizontal residual interest in each intermediate SPV established by or on behalf of that originator-seller for purposes of issuing interests collateralized by assets of such intermediate SPV to the eligible ABCP conduit in the same form, amount, and manner as would be required under §__.5(a) of this part if the originator-seller was the only sponsor of the intermediate SPV; and

(ii) Complies with the provisions of § __.14 of this part with respect to the eligible horizontal residual interest retained pursuant to paragraph (a)(1)(i) of this section as if it were a retaining sponsor with respect to such interest;

(2) The sponsor:

(i) Establishes the eligible ABCP conduit;

(ii) Approves each originator-seller permitted to sell or transfer assets, indirectly through an intermediate SPV, to the eligible ABCP conduit;

(iii) Establishes criteria governing the assets that the originator-sellers referred to in paragraph (a)(2)(ii) of this section are permitted to sell or transfer to an intermediate SPV;

(iv) Approves all interests in an intermediate SPV to be purchased by the eligible ABCP conduit;

(v) Administers the eligible ABCP conduit by monitoring the interests in any intermediate SPV acquired by the conduit and the assets collateralizing those interests, arranging for debt placement, compiling monthly reports, and ensuring compliance with the conduit documents and with the conduit's credit and investment policy; and

(vi) Maintains and adheres to policies and procedures for ensuring that the conditions in this paragraph (a) have been met.

(b) Disclosures. A sponsor utilizing this section shall provide, or cause to be provided, to potential investors a reasonable period of time prior to the sale of any ABCP by the eligible ABCP conduit as part of the securitization transaction and, upon request, to the Commission and its appropriate Federal banking agency, if any, in written form under the caption "Credit Risk Retention", the name and form of organization of:

(1) Each originator-seller that will retain (or has retained) an eligible horizontal residual interest in the securitization transaction pursuant to this section, including a description of the form, amount (expressed as a percentage and as a dollar amount), and nature of such interest; and

(2) Each regulated liquidity provider that provides liquidity support to the eligible ABCP conduit, including a description of the form, amount, and nature of such liquidity coverage.

(c) Duty to comply.

(1) The retaining sponsor shall be responsible for compliance with this section.

(2) A retaining sponsor relying on this section:

(i) Shall maintain and adhere to policies and procedures that are reasonably designed to monitor compliance by each originator-seller of the eligible ABCP conduit with the requirements of paragraph (a)(1) of this section; and

(ii) In the event that the sponsor determines that an originator-seller no longer complies with the requirements of paragraph (a)(1) of this section, shall promptly notify the holders of the ABS interests issued in the securitization transaction of such noncompliance by such originator-seller.

§ ___.10 Commercial mortgage-backed securities.

(a) Third-Party Purchaser. A sponsor satisfies the risk retention requirements of § __.3 of this part with respect to a securitization transaction if a third party purchases an eligible horizontal residual interest in the issuing entity in the same form, amount, and manner as would be required of the sponsor under § ___.5(a) of this part and all of the following conditions are met:

(1) Composition of collateral. At the closing of the securitization transaction, at least 95 percent of the total unpaid principal balance of the securitized assets in the securitization transaction are commercial real estate loans.

(2) Source of funds. The third-party purchaser:

(i) Pays for the eligible horizontal residual interest in cash at the closing of the securitization transaction; and

(ii) Does not obtain financing, directly or indirectly, for the purchase of such interest from any other person that is a party to the securitization transaction (including, but not limited to, the sponsor, depositor, or an unaffiliated servicer), other than a person that is a party to the transaction solely by reason of being an investor.

(3) Third-party review. The third-party purchaser conducts a review of the credit risk of each securitized asset prior to the sale of the asset-backed securities in the securitization transaction that includes, at a minimum, a review of the underwriting standards, collateral, and expected cash flows of each commercial real estate loan that is collateral for the asset-backed securities.

(4) Affiliation and control rights. (i) Except as provided in paragraphs (a)(4)(ii) or (iii) of this section:

(A) The third-party purchaser is not affiliated with any party to the securitization transaction (including, but not limited to, the sponsor, depositor, or servicer) other than investors in the securitization transaction; and

(B) The third-party purchaser or an affiliate of such third-party purchaser does not have control rights in connection with the securitization transaction (including, but not limited to, acting as a servicer for the securitized assets) that are not collectively shared with all other investors in the securitization.

(ii) Notwithstanding paragraph (a)(4)(i)(A) of this section, the third-party purchaser may be affiliated with one or more originators of the securitized assets so long as the assets originated by the affiliated originator or originators collectively comprise less than 10 percent of the unpaid principal balance of the securitized assets included in the securitization transaction at closing of the securitization transaction.

(iii) Paragraph (a)(4)(i) of this section shall not prevent the third-party purchaser from acting as, or being an affiliate of, a servicer for any of the securitized assets, and having such controls rights that are related to such servicing, if the underlying securitization transaction documents provide for the following:

(A) The appointment of an operating advisor (the "Operating Advisor") that:

(1) Is not affiliated with other parties to the securitization transaction;

(2) Does not directly or indirectly have any financial interest in the securitization transaction other than in fees from its role as Operating Advisor; and

(3) Is required to act in the best interest of, and for the benefit of, investors as a collective whole.

(B) Any servicer for the securitized assets that is, or is affiliated with, the third-party purchaser must consult with the Operating Advisor in connection with, and prior to, any major decision in connection with the servicing of the securitized assets, including, without limitation:

(1) Any material modification of, or waiver with respect to, any provision of a loan agreement (including a mortgage, deed of trust, or other security agreement);

(2) Foreclosure upon or comparable conversion of the ownership of a property; or

(3) Any acquisition of a property.

(C) The Operating Advisor shall be responsible for reviewing the actions of any servicer that is, or is affiliated with, the third-party purchaser and for issuing a report to investors and the issuing entity on a periodic basis concerning:

(1) Whether the Operating Advisor believes, in its sole discretion exercised in good faith, that such servicer is operating in compliance with any standard required of the servicer as provided in the applicable transaction documents; and

(2) What, if any, standard(s) the Operating Advisor believes, in its sole discretion exercised in good faith, with which such servicer has failed to comply;

(D) The Operating Advisor shall have the authority to recommend that a servicer that is, or is affiliated with, a third-party purchaser be replaced by a successor servicer if the Operating Advisor determines, in its sole discretion exercised in good faith, that:

(1) The servicer that is, or is affiliated with, the third-party purchaser has failed to comply with a standard required of the servicer as provided in the transaction documents; and

(2) Such replacement would be in the best interest of the investors as a collective whole; and

(E) If a recommendation described in paragraph (a)(4)(iii)(D) of this section is made, the servicer that is, or is affiliated with, the third-party purchaser must be replaced unless a majority of each class of ABS interests in the issuing entity eligible to vote on the matter votes to retain the servicer.

(5) Disclosures. The sponsor provides, or causes to be provided, to potential investors a reasonable period of time prior to the sale of the asset-backed securities as part of the securitization transaction and, upon request, to the Commission and its appropriate Federal banking agency, if any, the following disclosure in written form, and, with respect to subparagraphs (i) through (vii), under the caption "Credit Risk Retention":

(i) The name and form of organization of the third-party purchaser;

(ii) A description of the third-party purchaser's experience in investing in commercial mortgage-backed securities;

(iii) Any other information regarding the third-party purchaser or the third-party purchaser's retention of the eligible horizontal residual interest that is material to investors in light of the circumstances of the particular securitization transaction;

(iv) A description of the amount (expressed as a percentage and dollar amount) of the eligible horizontal residual interest that will be retained (or was retained) by the third-party purchaser, as well as the amount of the purchase price paid by the third-party purchaser for such interest;

(v) The amount (expressed as a percentage and dollar amount) of the eligible horizontal residual interest in the securitization transaction that the sponsor would have been required to retain pursuant to § __.5(a) of this part if the sponsor had relied on such section to meet the requirements of §__.3 of this part with respect to the transaction;

(vi) A description of the material terms of the eligible residual horizontal interest retained by the third-party purchaser;

(vii) The material assumptions and methodology used in determining the aggregate amount of ABS interests issued by the issuing entity in the securitization transaction, including those pertaining to any estimated cash flows and the discount rate used; and

(viii) The representations and warranties concerning the securitized assets, a schedule of any securitized assets that are determined do not comply with such representations and warranties, and what factors were used to make the determination that such securitized assets should be included in the pool notwithstanding that the securitized assets did not comply with such representations and warranties, such as compensating factors or a determination that the exceptions were not material.

(6) Hedging, transfer and pledging. The third-party purchaser complies with the hedging and other restrictions in § __.14 of this part as if it were the retaining sponsor with respect to the securitization transaction and had acquired the eligible horizontal residual interest pursuant to § __.5 of this part.

(b) Duty to comply.

(1) The retaining sponsor shall be responsible for compliance with this section.

(2) A retaining sponsor relying on this section:

(A) Shall maintain and adhere to policies and procedures to monitor the third-party purchaser's compliance with the requirements in paragraph (a) of this section (other than paragraphs (a)(1) and (a)(5)); and

(B) In the event that the sponsor determines that the third-party purchaser no longer complies with any of the requirements of paragraph (a) of this section (other than paragraphs (a)(1) and (a)(5)), shall promptly notify, or cause to be notified, the holders of the ABS interests issued in the securitization transaction of such noncompliance by the third-party purchaser.

§ __.11 Federal National Mortgage Association and Federal Home Loan Mortgage Corporation ABS.

(a) In general. The sponsor fully guarantees the timely payment of principal and interest on all ABS interests issued by the issuing entity in the securitization transaction and is:

(1) The Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation operating under the conservatorship or receivership of the Federal Housing Finance Agency pursuant to section 1367 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4617) with capital support from the United States; or

(2) Any limited-life regulated entity succeeding to the charter of either the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation pursuant to section 1367(i) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4617(i)), provided that the entity is operating with capital support from the United States.

(b) Certain provisions not applicable. The provisions of §__.12 and §__.14(b), (c), and (d) of this part shall not apply to a sponsor described in paragraph (a)(1) or (2) of this section, its affiliates, or the issuing entity with respect to a securitization transaction for which the sponsor has retained credit risk in accordance with the requirements of this section.

(c) Disclosure. A sponsor utilizing this section shall provide to investors, in written form under the caption "Credit Risk Retention" and, upon request, to the Federal Housing Finance Agency and the Commission, a description of the manner in which it has met the credit risk retention requirements of this part.

§ ___.12 Premium capture cash reserve account.

(a) When creation of a premium capture cash reserve account is required and calculation of amount. In addition to the economic interest in the credit risk that a retaining sponsor is required to retain, or cause to be retained under §__.3 of this part, the retaining sponsor shall, at closing of the securitization transaction, cause to be established and funded, in cash, a premium capture cash reserve account (as defined in paragraph (b) of this section) in an amount equal to the difference, if a positive amount, between:

(1) The gross proceeds, net of closing costs paid by the sponsor(s) or issuing entity to unaffiliated parties, received by the issuing entity from the sale of ABS interests in the issuing entity to persons other than the retaining sponsor; and

(2) (i) If the retaining sponsor has relied on § __.4, § __.5, § __.6, or § __.7 of this part with respect to the securitization transaction, 95 percent of the par value of all ABS interests in the issuing entity issued as part of the securitization transaction; or

(ii) If the retaining sponsor has relied on § __.8, § __.9, or § __.10 of this part with respect to the securitization transaction, 100 percent of the par value of all ABS interests in the issuing entity issued as part of the securitization transaction.

(b) <u>Operation of premium capture cash reserve account</u>. For purposes of this section, a premium capture cash reserve account means an account that meets all of the following conditions:

(1) The account is held by the trustee (or person performing similar functions) in the name and for the benefit of the issuing entity;

(2) Amounts in the account may be invested only in:

(A) United States Treasury securities with maturities of 1 year or less; and

(B) Deposits in one or more insured depository institutions (as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813)) that are fully insured by federal deposit insurance; and

(3) Until all ABS interests in the issuing entity are paid in full or the issuing entity is dissolved, no funds may be withdrawn or distributed from the account except as follows:

(i) Amounts in the account shall be released to satisfy payments on ABS interests in the issuing entity on any payment date on which the issuing entity has insufficient funds to satisfy an amount due on an ABS interest prior to the allocation of any losses to:

(A) An eligible horizontal residual interest held pursuant to § __.5, §__.6, §__.9, §__.10, or §__.13 of this part, if any; or

(B) If an eligible horizontal residual interest in the issuing entity is not held pursuant to § __.5, §__.6, §__.9, §__.10, or §__.13 of this part, the class of ABS interests in the issuing entity that:

(<u>1</u>) Is allocated losses before other classes; or

(<u>2</u>) If the contractual terms of the securitization transaction do not provide for the allocation of losses by class, the class of ABS interests that has the most subordinate claim to payment of principal or interest by the issuing entity; and

(ii) Interest on investments made in accordance with paragraph (b)(2) of this section may be released to any person once received by the account.

(c) Calculation of gross proceeds received by issuing entity.

(1) Anti-evasion provision for certain resales and senior excess spread tranches. For purposes of paragraph (a)(1) of this section, the gross proceeds received by the issuing entity from the sale of ABS interests to persons other than the retaining sponsor shall include the par value, or if an ABS interest does not have a par value, the fair value, of any ABS interest in the issuing entity that is directly or indirectly transferred to the retaining sponsor in connection with the closing of the securitization transaction and that:

(i) The retaining sponsor does not intend to hold to maturity; or

(ii) Represents a contractual right to receive some or all of the interest and no more than a minimal amount of principal payments received by the issuing entity and that has priority of payment of interest (or principal, if any) senior to the most subordinated class of ABS interests in the issuing entity, provided, however, this paragraph (c)(1)(ii) shall not apply to any ABS interest that:

(A) Does not have a par value;

(B) Is held by a sponsor that is relying on § __.4 or § __.6 of this part with respect to the securitization transaction; and

(C) The sponsor is required to retain pursuant to § __.4 or § __.6(a)(1) of this part.

(d) Disclosures. A sponsor that is required to establish and fund a premium capture cash reserve account pursuant to this section shall provide, or cause to be provided, to potential investors a reasonable period of time prior to the sale of the asset-backed securities as part of the securitization transaction and, upon request, to the Commission and its appropriate Federal banking agency, if any, the following disclosure in written form under the caption "Credit Risk Retention":

(1) The dollar amount required to be placed in the account pursuant to this section and any other amounts the sponsor will place (or has placed) in the account in connection with the securitization transaction; and

(2) The material assumptions and methodology used in determining the fair value of any ABS interest in the issuing entity that does not have a par value and that was used in calculating the amount required for the premium capture cash reserve account pursuant to paragraph (c).

SUBPART C—TRANSFER OF RISK RETENTION

§ __.13 Allocation of risk retention to an originator.

(a) In general. A sponsor choosing to retain a portion of each class of ABS interests in the issuing entity under the vertical risk retention option in § __.4 of this part or an eligible horizontal residual interest pursuant to § __.5(a) of this part with respect to a securitization transaction may offset the amount of its risk retention requirements under § __.4 or § __.5(a) of this part, as applicable, by the amount of the ABS interests or eligible horizontal residual interest, respectively, acquired by an originator of one or more of the securitized assets if:

(1) Amount of retention. At the closing of the securitization transaction:

(i) The originator acquires and retains the ABS interests or eligible horizontal residual interest from the sponsor in the same manner as would have been retained by the sponsor under § __.4 or § __.5(a) of this part, as applicable;

(ii) The ratio of the dollar amount of ABS interests or eligible horizontal residual interest acquired and retained by the originator to the total dollar amount of ABS interests or eligible horizontal residual interest otherwise required to be retained by the sponsor pursuant to § __.4 or § __.5(a) of this part, as applicable, does not exceed the ratio of:

(A) The unpaid principal balance of all the securitized assets originated by the originator; to

(B) The unpaid principal balance of all the securitized assets in the securitization transaction;

(iii) The originator acquires and retains at least 20 percent of the aggregate risk retention amount otherwise required to be retained by the sponsor pursuant to § __.4 or § __.5(a) of this part, as applicable; and

(iv) The originator purchases the ABS interests or eligible horizontal residual interest from the sponsor at a price that is equal, on a dollar-for-dollar basis, to the amount by which the sponsor's required risk retention is reduced in accordance with this section, by payment to the sponsor in the form of:

(A) Cash; or

(B) A reduction in the price received by the originator from the sponsor or depositor for the assets sold by the originator to the sponsor or depositor for inclusion in the pool of securitized assets.

(2) Disclosures. In addition to the disclosures required pursuant to § __.4(b) or § __.5(c) of this part, the sponsor provides, or causes to be provided, to potential investors a reasonable period of time prior to the sale of the asset-backed securities as part of the securitization transaction and, upon request, to the Commission and its appropriate Federal banking agency, if any, in written form under the caption "Credit Risk Retention", the name and form of organization of any originator that will acquire and retain (or has acquired and retained) an interest in the transaction pursuant to this section, including a description of the form, amount (expressed as a percentage and dollar amount), and nature of the interest, as well as the method of payment for such interest under paragraph (a)(1)(iv).

(3) Hedging, transferring and pledging. The originator complies with the hedging and other restrictions in § __.14 of this part with respect to the interests retained by the originator pursuant to this section as if it were the retaining sponsor and was required to retain the interest under subpart B of this part.

(b) Duty to comply.

(1) The retaining sponsor shall be responsible for compliance with this section.

(2) A retaining sponsor relying on this section:

(A) Shall maintain and adhere to policies and procedures that are reasonably designed to monitor the compliance by each originator that is allocated a portion of the sponsor's risk retention obligations with the requirements in paragraphs (a)(1) and (a)(3) of this section; and

(B) In the event the sponsor determines that any such originator no longer complies with any of the requirements in paragraphs (a)(1) and (a)(3) of this section, shall promptly notify, or cause to be notified, the holders of the ABS interests issued in the securitization transaction of such noncompliance by such originator.

§ __.14. Hedging, transfer and financing prohibitions.

(a) Transfer. A retaining sponsor may not sell or otherwise transfer any interest or assets that the sponsor is required to retain pursuant to subpart B of this part to any person other than an entity that is and remains a consolidated affiliate.

(b) Prohibited hedging by sponsor and affiliates. A retaining sponsor and its consolidated affiliates may not purchase or sell a security, or other financial instrument, or enter into an agreement, derivative or other position, with any other person if:

(1) Payments on the security or other financial instrument or under the agreement, derivative, or position are materially related to the credit risk of one or more particular ABS interests, assets, or securitized assets that the retaining sponsor is required to retain with respect to a securitization transaction pursuant to subpart B of this part or one or more of the particular securitized assets that collateralize the asset-backed securities issued in the securitization transaction; and

(2) The security, instrument, agreement, derivative, or position in any way reduces or limits the financial exposure of the sponsor to the credit risk of one or more of the particular ABS interests, assets, or securitized assets that the retaining sponsor is required to retain with respect to a securitization transaction pursuant to subpart B of this part or one or more of the particular securitized assets that collateralize the asset-backed securities issued in the securitization transaction.

(c) Prohibited hedging by issuing entity. The issuing entity in a securitization transaction may not purchase or sell a security or other financial instrument, or enter into an agreement, derivative or position, with any other person if:

(1) Payments on the security or other financial instrument or under the agreement, derivative or position are materially related to the credit risk of one or more particular interests, assets, or securitized assets that the retaining sponsor for the transaction is required to retain with respect to the securitization transaction pursuant to subpart B of this part; and

(2) The security, instrument, agreement, derivative, or position in any way reduces or limits the financial exposure of the retaining sponsor to the credit risk of one or more of the particular interests or assets that the sponsor is required to retain pursuant to subpart B of this part.

(d) Permitted hedging activities. The following activities shall not be considered prohibited hedging activities by a retaining sponsor, a consolidated affiliate or an issuing entity under paragraph (b) or (c) of this section:

(1) Hedging the interest rate risk (which does not include the specific interest rate risk, known as spread risk, associated with the ABS interest that is otherwise considered part of the credit risk) or foreign exchange risk arising from one or more of the particular ABS interests, assets, or securitized assets required to be retained by the sponsor under subpart B of this part or one or more of the particular securitized assets that underlie the asset-backed securities issued in the securitization transaction; or

(2) Purchasing or selling a security or other financial instrument or entering into an agreement, derivative, or other position with any third party where payments on the security or other financial instrument or under the agreement, derivative, or position are based, directly or indirectly, on an index of instruments that includes asset-backed securities if:

(i) Any class of ABS interests in the issuing entity that were issued in connection with the securitization transaction and that are included in the index represents no more than 10 percent of the dollar-weighted average of all instruments included in the index; and

(ii) All classes of ABS interests in all issuing entities that were issued in connection with any securitization transaction in which the sponsor was required to retain an interest pursuant to subpart B of this part and that are included in the index represent, in the aggregate, no more than 20 percent of the dollar-weighted average of all instruments included in the index.

(e) Prohibited non-recourse financing. Neither a retaining sponsor nor any of its consolidated affiliates may pledge as collateral for any obligation (including a loan, repurchase agreement, or other financing transaction) any interest or asset that the sponsor is required to retain with respect to a securitization transaction pursuant to subpart B of this part unless such obligation is with full recourse to the sponsor or consolidated affiliate, respectively.

SUBPART D—EXCEPTIONS AND EXEMPTIONS

§ ___.15 Exemption for qualified residential mortgages.

(a) Definitions. For purposes of this section, the following definitions shall apply:

Borrower includes any co-borrower, unless the context otherwise requires.

Borrower funds means funds:

(1) Derived from one or more sources identified as acceptable sources of funds in the Additional QRM Standards Appendix to this part; and

(2) That are verified in accordance with the requirements set forth in the Additional QRM Standards Appendix to this part.

Cash-out refinancing means a refinancing transaction in a principal amount that exceeds the sum of the amount used to:

(1) Fully repay the balance outstanding on the borrower's existing first-lien mortgage that is secured by the one-to-four family property being refinanced;

(2) Fully repay the balance outstanding as of the date of the mortgage transaction on any subordinate-lien mortgage that was used in its entirety to purchase such one-to-four family property;

(3) Pay closing or settlement charges required to be included on the related HUD-1 or HUD-1A Settlement Statement or a successor form in accordance with 24 CFR Part 3500 or a successor regulation; and

(4) Disburse up to $500 of cash to the borrower or any other payee.

Closed-end credit means any consumer credit extended by a creditor other than open-end credit.

Combined loan-to-value ratio means, with respect to a first-lien refinancing transaction on a one-to-four family property, the ratio (expressed as a percentage) of:

(1) The sum of:

(i) The principal amount of the first-lien mortgage transaction at the closing of the transaction;

(ii) The unpaid principal amount of any other closed-end credit transaction that to the creditor's knowledge would exist at the closing of the refinancing transaction and that is or would be secured by the same one-to-four family property; and

(iii) The face amount (as if fully drawn) of any open-end credit transaction that to the creditor's knowledge would exist at the closing of the refinancing transaction and that is or would be secured by the same one-to-four family property; to

(2) The estimated market value of the one-to-four family property as determined by a qualifying appraisal.

Consumer credit means credit offered or extended to a borrower primarily for personal, family, or household purposes.

Consumer reporting agency that compiles and maintains files on consumers on a nationwide basis has the same meaning as in 15 U.S.C. 1681a(p).

Creditor has the same meaning as in 15 U.S.C. 1602(f).

Currently performing means the borrower in the mortgage transaction is not currently thirty (30) days past due, in whole or in part, on the mortgage transaction.

Loan-to-value ratio means, with respect to a mortgage transaction to purchase a one-to-four family property, the ratio (expressed as a percentage) of:

(1) The principal amount of the first-lien mortgage transaction at the closing of the mortgage transaction; to

(2) The lesser of:

(i) The estimated market value of the one-to-four family property as determined by a qualifying appraisal; and

(ii) The purchase price of the one-to-four family property to be paid in connection with the mortgage transaction.

Mortgage originator has the same meaning as in 15 U.S.C. 1602(cc)(2) and the regulations issued thereunder.

Mortgage transaction means a closed-end credit transaction to purchase or refinance a one-to-four family property at least one unit of which is the borrower's principal dwelling.

One-to-four family property means real property that is held in fee simple, on leasehold under a lease for not less than 99 years which is renewable, or under a lease having a period of not less than 10 years to run beyond the maturity date of the mortgage and that is improved by a residential structure that contains one to four units, including but not limited to: (1) An individual condominium; (2) An individual cooperative unit; or (3) An individual manufactured home that is constructed in conformance with the National Manufactured Home Construction and Safety Standards, as evidenced by a certification label affixed to the exterior of the home, and that is erected on or that otherwise is affixed to a foundation in accordance with requirements established by the Federal Housing Administration.

Open-end credit means any consumer credit extended by a creditor under a plan in which:

(1) The creditor reasonably contemplates repeated consumer credit transactions;

(2) The creditor may impose a finance charge from time to time on an outstanding unpaid balance; and

(3) The amount of credit that may be extended to the borrower during the term of the plan (up to any limit set by the creditor) is generally made available to the extent that any outstanding balance is repaid.

Points and fees means:

(1) All items considered to be a finance charge under 12 CFR 226.4(a) and 226.4(b), except:

(i) Interest or the time-price differential; and

(ii) Items excluded from the finance charge under 12 CFR 226.4(c), 226.4(d) and 226.4(e), unless included in paragraphs (2) through (5) below;

(2) All compensation paid directly or indirectly by the borrower or creditor to a mortgage originator, including a mortgage originator that is also the creditor in a table-funded transaction;

(3) All items (other than amounts held for future payment of taxes) listed in section 12 CFR 226.4(c)(7) unless:

(i) The charge is bona fide and reasonable;

(ii) The creditor and mortgage originator receive no direct or indirect compensation in connection with the charge; and

(iii) The charge is not paid to an affiliate of the creditor or mortgage originator;

(4) Premiums or other charges payable at or before closing for any credit life, credit disability, credit unemployment, or credit property insurance, or any other accident, loss-of-income, life or health insurance, or any payments directly or indirectly for any debt cancellation or suspension agreement or contract; and

(5) If the mortgage transaction refinances a previous loan made or currently held by the same creditor or an affiliate of the same creditor, all prepayment fees or penalties that are incurred by the consumer in connection with the payment of the previous loan.

Prepayment penalty means a penalty imposed solely because the mortgage obligation is prepaid in full or in part. For purposes of this definition, a prepayment penalty does not include, for example, fees imposed for preparing and providing documents in connection with prepayment, such as a loan payoff statement, a reconveyance, or other document releasing the creditor's security interest in the one-to-four family property securing the loan.

Principal dwelling means a one-to-four family property, or unit thereof, that is occupied or will be occupied by at least one borrower as a principal residence. For purposes of this definition, a borrower can only have one principal dwelling at a time; however, if a borrower buys a new dwelling that will become the borrower's principal dwelling within a year or upon the completion of construction, the new dwelling is considered the principal dwelling for purposes of applying this definition to a credit transaction to purchase the new dwelling.

Qualifying appraisal means an appraisal that meets the requirements of § __.15(d)(11) of this part.

Rate and term refinancing means a refinancing transaction that is not a cash-out refinancing.

Refinancing transaction means:

(1) A closed-end credit transaction secured by a one-to-four family property that is entered into by the borrower that satisfies and replaces an existing credit transaction that was entered into by the same borrower and that is secured by the same one-to-four family property; or

(2) A closed-end credit transaction secured by the borrower's principal dwelling on which there are no existing liens.

Reverse mortgage means a nonrecourse consumer credit transaction in which:

(1) A mortgage, deed of trust, or equivalent consensual security interest securing one or more advances is created in the borrower's principal dwelling; and

(2) Any principal, interest, or shared appreciation or equity is due and payable (other than in the case of default) only after:

(i) The borrower dies;

(ii) The dwelling is transferred; or

(iii) The borrower ceases to occupy the one-to-four family property as a principal dwelling.

Total loan amount means the amount financed, as determined according to 12 CFR 226.18(b), less any cost listed in paragraphs (3), (4) and (5) of the definition of "points of fees" that is both included in the definition of points and fees and financed by the creditor.

(b) Exemption. A sponsor shall be exempt from the risk retention requirements in subpart B of this part with respect to any securitization transaction, if:

(1) All of the securitized assets that collateralize the asset-backed securities are qualified residential mortgages;

(2) None of the securitized assets that collateralize the asset-backed securities are other asset-backed securities;

(3) At the closing of the securitization transaction, each qualified residential mortgage collateralizing the asset-backed securities is currently performing; and

(4) (i) The depositor of the asset-backed security certifies 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;

(ii) The evaluation of the effectiveness of the depositor's internal supervisory controls referenced in paragraph (b)(4)(i) of this section shall be performed, for each issuance of an asset-backed security in reliance on this section, as of a date within 60 days of the cut-off date or similar date for establishing the composition of the asset pool collateralizing such asset-backed security; and

(iii) The sponsor provides, or causes to be provided, a copy of the certification described in paragraph (b)(4)(i) of this section to potential investors a reasonable period of time prior to the sale of asset-backed securities in the issuing entity, and, upon request, to the Commission and its appropriate Federal banking agency, if any.

(c) Qualified residential mortgage. The term "qualified residential mortgage" means a closed-end credit transaction to purchase or refinance a one-to-four family property at least one unit of which is the principal dwelling of a borrower that:

(1) Meets all of the criteria in paragraph (d) of this section; and

(2) Is not:

(i) Made to finance the initial construction of a dwelling;

(ii) A reverse mortgage;

(iii) A temporary or "bridge" loan with a term of twelve months or less, such as a loan to purchase a new dwelling where the borrower plans to sell a current dwelling within twelve months; or

(iv) A timeshare plan described in 11 U.S.C. § 101(53D).

(d) Eligibility criteria.

(1) First-lien required. The mortgage transaction is secured by a first lien:

(i) On the one-to-four family property to be purchased or refinanced; and

(ii) That is perfected in accordance with applicable law.

(2) Subordinate liens. If the mortgage transaction is to purchase a one-to-four family property, no other recorded or perfected liens on the one-to-four family property would exist, to the creditor's knowledge at the time of the closing of the mortgage transaction, upon the closing of that transaction.

(3) Original maturity. At the closing of the mortgage transaction, the maturity date of the mortgage transaction does not exceed 30 years.

(4) Written Application. The borrower completed and submitted to the creditor a written application for the mortgage transaction that, as supplemented or amended prior to closing, includes an acknowledgement by the borrower that the information provided in the application is

true and correct as of the date executed by the borrower and that any intentional or negligent misrepresentation of the information provided in the application may result in civil liability and/or criminal penalties under 18 U.S.C. 1001.

(5) Credit history.

(i) In general. The creditor has verified and documented that within ninety (90) days prior to the closing of the mortgage transaction:

(A) The borrower is not currently 30 days or more past due, in whole or in part, on any debt obligation;

(B) Within the previous twenty-four (24) months, the borrower has not been 60 days or more past due, in whole or in part, on any debt obligation; and

(C) Within the previous thirty-six (36) months:

(1) The borrower has not been a debtor in a case commenced under Chapter 7, Chapter 12, or Chapter 13 of Title 11, United States Code, or been the subject of any Federal or State judicial judgment for the collection of any unpaid debt;

(2) The borrower has not had any personal property repossessed; and

(3) No one-to-four family property owned by the borrower has been the subject of any foreclosure, deed-in-lieu of foreclosure, or short sale.

(ii) Safe harbor. A creditor will be deemed to have met the requirements of paragraph (d)(5)(i) of this section if:

(A) The creditor, no more than 90 days before the closing of the mortgage transaction, obtains a credit report regarding the borrower from at least two consumer reporting agencies that compile and maintain files on consumers on a nationwide basis;

(B) Based on the information in such credit reports, the borrower meets all of the requirements of paragraph (d)(5)(i) of this section, and no information in a credit report subsequently obtained by the creditor before the closing of the mortgage transaction contains contrary information; and

(C) The creditor maintains copies of such credit reports in the loan file for the mortgage transaction.

(6) Payment terms. Based on the terms of the mortgage transaction at the closing of the transaction:

(i) The regularly scheduled principal and interest payments on the mortgage transaction:

(A) Would not result in an increase of the principal balance of the mortgage transaction; and

(B) Do not allow the borrower to defer payment of interest or repayment of principal;

(ii) No scheduled payment of principal and interest would be more than twice as large as any earlier scheduled payment of principal and interest;

(iii) If the rate of interest applicable to the mortgage transaction may increase after the closing of the mortgage transaction, any such increase may not exceed:

(A) 2 percent (200 basis points) in any twelve month period; and

(B) 6 percent (600 basis points) over the life of the mortgage transaction; and

(iv) The mortgage transaction does not include or provide for any prepayment penalty.

(7) Points and fees. The total points and fees payable by the borrower in connection with the mortgage transaction shall not exceed three percent of the total loan amount.

(8) Debt-to-income ratios.

(i) In general. The creditor has determined that, as of a date that is no more than 60 days prior to the closing of the mortgage transaction, the ratio of:

(A) The borrower's monthly housing debt to the borrower's monthly gross income does not exceed 28 percent; and

(B) The borrower's total monthly debt to the borrower's monthly gross income does not exceed 36 percent.

(ii) Applicable standards. For purposes of determining the borrower's compliance with the ratios set forth in paragraph (d)(8)(i) of this section, the creditor shall:

(A) Verify, document, and determine the borrower's monthly gross income in accordance with the effective income standards established in the Additional QRM Standards Appendix to this part; and

(B) Except as provided in paragraph (d)(8)(iii) of this section, verify, document, and determine the borrower's monthly housing debt and total monthly debt in accordance with the standards established in the Additional QRM Standards Appendix to this part.

(iii) Housing debt. Notwithstanding paragraph (d)(8)(ii)(B) of this section, for purposes of determining the borrower's compliance with the ratios set forth in paragraph (d)(8)(i) of this section, the creditor shall:

(A) Determine the borrower's monthly periodic payment for principal and interest on the mortgage transaction and, if the mortgage transaction is a refinancing transaction, any other credit transaction (including any open-end credit transaction as if fully drawn) that to the creditor's knowledge would exist at the closing of the refinancing transaction and that would be secured by the one-to-four family property being refinanced, based on:

(1) The maximum interest rate that is permitted or required under any feature (including any conversion or other feature that allows a variable interest rate to convert to a fixed interest rate) of the relevant credit transaction documents during the first five years after the date on which the first regular periodic payment will be due; and

(2) A payment schedule that fully amortizes the mortgage transaction over the term of the mortgage transaction; and

(B) Include in the borrower's monthly housing debt and total monthly debt the monthly pro rata amount of the following, as applicable, with respect to the one-to-four family property being purchased or refinanced:

(1) Real estate taxes;

(2) Hazard insurance, flood insurance, mortgage guarantee insurance, and any other required insurance;

(3) Homeowners' and condominium association dues;

(4) Ground rent or leasehold payments; and

(5) Special assessments.

(9) Loan-to-value ratio.

(i) Purchase mortgages. If the mortgage transaction is to purchase a one-to-four family property, at the closing of the mortgage transaction, the loan-to-value ratio of the mortgage transaction does not exceed 80 percent.

(ii) Rate and term refinancings. If the mortgage transaction is a rate and term refinancing, at the closing of the mortgage transaction, the combined loan-to-value ratio of the mortgage transaction does not exceed 75 percent.

(iii) Cash-out refinancings. If the mortgage transaction is a cash-out refinancing, at the closing of the mortgage transaction, the combined loan-to-value ratio of the mortgage transaction does not exceed 70 percent.

(10) Down payment. If the mortgage transaction is for the purchase of a one-to-four family property:

(i) The borrower provides, at closing, a cash down payment in an amount equal to at least the sum of:

(A) The closing costs payable by the borrower in connection with the mortgage transaction;

(B) 20 percent of the lesser of:

(1) The estimated market value of the one-to-four family property as determined by a qualifying appraisal; and

(2) The purchase price of the one-to-four family property to be paid in connection with the mortgage transaction; and

(C) The difference, if a positive amount, between:

(1) The purchase price of the one-to-four family property to be paid in connection with the mortgage transaction; and

(2) The estimated market value of the one-to-four family property as determined by a qualifying appraisal;

(ii) The funds used by the borrower to satisfy the down payment required by paragraph (d)(10)(i) of this section:

(A) Must come solely from borrower funds;

(B) May not be subject to any contractual obligation by the borrower to repay; and

(C) May not have been obtained by the borrower from a person or entity with an interest in the sale of the property (other than the borrower); and

(iii) The creditor shall verify and document the borrower's compliance with the conditions set forth in paragraphs (d)(10)(i) and (d)(10)(ii) of this section.

(11) Appraisal. The creditor obtained a written appraisal of the property securing the mortgage that was performed not more than 90 days prior to the closing of the mortgage transaction by an appropriately state-certified or state-licensed appraiser that conforms to generally accepted appraisal standards as evidenced by the Uniform Standards of Professional Appraisal Practice (USPAP) promulgated by the Appraisal Standards Board (ASB) of the Appraisal Foundation, the appraisal requirements of the Federal banking agencies, and applicable laws.

(12) Assumability. The mortgage transaction is not assumable by any person that was not a borrower under the mortgage transaction at closing.

(13) Default mitigation. The mortgage originator –

(i) Includes terms in the mortgage transaction documents under which the creditor commits to have servicing policies and procedures under which the creditor shall –

(A) Mitigate risk of default on the mortgage loan by taking loss mitigation actions, such as loan modification or other loss mitigation alternative, in the event the estimated resulting net present value of such action exceeds the estimated net present value of recovery through foreclosure, without regard to whether the particular action benefits the interests of a particular class of investors in a securitization;

(B) Take into account the borrower's ability to repay and other appropriate underwriting criteria in such loss mitigation actions;

(C) Initiate loss mitigation activities within 90 days after the mortgage loan becomes delinquent (if the delinquency has not been cured);

(D) Implement or maintain servicing compensation arrangements consistent with the obligations under subparagraphs (i)(A), (B), and (C);

(E) Implement procedures for addressing any whole loan owned by the creditor (or any of its affiliates) and secured by a subordinate lien on the same property that secures the first mortgage loan if the borrower becomes more than 90 days past due on the first mortgage loan;

(F) If the first mortgage loan will collateralize any asset-backed securities, disclose or require to be disclosed to potential investors within a reasonable period of time prior to the sale of the asset-backed securities a description of the procedures to be implemented pursuant to subparagraph (i)(E); and

(G) Not sell, transfer or assign servicing rights for the mortgage loan unless the agreement requires the purchaser, transferee or assignee servicer to abide by the default mitigation commitments of the creditor under this section 13(i) as if the purchaser, transferee or assignee were the creditor under this section.

(ii) Provides disclosure of the foregoing default mitigation commitments to the borrower at or prior to the closing of the mortgage transaction.

(e) <u>Repurchase of loans subsequently determined to be non-qualified after closing</u>. A sponsor that has relied on the exemption provided in paragraph (b) of this section with respect to a securitization transaction shall not lose such exemption with respect to such transaction if, after closing of the securitization transaction, it is determined that one or more of the residential mortgage loans collateralizing the asset-backed securities does not meet all of the criteria to be a qualified residential mortgage <u>provided that</u>:

(1) The depositor complied with the certification requirement set forth in paragraph (b)(4) of this section;

(2) The sponsor repurchases the loan(s) from the issuing entity at a price at least equal to the remaining aggregate unpaid principal balance and accrued interest on the loan(s) no later than 90 days after the determination that the loans do not satisfy the requirements to be a qualified residential mortgage; and

(3) The sponsor promptly notifies, or causes to be notified, the holders of the asset-backed securities issued in the securitization transaction of any loan(s) included in such securitization transaction that is (or are) required to be repurchased by the sponsor pursuant to paragraph (e)(2) of this section, including the amount of such repurchased loan(s) and the cause for such repurchase.

§ __.16 Definitions applicable to qualifying commercial mortgages, commercial loans, and auto loans.

The following definitions apply for purposes of §§ __.17 through __.20 of this part:

Appraisal Standards Board means the board of the Appraisal Foundation that establishes generally accepted standards for the appraisal profession.

Automobile loan:

(1) Means any loan to an individual to finance the purchase of, and is secured by a first lien on, a passenger car or other passenger vehicle, such as a minivan, van, sport-utility vehicle, pickup truck, or similar light truck for personal, family, or household use; and

(2) Does not include any:

(i) Loan to finance fleet sales;

(ii) Personal cash loan secured by a previously purchased automobile;

(iii) Loan to finance the purchase of a commercial vehicle or farm equipment that is not used for personal, family, or household purposes;

(iv) Lease financing; or

(v) Loan to finance the purchase of a vehicle with a salvage title.

Combined loan-to-value (CLTV) ratio means, at the time of origination, the sum of the principal balance of a first-lien mortgage loan on the property, plus the principal balance of any junior-lien mortgage loan that, to the creditor's knowledge, would exist at the closing of the transaction and that is secured by the same property, divided by:

(1) For acquisition funding, the lesser of the purchase price or the estimated market value of the real property based on an appraisal that meets the requirements set forth in §__.19(b)(2)(ii) of this part; or

(2) For refinancing, the estimated market value of the real property based on an appraisal that meets the requirements set forth in §__.19(b)(2)(ii) of this part.

Commercial loan means a secured or unsecured loan to a company or an individual for business purposes, other than any:

(1) Loan to purchase or refinance a one-to-four family residential property;

(2) Loan for the purpose of financing agricultural production; or

(3) Loan for which the primary source (fifty (50) percent or more) of repayment is expected to be derived from rents collected from persons or firms that are not affiliates of the borrower.

Commercial real estate (CRE) loan:

(1) Means a loan secured by a property with five or more single family units, or by nonfarm nonresidential real property, the primary source (fifty (50) percent or more) of repayment for which is expected to be derived from:

(i) The proceeds of the sale, refinancing, or permanent financing of the property; or

(ii) Rental income associated with the property other than rental income derived from any affiliate of the borrower; and

(2) Does not include:

(i) A land development and construction loan (including 1- to 4-family residential or commercial construction loans);

(ii) Any other land loan;

(iii) A loan to a real estate investment trusts (REITs); or

(iv) An unsecured loan to a developer.

Debt service coverage (DSC) ratio means:

(1) For qualifying leased CRE loans, qualifying multi-family loans, and other CRE loans, the ratio of:

(i) The annual NOI less the annual replacement reserve of the CRE property at the time of origination of the CRE loans; to

(ii) The sum of the borrower's annual payments for principal and interest on any debt obligation.

(2) For commercial loans, the ratio of:

(i) The borrower's EBITDA as of the most recently completed fiscal year; to

(ii) The sum of the borrower's annual payments for principal and interest on any debt obligation.

Debt to income (DTI) ratio means the ratio of:

(1) The borrower's total debt (for automobile loans), including the monthly amount due on the automobile loan; to

(2) The borrower's monthly income.

Earnings before interest, taxes, depreciation, and amortization (EBITDA) means the annual income of a business before expenses for interest, taxes, depreciation and amortization, as determined in accordance with U.S. Generally Accepted Accounting Principles (GAAP).

Environmental risk assessment means a process for determining whether a property is contaminated or exposed to any condition or substance that could result in contamination that has an adverse effect on the market value of the property or the realization of the collateral value.

First lien means a lien or encumbrance on property that has priority over all other liens or encumbrances on the property.

Junior lien means a lien or encumbrance on property that is lower in priority relative to other liens or encumbrances on the property.

Leverage ratio means the ratio of:

(1) The borrower's total debt (for commercial loans); to

(2) The borrower's EBITDA.

Machinery and equipment (M&E) collateral means collateral for a commercial loan that consists of machinery and equipment that is identifiable by make, model, and serial number.

Model year means the year determined by the manufacturer and reflected on the vehicle's Motor Vehicle Title as part of the vehicle description.

Net operating income (NOI) refers to the income a CRE property generates after all expenses have been deducted for federal income tax purposes, except for depreciation, debt service expenses, and federal and state income taxes, and excluding any unusual and nonrecurring items of income.

New vehicle means any vehicle that:

(1) Is not a used vehicle; and

(2) Has not been previously sold to an end user.

Payment-in-kind (PIK) means payments of principal or accrued interest that are not paid in cash when due, and instead are paid by increasing the principal or by providing shares or stock in the borrowing company. A PIK loan is a type of loan that typically does not provide for any cash payments of principal or interest from the borrower to the lender between the drawdown date and the maturity or refinancing date.

Purchase price means:

(1) For a new vehicle, the amount paid by the borrower for the new vehicle net of any incentive payments or manufacturer cash rebates; and

(2) For a vehicle other than a new vehicle, the lesser of:

(i) The purchase price as would be determined for a new vehicle; or

(ii) The retail value of the used vehicle, as determined by a nationally recognized automobile pricing agency and based on the manufacturer, year, model, features, and condition of the vehicle.

Qualified tenant means

(1) A tenant with a triple net lease who has satisfied all obligations with respect to the property in a timely manner; or

(2) A tenant who originally had a triple net lease that subsequently expired and currently is leasing the property on a month-to-month basis, has occupied the property for at least three years prior to the date of origination, and has satisfied all obligations with respect to the property in a timely manner.

Qualifying leased CRE loan means a CRE loan secured by commercial nonfarm real property, other than a multi-family property or a hotel, inn, or similar property:

(1) That is occupied by one or more qualified tenants pursuant to a lease agreement with a term of no less than one (1) month; and

(2) Where no more than 20 percent of the aggregate gross revenue of the property is payable from one or more tenants who:

(i) Are subject to a lease that will terminate within six months following the date of origination; or

(ii) Are not qualified tenants.

Qualifying multi-family loan:

(1) Means a CRE loan secured by any residential property (other than a hotel, motel, inn, hospital, nursing home, or other similar facility where dwellings are not leased to residents):

(i) That consists of five or more dwelling units (including apartment buildings, condominiums, cooperatives and other similar structures) primarily for residential use; and

(ii) Where at least seventy-five (75) percent of the NOI is derived from residential rents and tenant amenities (including income from parking garages, health or swim clubs, and dry cleaning), and not from other commercial uses.

Replacement reserve means the monthly capital replacement or maintenance amount based on the property type, age, construction and condition of the property that is adequate to maintain the physical condition and NOI of the property.

Salvage title means a form of vehicle title branding, which notes that the vehicle has been severely damaged and/or deemed a total loss and uneconomical to repair by an insurance company that paid a claim on the vehicle.

Total debt, with respect to a borrower, means:

(1) In the case of an automobile loan, the sum of:

(i) All monthly housing payments (rent- or mortgage-related, including property taxes, insurance and home owners association fees); and

(ii) Any of the following that are dependent upon the borrower's income for payment:

(A) Monthly payments on other debt and lease obligations, such as credit card loans or installment loans, including the monthly amount due on the automobile loan;

(B) Estimated monthly amortizing payments for any term debt, debts with other than monthly payments and debts not in repayment (such as deferred student loans, interest-only loans); and

(C) Any required monthly alimony, child support or court-ordered payments; and

(2) In the case of a commercial loan, the outstanding balance of all long-term debt (obligations that have a remaining maturity of more than one year) and the current portion of all debt that matures in one year or less.

Total liabilities ratio means the ratio of:

(1) The borrower's total liabilities, determined in accordance with U.S. GAAP; to

(2) The sum of the borrower's total liabilities and equity, less the borrower's intangible assets, with each component determined in accordance with U.S. GAAP.

Trade-in allowance means the amount a vehicle purchaser is given as a credit at the purchase of a vehicle for the fair exchange of the borrower's existing vehicle to compensate the dealer for some portion of the vehicle purchase price, except that such amount shall not exceed the trade-in value of the used vehicle, as determined by a nationally recognized automobile pricing agency and based on the manufacturer, year, model, features, and condition of the vehicle.

Triple net lease means a lease pursuant to which the lessee is required to pay rent as well as all taxes, insurance, and maintenance expenses associated with the property.

Uniform Standards of Professional Appraisal Practice (USPAP) means the standards issued by the Appraisal Standards Board for the performance of an appraisal, an appraisal review, or an appraisal consulting assignment.

Used vehicle:

(1) Means any vehicle driven more than the limited use necessary in transporting or road testing the vehicle prior to the initial sale of the vehicle; and

(2) Does not include any vehicle sold only for scrap or parts (title documents surrendered to the State and a salvage certificate issued).

§ __.17 Exceptions for qualifying commercial loans, commercial mortgages, and auto loans.

The risk retention requirements in subpart B of this part shall not apply to securitization transactions that satisfy the standards provided in §§ __.18, __.19, or __.20 of this part.

§ __.18 Underwriting standards for qualifying commercial loans.

(a) General. The securitization transaction—

(1) Is collateralized solely (excluding cash and cash equivalents) by one or more commercial loans, each of which meets all of the requirements of paragraph (b) of this section; and

(2) Does not permit reinvestment periods.

(b) Underwriting, product and other standards.

(1) Prior to origination of the commercial loan, the originator:

(i) Verified and documented the financial condition of the borrower:

(A) As of the end of the borrower's two most recently completed fiscal years; and

(B) During the period, if any, since the end of its most recently completed fiscal year;

(ii) Conducted an analysis of the borrower's ability to service its overall debt obligations during the next two years, based on reasonable projections;

(iii) Determined that, based on the previous two years' actual performance, the borrower had:

(A) A total liabilities ratio of 50 percent or less;

(B) A leverage ratio of 3.0 or less; and

(C) A DSC ratio of 1.5 or greater;

(iv) Determined that, based on the two years of projections, which include the new debt obligation, following the closing date of the loan, the borrower will have:

(A) A total liabilities ratio of 50 percent or less;

(B) A leverage ratio of 3.0 or less;

(C) A DSC ratio of 1.5 or greater; and

(v) If the loan is originated on a secured basis, obtained a first-lien security interest on all of the property pledged to collateralize the loan.

(2) The loan documentation for the commercial loan includes covenants that:

(i) Require the borrower to provide to the originator or subsequent holder, and the servicer, of the commercial loan the borrower's financial statements and supporting schedules on an ongoing basis, but not less frequently than quarterly;

(ii) Prohibit the borrower from retaining or entering into a debt arrangement that permits payments-in-kind;

(iii) Impose limits on:

(A) The creation or existence of any other security interest with respect to any of the borrower's property;

(B) The transfer of any of the borrower's assets; and

(C) Any change to the name, location or organizational structure of the borrower, or any other party that pledges collateral for the loan;

(iv) Require the borrower and any other party that pledges collateral for the loan to:

(A) Maintain insurance that protects against loss on any collateral for the commercial loan at least up to the amount of the loan, and that names the originator or any subsequent holder of the loan as an additional insured or loss payee;

(B) Pay taxes, charges, fees, and claims, where non-payment might give rise to a lien on any collateral;

(C) Take any action required to perfect or protect the security interest of the originator or any subsequent holder of the loan in the collateral for the commercial loan or the priority thereof, and to defend the collateral against claims adverse to the lender's interest;

(D) Permit the originator or any subsequent holder of the loan, and the servicer of the loan, to inspect the collateral for the commercial loan and the books and records of the borrower; and

(E) Maintain the physical condition of any collateral for the commercial loan.

(3) Loan payments required under the loan agreement are:

(i) Based on straight-line amortization of principal and interest that fully amortize the debt over a term that does not exceed five years from the date of origination; and

(ii) To be made no less frequently than quarterly over a term that does not exceed five years.

(4) The primary source of repayment for the loan is revenue from the business operations of the borrower.

(5) The loan was funded within the six (6) months prior to the closing of the securitization transaction.

(6) At the closing of the securitization transaction, all payments due on the loan are contractually current.

(7) (i) The depositor of the asset-backed security certifies 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 meet all of the requirements set forth in paragraphs (b)(1) through (b)(6) of this section and has concluded that its internal supervisory controls are effective;

(ii) The evaluation of the effectiveness of the depositor's internal supervisory controls referenced in paragraph (b)(7)(i) of this section shall be performed, for each issuance of an asset-backed security, as of a date within 60 days of the cut-off date or similar date for establishing the composition of the asset pool collateralizing such asset-backed security; and

(iii) The sponsor provides, or causes to be provided, a copy of the certification described in paragraph (b)(7)(i) of this section to potential investors a reasonable period of time prior to the sale of asset-backed securities in the issuing entity, and, upon request, to its appropriate Federal banking agency, if any.

(c) Buy-back requirement. A sponsor that has relied on the exception provided in paragraph (a) of this section with respect to a securitization transaction shall not lose such exception with respect to such transaction if, after the closing of the securitization transaction, it is determined that one or more of the loans collateralizing the asset-backed securities did not meet all of the requirements set forth in paragraphs (b)(1) through (b)(6) of this section provided that:

(1) The depositor complied with the certification requirement set forth in paragraph (b)(7) of this section;

(2) The sponsor repurchases the loan(s) from the issuing entity at a price at least equal to the remaining principal balance and accrued interest on the loan(s) no later than ninety (90) days after the determination that the loans do not satisfy all of the requirements of paragraphs (b)(1) through (b)(6) of this section; and

(3) The sponsor promptly notifies, or causes to be notified, the holders of the asset-backed securities issued in the securitization transaction of any loan(s) included in such securitization transaction that is required to be repurchased by the sponsor pursuant to paragraph (c)(2) of this section, including the principal amount of such repurchased loan(s) and the cause for such repurchase.

§ __.19 Underwriting standards for qualifying CRE loans.

(a) General. The securitization transaction is collateralized solely (excluding cash and cash equivalents) by one or more CRE loans, each of which meets all of the requirements of paragraph (b) of this section.

(b) Underwriting, product and other standards.

(1) The CRE loan must be secured by a first lien on the commercial real estate.

(2) Prior to origination of the CRE loan, the originator:

(i) Verified and documented the current financial condition of the borrower;

(ii) Obtained a written appraisal of the real property securing the loan that:

(A) Was performed not more than six months from the origination date of the loan by an appropriately state-certified or state-licensed appraiser;

(B) Conforms to generally accepted appraisal standards as evidenced by the Uniform Standards of Professional Appraisal Practice (USPAP) promulgated by the Appraisal Standards Board and the appraisal requirements[239] of the Federal banking agencies; and

(C) Provides an "as is" opinion of the market value of the real property, which includes an income valuation approach that uses a discounted cash flow analysis;

(iii) Qualified the borrower for the CRE loan based on a monthly payment amount derived from a straight-line amortization of principal and interest over the term of the loan (but not exceeding 20 years);

(iv) Conducted an environmental risk assessment to gain environmental information about the property securing the loan and took appropriate steps to mitigate any environmental liability determined to exist based on this assessment;

(v) Conducted an analysis of the borrower's ability to service its overall debt obligations during the next two years, based on reasonable projections;

(vi) Determined that, based on the previous two years' actual performance, the borrower had:

(A) A DSC ratio of 1.5 or greater, if the loan is a qualifying leased CRE loan, net of any income derived from a tenant(s) who is not a qualified tenant(s);

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[239] OCC: 12 CFR part 34, subpart C; FRB: 12 CFR part 208, subpart E, and 12 CFR part 225, subpart G; and FDIC: 12 CFR part 323.

(B) A DSC ratio of 1.5 or greater, if the loan is a qualifying multi-family property loan; or

(C) A DSC ratio of 1.7 or greater, if the loan is any other type of CRE loan;

(vii) Determined that, based on two years of projections, which include the new debt obligation, following the origination date of the loan, the borrower will have:

(A) A DSC ratio of 1.5 or greater, if the loan is a qualifying leased CRE loan, net of any income derived from a tenant(s) who is not a qualified tenant(s);

(B) A DSC ratio of 1.5 or greater, if the loan is a qualifying multi-family property loan; or

(C) A DSC ratio of 1.7 or greater, if the loan is any other type of CRE loan.

(3) The loan documentation for the CRE loan includes covenants that:

(i) Require the borrower to provide to the originator and any subsequent holder of the commercial loan, and the servicer, the borrower's financial statements and supporting schedules on an ongoing basis, but not less frequently than quarterly, including information on existing, maturing and new leasing or rent-roll activity for the property securing the loan, as appropriate; and

(ii) Impose prohibitions on:

(A) The creation or existence of any other security interest with respect to any collateral for the CRE loan;

(B) The transfer of any collateral pledged to support the CRE loan; and

(C) Any change to the name, location or organizational structure of the borrower, or any other party that pledges collateral for the loan;

(iii) Require the borrower and any other party that pledges collateral for the loan to:

(A) Maintain insurance that protects against loss on any collateral for the CRE loan, at least up to the amount of the loan, and names the originator or any subsequent holder of the loan as an additional insured or loss payee;

(B) Pay taxes, charges, fees, and claims, where non-payment might give rise to a lien on any collateral for the CRE loan;

(C) Take any action required to perfect or protect the security interest of the originator or any subsequent holder of the loan in the collateral for the CRE loan or the priority thereof, and to defend such collateral against claims adverse to the originator's or subsequent holder's interest;

(D) Permit the originator or any subsequent holder of the loan, and the servicer, to inspect the collateral for the CRE loan and the books and records of the borrower or other party relating to the collateral for the CRE loan;

(E) Maintain the physical condition of the collateral for the CRE loan;

(F) Comply with all environmental, zoning, building code, licensing and other laws, regulations, agreements, covenants, use restrictions, and proffers applicable to the collateral;

(G) Comply with leases, franchise agreements, condominium declarations, and other documents and agreements relating to the operation of the collateral, and to not modify any material terms and conditions of such agreements over the term of the loan without the consent of the originator or any subsequent holder of the loan, or the servicer; and

(H) Not materially alter the collateral for the CRE loan without the consent of the originator or any subsequent holder of the loan, or the servicer.

(4) The loan documentation for the CRE loan prohibits the borrower from obtaining a loan secured by a junior lien on any property that serves as collateral for the CRE loan, unless such loan finances the purchase of machinery and equipment and the borrower pledges such machinery and equipment as additional collateral for the CRE loan.

(5) The CLTV ratio for the loan is:

(i) Less than or equal to 65 percent; or

(ii) Less than or equal to 60 percent, if the capitalization rate used in an appraisal that meets the requirements set forth in paragraph (b)(2)(ii) of this section is less than or equal to the sum of:

(A) The 10-year swap rate, as reported in the Federal Reserve Board H.15 Report as of the date concurrent with the effective date of an appraisal that meets the requirements set forth in paragraph (b)(2)(ii) of this section; and

(B) 300 basis points.

(6) All loan payments required to be made under the loan agreement are:

(i) Based on straight-line amortization of principal and interest over a term that does not exceed 20 years; and

(ii) To be made no less frequently than monthly over a term of at least ten years.

(7) Under the terms of the loan agreement:

(i) Any maturity of the note occurs no earlier than ten years following the date of origination;

(ii) The borrower is not permitted to defer repayment of principal or payment of interest; and

(iii) The interest rate on the loan is:

(A) A fixed interest rate; or

(B) An adjustable interest rate and the borrower, prior to or concurrently with origination of the CRE loan, obtained a derivative that effectively results in a fixed interest rate.

(8) The originator does not establish an interest reserve at origination to fund all or part of a payment on the loan.

(9) At the closing of the securitization transaction, all payments due on the loan are contractually current.

(10) (i) The depositor of the asset-backed security certifies 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 meet all of the requirements set forth in paragraphs (b)(1) through (9) of this section and has concluded that its internal supervisory controls are effective;

(ii) The evaluation of the effectiveness of the depositor's internal supervisory controls referenced in paragraph (b)(10)(i) of this section shall be performed, for each issuance of an asset-backed security, as of a date within 60 days of the cut-off date or similar date for establishing the composition of the asset pool collateralizing such asset-backed security; and

(iii) The sponsor provides, or causes to be provided, a copy of the certification described in paragraph (b)(10)(i) of this section to potential investors a reasonable period of time prior to the sale of asset-backed securities in the issuing entity, and, upon request, to its appropriate Federal banking agency, if any.

(c) Buy-back requirement. A sponsor that has relied on the exception provided in paragraph (a) of this section with respect to a securitization transaction shall not lose such exception with respect to such transaction if, after the closing of the securitization transaction, it is determined that one or more of the CRE loans collateralizing the asset-backed securities did not meet all of the requirements set forth in paragraphs (b)(1) through (b)(9) of this section provided that:

(1) The depositor has complied with the certification requirement set forth in paragraph (b)(10) of this section;

(2) The sponsor repurchases the loan(s) from the issuing entity at a price at least equal to the remaining principal balance and accrued interest on the loan(s) no later than ninety (90) days after the determination that the loans do not satisfy all of the requirements of paragraphs (b)(1) through (b)(9) of this section; and

(3) The sponsor promptly notifies, or causes to be notified, the holders of the asset-backed securities issued in the securitization transaction of any loan(s) included in such securitization transaction that is required to be repurchased by the sponsor pursuant to paragraph (c)(2) of this section, including the principal amount of such repurchased loan(s) and the cause for such repurchase.

§ __.20 Underwriting standards for qualifying auto loans.

(a) General. The securitization transaction is collateralized solely (excluding cash and cash equivalents) by one or more automobile loans, each of which meets all of the requirements of paragraph (b) of this section.

(b) Underwriting, product and other standards.

(1) Prior to origination of the automobile loan, the originator:

(i) Verified and documented that within 30 days of the date of origination:

(A) The borrower was not currently 30 days or more past due, in whole or in part, on any debt obligation;

(B) Within the previous twenty-four (24) months, the borrower has not been 60 days or more past due, in whole or in part, on any debt obligation;

(C) Within the previous thirty-six (36) months, the borrower has not:

(1) Been a debtor in a proceeding commenced under Chapter 7 (Liquidation), Chapter 11 (Reorganization), Chapter 12 (Family Farmer or Family Fisherman plan), or Chapter 13 (Individual Debt Adjustment) of the U.S. Bankruptcy Code; or

(2) Been the subject of any Federal or State judicial judgment for the collection of any unpaid debt;

(D) Within the previous thirty-six (36) months, no one-to-four family property owned by the borrower has been the subject of any foreclosure, deed in lieu of foreclosure, or short sale; or

(E) Within the previous thirty-six (36) months, the borrower has not had any personal property repossessed;

(ii) Determined and documented that, upon the origination of the loan, the borrower's DTI ratio is less than or equal to thirty-six (36) percent.

(A) For the purpose of making the determination under paragraph (b)(1)(ii) of this section, the originator must:

(1) Verify and document all income of the borrower that the originator includes in the borrower's effective monthly income (using payroll stubs, tax returns, profit and loss statements, or other similar documentation); and

(2) On or after the date of the borrower's written application and prior to origination, obtain a credit report regarding the borrower from a consumer reporting agency that compiles and maintain files on consumers on a nationwide basis (within the meaning of 15 U.S.C. 1681a(p)) and verify that all outstanding debts reported in the borrower's credit report are incorporated into the calculation of the borrower's DTI ratio under paragraph (b)(1)(ii) of this section;

(2) An originator will be deemed to have met the requirements of paragraph (b)(1)(i) of this section if:

(i) The originator, no more than 90 days before the closing of the loan, obtains a credit report regarding the borrower from at least two consumer reporting agencies that compile and maintain files on consumers on a nationwide basis (within the meaning of 15 U.S.C. 1681a(p));

(ii) Based on the information in such credit reports, the borrower meets all of the requirements of paragraph (b)(1)(i) of this section, and no information in a credit report subsequently obtained by the originator before the closing of the mortgage transaction contains contrary information; and

(iii) The originator obtains electronic or hard copies of such credit reports.

(3) At closing of the automobile loan, the borrower makes a down payment from the borrower's personal funds and trade-in allowance, if any, that is at least equal to the sum of:

(i) The full cost of the vehicle title, tax, and registration fees;

(ii) Any dealer-imposed fees; and

(iii) 20 percent of the vehicle purchase price.

(4) The transaction documents require the originator, subsequent holder of the loan, or an agent of the originator or subsequent holder of the loan to maintain physical possession of the title for the vehicle until the loan is repaid in full and the borrower has otherwise satisfied all obligations under the terms of the loan agreement.

(5) If the loan is for a new vehicle, the terms of the loan agreement provide a maturity date for the loan that does not exceed 5 years from the date of origination.

(6) If the loan is for a vehicle other than a new vehicle, the term of the loan (as set forth in the loan agreement) plus the difference between the current model year and the vehicle's model year does not exceed 5 years.

(7) The terms of the loan agreement:

(i) Specify a fixed rate of interest for the life of the loan;

(ii) Provide for a monthly payment amount that:

(A) Is based on straight-line amortization of principal and interest over the term of the loan; and

(B) Do not permit the borrower to defer repayment of principal or payment of interest; and

(C) Require the borrower to make the first payment on the automobile loan within 45 days of the date of origination.

(8) At the closing of the securitization transaction, all payments due on the loan are contractually current; and

(9) (i) The depositor of the asset-backed security certifies 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 meet all of the requirements set forth in paragraphs (b)(1) through (b)(8) of this section and has concluded that its internal supervisory controls are effective;

(ii) The evaluation of the effectiveness of the depositor's internal supervisory controls referenced in paragraph (b)(9)(i) of this section shall be performed, for each issuance of an asset-backed security, as of a date within 60 days of the cut-off date or similar date for establishing the composition of the asset pool collateralizing such asset-backed security; and

(iii) The sponsor provides, or causes to be provided, a copy of the certification described in paragraph (b)(9)(i) of this section to potential investors a reasonable period of time prior to the sale of asset-backed securities in the issuing entity, and, upon request, to its appropriate Federal banking agency, if any.

(c) Buy-back requirement. A sponsor that has relied on the exception provided in this paragraph (a) of this section with respect to a securitization transaction shall not lose such exception with respect to such transaction if, after the closing of the securitization transaction, it is determined that one or more of the automobile loans collateralizing the asset-backed securities did not meet all of the requirements set forth in paragraphs (b)(1) through (b)(8) of this section provided that:

(1) The depositor has complied with the certification requirement set forth in paragraph (b)(9) of this section;

(2) The sponsor repurchases the loan(s) from the issuing entity at a price at least equal to the remaining principal balance and accrued interest on the loan(s) no later than 90 days after the determination that the loans do not satisfy all of the requirements of paragraphs (b)(1) through (b)(8) of this section; and

(3) The sponsor promptly notifies, or causes to be notified, the holders of the asset-backed securities issued in the securitization transaction of any loan(s) included in such securitization transaction that is required to be repurchased by the sponsor pursuant to paragraph (c)(2) of this section, including the principal amount of such repurchased loan(s) and the cause for such repurchase.

§ __.21 General exemptions.

(a) This part shall not apply to:

(1) Any securitization transaction that:

(i) Is collateralized solely (excluding cash and cash equivalents) by residential, multifamily, or health care facility mortgage loan assets that are insured or guaranteed as to the payment of principal and interest by the United States or an agency of the United States; or

(ii) Involves the issuance of asset-backed securities that:

(A) Are insured or guaranteed as to the payment of principal and interest by the United States or an agency of the United States; and

(B) Are collateralized solely (excluding cash and cash equivalents) by residential, multifamily, or health care facility mortgage loan assets or interests in such assets.

(2) Any securitization transaction that is collateralized solely (excluding cash and cash equivalents) by loans or other assets made, insured, guaranteed, or purchased by any institution that is subject to the supervision of the Farm Credit Administration, including the Federal Agricultural Mortgage Corporation;

(3) Any asset-backed security that is a security issued or guaranteed by any State of the United States, or by any political subdivision of a State or territory, or by any public instrumentality of a State or territory that is exempt from the registration requirements of the Securities Act of 1933 by reason of section 3(a)(2) of that Act (15 U.S.C. 77c(a)(2)); and

(4) Any asset-backed security that meets the definition of a qualified scholarship funding bond, as set forth in section 150(d)(2) of the Internal Revenue Code of 1986 (26 U.S.C. 150(d)(2)).

(5) Any securitization transaction that:

(i) Is collateralized solely (other than cash and cash equivalents) by existing asset-backed securities issued in a securitization transaction:

(A) For which credit risk was retained as required under subpart B of this part; or

(B) That was exempted from the credit risk retention requirements of this part pursuant to subpart D of this part;

(ii) Is structured so that it involves the issuance of only a single class of ABS interests; and

(iii) Provides for the pass-through of all principal and interest payments received on the underlying ABS (net of expenses of the issuing entity) to the holders of such class.

(b) This part shall not apply to any securitization transaction if the asset-backed securities issued in the transaction are:

(1) Collateralized solely (excluding cash and cash equivalents) by obligations issued by the United States or an agency of the United States;

(2) Collateralized solely (excluding cash and cash equivalents) by assets that are fully insured or guaranteed as to the payment of principal and interest by the United States or an agency of the United States (other than those referred to in paragraph (a)(1)(i) of this section); or

(3) Fully guaranteed as to the timely payment of principal and interest by the United States or any agency of the United States;

(c) Rule of construction. Securitization transactions involving the issuance of asset-backed securities that are either issued, insured, or guaranteed by, or are collateralized by obligations issued by, or loans that are issued, insured, or guaranteed by, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, or a Federal home loan bank shall not on that basis qualify for exemption under this section.

§__.22 Safe harbor for certain foreign-related transactions.

(a) In general. This part shall not apply to a securitization transaction if all the following conditions are met:

(1) The securitization transaction is not required to be and is not registered under the Securities Act of 1933 (15 U.S.C. 77a et seq.);

(2) No more than 10 percent of the dollar value by proceeds (or equivalent if sold in a foreign currency) of all classes of ABS interests sold in the securitization transaction are sold to U.S. persons or for the account or benefit of U.S. persons;

(3) Neither the sponsor of the securitization transaction nor the issuing entity is:

(i) Chartered, incorporated, or organized under the laws of the United States, any State of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, or any other possession of the United States (each of the foregoing, a "U.S. jurisdiction");

(ii) An unincorporated branch or office (wherever located) of an entity chartered, incorporated, or organized under the laws of a U.S. jurisdiction; or

(iii) An unincorporated branch or office located in a U.S. jurisdiction of an entity that is chartered, incorporated, or organized under the laws of a jurisdiction other than a U.S. jurisdiction; and

(4) If the sponsor or issuing entity is chartered, incorporated, or organized under the laws of a jurisdiction other than a U.S. jurisdiction, no more than 25 percent (as determined based on unpaid principal balance) of the assets that collateralize the ABS interests sold in the

securitization transaction were acquired by the sponsor or issuing entity, directly or indirectly, from:

(i) A consolidated affiliate of the sponsor or issuing entity that is chartered, incorporated, or organized under the laws of a U.S. jurisdiction; or

(ii) An unincorporated branch or office of the sponsor or issuing entity that is located in a U.S. jurisdiction.

(b) Evasions prohibited. In view of the objective of these rules and the policies underlying Section 15G of the Exchange Act, the safe harbor described in paragraph (a) of this section is not available with respect to any transaction or series of transactions that, although in technical compliance with such paragraph (a), is part of a plan or scheme to evade the requirements of section 15G and this Regulation. In such cases, compliance with section 15G and this part is required.

§ __.23 Additional exemptions.

(a) Securitization transactions. The federal agencies with rulewriting authority under section 15G(b) of the Exchange Act (15 U.S.C. 78o-11(b)) with respect to the type of assets involved may jointly provide a total or partial exemption of any securitization transaction as such agencies determine may be appropriate in the public interest and for the protection of investors.

(b) Exceptions, exemptions, and adjustments. The Federal banking agencies and the Commission, in consultation with the Federal Housing Finance Agency and the Department of Housing and Urban Development, may jointly adopt or issue exemptions, exceptions or adjustments to the requirements of this part, including exemptions, exceptions or adjustments for classes of institutions or assets in accordance with section 15G(e) of the Exchange Act (15 U.S.C. 78o-11(e)).

Additional QRM Standards Appendix

Standards for Determining Acceptable Sources of Borrower Funds, Borrower's Monthly Gross Income, Monthly Housing Debt, and Total Monthly Debt

I. Borrower Funds to Close

A. Cash and Savings/Checking Accounts as Acceptable Sources of Funds

1. Earnest Money Deposit

The lender must verify with documentation, the deposit amount and source of funds, if the amount of the earnest money deposit:

- Exceeds 2 percent of the sales price, or
- Appears excessive based on the borrower's history of accumulating savings.

Satisfactory documentation includes:

- A copy of the borrower's cancelled check
- Certification from the deposit-holder acknowledging receipt of funds, or
- Separate evidence of the source of funds.

Separate evidence includes a verification of deposit (VOD) or bank statement showing that the average balance was sufficient to cover the amount of the earnest money deposit, at the time of the deposit.

2. Savings and Checking Accounts

A VOD, along with the most recent bank statement, may be used to verify savings and checking accounts.

If there is a large increase in an account, or the account was recently opened, the lender must obtain from the borrower a credible explanation of the source of the funds.

3. Cash Saved at Home

Borrowers who have saved cash at home and are able to adequately demonstrate the ability to do so, are permitted to have this money included as an acceptable source of funds to close the mortgage.

To include cash saved at home when assessing the borrower's cash assets, the:

- Money must be verified, whether deposited in a financial institution, or held by the escrow/title company, and
- Borrower must provide satisfactory evidence of the ability to accumulate such savings.

4. Verifying Cash Saved at Home

Verifying the cash saved at home assets requires the borrower to explain in writing:

- How the funds were accumulated, and
- The amount of time it took to accumulate the funds.

The lender must determine the reasonableness of the accumulation, based on the:

- Borrower's income stream
- Time period during which the funds were saved
- Borrower's spending habits, and
- Documented expenses and the borrower's history of using financial institutions.

Note: Borrowers with checking and/or savings accounts are less likely to save money at home, than individuals with no history of such accounts.

5. Cash Accumulated with Private Savings Clubs

Some borrowers may choose to use non-traditional methods to save money by making deposits into private savings clubs. Often, these private savings clubs pool resources for use among the membership.

If a borrower claims that the cash to close mortgage is from savings held with a private savings club, he/she *must* be able to adequately document the accumulation of the funds with the club.

6. Requirements for Private Savings Clubs

While private savings clubs are not supervised banking institutions, the clubs must, at a minimum, have:

- Account ledgers
- Receipts from the club
- Verification from the club treasurer, and
- Identification of the club.

The lender must reverify the information, and the underwriter must be able to determine that:

- It was reasonable for the borrower to have saved the money claimed, and
- There is no evidence that the funds were borrowed with an expectation of repayment.

B. Investments as an Acceptable Source of Funds

1. IRAs, Thrift Savings Plans, and 401(k)s and Keogh Accounts

Up to 60 percent of the value of assets such as IRAs, thrift savings plans, 401(k) and Keogh accounts may be included in the underwriting analysis, unless the borrower provides conclusive evidence that a higher percentage may be withdrawn, after subtracting any:

- Federal income tax, and
- Withdrawal penalties.

Notes:

- Redemption evidence is required.
- The portion of the assets not used to meet closing requirements, after adjusting for taxes and penalties may be counted as reserves.

2. Stocks and Bonds

The monthly or quarterly statement provided by the stockbroker or financial institution managing the portfolio may be used to verify the value of stocks and bonds.

Note: The actual receipt of funds must be verified and documented.

3. Savings Bonds

Government issued bonds are counted at the original purchase price, unless eligibility for redemption and the redemption value are confirmed.

Note: The actual receipt of funds at redemption must be verified.

C. Gifts as an Acceptable Source of Funds

1. Description of Gift Funds

In order for funds to be considered a gift there must be no expected or implied repayment of the funds to the donor by the borrower.

Note: The portion of the gift not used to meet closing requirements may be counted as reserves.

2. Who Can Provide a Gift?

An outright gift of the cash investment is acceptable if the donor is:

- The borrower's relative
- The borrower's employer or labor union
- A charitable organization
- A governmental agency or public entity that has a program providing home ownership assistance to
  - Low- and moderate-income families
  - First-time homebuyers, or
- A close friend with a clearly defined and documented interest in the borrower.

3. Who Cannot Provide a Gift?

The gift donor may *not* be a person or entity with an interest in the sale of the property, such as:

- The seller
- The real estate agent or broker
- The builder, or
- An associated entity.

Gifts from these sources are considered inducements to purchase, and *must* be subtracted from the sales price.

Note: This applies to properties where the seller is a government agency selling foreclosed properties, such as the US Department of Veterans Affairs (VA) or Rural Housing Services.

4. Lender Responsibility for Verifying the Acceptability of Gift Fund Sources

Regardless of when gift funds are made available to a borrower, the lender *must* be able to determine that the gift funds were *not* provided by an unacceptable source, and were the donor's own funds.

When the transfer occurs at closing, the lender is responsible for verifying that the closing agent received the funds from the donor for the amount of the gift, and that the funds were from an acceptable source.

5. Requirements Regarding Donor Source of Funds

As a general rule, how a donor obtains gift funds is not of concern, provided that the funds are not derived in any manner from a party to the sales transaction.

Donors may borrow gift funds from any other acceptable source, provided the mortgage borrowers are not obligors to any note to secure money borrowed to give the gift.

6. Equity Credit

Only family members may provide equity credit as a gift on property being sold to other family members.

7. Payment of Consumer Debt Must Result in Sales Price Reduction

The payment of consumer debt by third parties is considered to be an inducement to purchase.

While sellers and other parties may make contributions subject to any percentage limitation of the sales price of a property toward a buyer's actual closing costs and financing concessions, this applies *exclusively* to the mortgage financing provision.

When someone other than a family member has paid off debts or other expenses on behalf of the borrower:

- The funds must be treated as an inducement to purchase, and
- There *must* be a dollar for dollar reduction to the sales price when calculating the maximum insurable mortgage.

Note: The dollar for dollar reduction to the sales price also applies to gift funds not meeting the requirement that:

- The gift be for down payment assistance, and
- That it be provided by an acceptable source.

8. Using Downpayment Assistance Programs

Downpayment assistance programs providing gifts administered by charitable organizations, such as nonprofits should be carefully monitored. Nonprofit entities should not provide gifts to pay off:

- Installment loans
- Credit cards
- Collections
- Judgments, and
- Similar debts.

Lenders *must* ensure that a gift provided by a charitable organization meets these requirements and that the transfer of funds is properly documented.

9. Gifts from Charitable Organizations that Lose or Give Up Their Federal Tax-Exempt Status.

If a charitable organization makes a gift that is to be used for all, or part, of a borrower's down payment, and the organization providing the gift loses or gives up its Federal tax exempt status, the gift will be recognized as an acceptable source of the down payment provided that:

- The gift is made to the borrower
- The gift is properly documented, and
- The borrower has entered into a contract of sale (including any amendments to purchase price) *on, or before*, the date the IRS officially announces that the charitable organization's tax exempt status is terminated.

10. Lender Responsibility for Ensuring That an Entity Is a Charitable Organization

The lender is responsible for ensuring that an entity is a charitable organization as defined by Section 501(a) of the Internal Revenue Code (IRC) of 1986 (26 U.S.C. 150(d)(2)) pursuant to Section 501(c) (3) of the IRC.

One resource available to lenders for obtaining this information is the Internal Revenue Service (IRS) Publication 78, *Cumulative List of Organizations described in Section 170(c) of the Internal Revenue Code of 1986*, which contains a list of organizations eligible to receive tax-deductible charitable contributions.

The IRS has an online version of this list that can help lenders and others conduct a search of these organizations. The online version can be found at http://apps.irs.gov/app/pub78 using the following instructions to obtain the latest update:

- Enter search data and click "Search"
- Click "Search for Charities" under the "Charities & Non-Profits Topics" heading on the left-hand side of the page
- Click "Recent Revocations and Deletions from Cumulative List" under the "Additional Information" heading in the middle of the page, and
- Click the name of the organization if the name appears on the list displayed.

D. Gift Fund Required Documentation

1. Gift Letter Requirement

A lender must document any borrower gift funds through a gift letter, signed by the donor and borrower. The gift letter must show the donor's name, address, telephone number, specify the dollar amount of the gift, and state the nature of the donor's relationship to the borrower and that no repayment is required. If sufficient funds required for closing are not already verified in the borrower's accounts, document the transfer of the gift funds to the borrower's accounts, in accordance with the instructions described in section (I)(D)(2).

2. Documenting the Transfer of Gift Funds

The lender must document the transfer of the gift funds from the donor to the borrower. The table below describes the requirements for the transfer of gift funds.

If the gift funds ...	**Then ...**
Are in the borrower's account	Obtain • A copy of the withdrawal document showing that the withdrawal is from the donor's account, and • The borrower's deposit slip and bank statement showing the deposit.
• Are to be provided at closing, and • Are in the form of a certified check from the donor's account	Obtain a • Bank statement showing the withdrawal from the donor's account, and • Copy of the certified check.
• Are to be provided at closing, and • Are in the form of a cashier's check, money order, official check, or other type of bank check	Have the donor provide a withdrawal document or cancelled check for the amount of the gift, showing that the funds came from the donor's personal account.
• Are to be provided at closing, and	Have the donor provide documentation of the wire transfer.

If the gift funds ...	Then ...
• Are in the form of an electronic wire transfer to the closing agent	**Note**: The lender must obtain and keep the documentation of the wire transfer in its mortgage loan application binder. While the document does not need to be provided in the insurance binder, it must be available for inspection.
• Are being borrowed by the donor, and • Documentation from the bank or other savings account is *not* available	Have the donor provide written evidence that the funds were borrowed from an acceptable source, not from a party to the transaction, including the lender. ***IMPORTANT***: *Cash on hand* is *not* an acceptable source of donor gift funds.

E. Property Related Acceptable Sources of Funds
1. Type of Personal Property

In order to obtain cash for closing, a borrower may sell various personal property items. The types of personal property items that a borrower can sell include

- Cars
- Recreational vehicles
- Stamps
- Coins, and
- Baseball card collections.

2. Sale of Personal Property Documentation Requirement

If a borrower plans to sell personal property items to obtain funds for closing, he/she must provide

- Satisfactory estimate of the worth of the personal property items, and
- Evidence that the items were sold.

The estimated worth of the items being sold may be in the form of

- Published value estimates issued by organizations, such as
  - automobile dealers, or
  - philatelic or numismatic associations, or

- A separate written appraisal by a qualified appraiser with no financial interest in the loan transaction.

Only the *lesser* of the estimated value or actual sales prices are considered as assets to close.

3. Net Sales Proceeds From a Property

The net proceeds from an arms-length sale of a currently owned property may be used for the cash investment on a new house. The borrower must provide satisfactory evidence of the accrued cash sales proceeds.

If the property has not sold by the time of underwriting, condition loan approval by verifying the actual proceeds received by the borrower. The lender must document the

- Actual sale, and

- Sufficiency of the net proceeds required for settlement.

Note: If the property has not sold by the time of the subject settlement, the existing mortgage must be included as a liability for qualifying purposes.

4. Commission From the Sale of the Property

If the borrower is a licensed real estate agent entitled to a real estate commission from the sale of the property being purchased, then he/she may use that amount for the cash investment, with no adjustment to the maximum mortgage required.

A family member entitled to the commission may also provide gift funds to the borrower.

5. Trade Equity

The borrower may agree to trade his/her real property to the seller as part of the cash investment. The amount of the borrower's equity contribution is determined by

- Using the *lesser* of the property's appraised value or sales price, and
- Subtracting all liens against the property being traded, along with any real estate commission.

In order to establish the property value, the borrower must provide

- A residential appraisal no more than six months old to determine the property's value, and
- Evidence of ownership.

Note: If the property being traded has an FHA-insured mortgage, assumption processing requirements and restrictions apply.

6. Rent Credit

The cumulative amount of rental payments that exceed the appraiser's estimate of fair market rent may be considered accumulation of the borrower's cash investment.

The following *must* be included in the endorsement package:

- Rent with option to purchase agreement, and
- Appraiser's estimate of market rent.

Conversely, treat the rent as an inducement to purchase with an appropriate reduction to the mortgage, *if* the sales agreement reveals that the borrower

- Has been living in the property rent-free, or
- Has an agreement to occupy the property as a rental considerably below fair market value in anticipation of eventual purchase.

Exception: An exception may be granted when a builder

- Fails to deliver a property at an agreed to time, and
- Permits the borrower to occupy an existing or other unit for less than market rent until construction is complete.

7. Sweat Equity Considered a Cash Equivalent

Labor performed, or materials furnished by the borrower before closing on the property being purchased (known as "sweat equity"), may be considered the equivalent of a cash investment, to the amount of the estimated cost of the work or materials.

Note: Sweat equity may also be "gifted," subject to

- The additional requirements in section (I)(E)(8), and
- The gift fund requirements described in section (I)(D).

8. Additional Sweat Equity Requirements

The table below describes additional requirements for applying sweat equity as a cash equivalent and as an acceptable source of borrower funds.

Sweat Equity Category	**Requirement**
Existing Construction	Only repairs or improvements listed on the appraisal are eligible for sweat equity. Any work completed or materials provided before the appraisal are *not* eligible.
Proposed Construction	The sales contract must indicate the tasks to be performed by the borrower during construction.
Borrower's Labor	The borrower must demonstrate his/her ability

	to complete the work in a satisfactory manner. The lender must document the contributory value of the labor either through • The appraiser's estimate, or • A cost-estimating service.
Delayed Work	The following *cannot* be included as sweat equity: • Delayed work (on-site escrow) • Clean up • Debris removal, and • Other general maintenance.
Cash Back	Cash back to the borrower in sweat equity transactions is *not* permitted.
Sweat Equity on Property Not Being Purchased	Sweat equity is *not* acceptable on property other than the property being purchased. Compensation for work performed on other properties must be • In cash, and • Properly documented.
Source of Funds Evidence	Evidence of the following must be provided if the borrower furnishes funds and materials: • Source of the funds, and • Market value of the materials.

9. Trade-In Manufactured Home

An acceptable source of borrower cash investment commonly associated with manufactured homes is the sale or trade-in of another manufactured home that is not considered real estate. Trade-ins for cash funds are considered a seller inducement and are not permitted.]

II. Borrower Eligibility

A. Stability of Income

1. Effective Income

Income may not be used in calculating the borrower's income ratios if it comes from any source that cannot be verified, is not stable, or will not continue.

2. Verifying Employment History

The lender must verify the borrower's employment for the most recent two full years, and the borrower must

- Explain any gaps in employment that span one or more months, and
- Indicate if he/she was in school or the military for the recent two full years, providing Evidence supporting this claim, such as
    - College transcripts, or
    - Discharge papers.

Allowances can be made for seasonal employment, typical for the building trades and agriculture, if documented by the lender.

Note: A borrower with a 25 percent or greater ownership interest in a business is considered self employed and will be evaluated as a self employed borrower for underwriting purposes.

3. Analyzing a Borrower's Employment Record

When analyzing the probability of continued employment, lenders must examine:

- The borrower's past employment record
- Qualifications for the position
- Previous training and education, and
- The employer's confirmation of continued employment.

Favorably consider a borrower for a mortgage if he/she changes jobs frequently within the same line of work, but continues to advance in income or benefits. In this analysis, income stability takes precedence over job stability.

4. Borrowers Returning to Work after an Extended Absence

A borrower's income may be considered effective and stable when recently returning to work after an extended absence if he/she:

- Is employed in the current job for six months or longer, and
- Can document a two year work history prior to an absence from employment using
    - Traditional employment verifications, and/or
    - Copies of W-2 forms or pay stubs.

Note: An acceptable employment situation includes individuals who took several years off from employment to raise children, then returned to the workforce.

Important: Situations not meeting the criteria listed above may *only* be considered as compensating factors. Extended absence is defined as six months.

B. Salary, Wage and Other Forms of Income

1. General Policy on Borrower Income Analysis

The income of each borrower who will be obligated for the mortgage debt *must* be analyzed to determine whether his/her income level can be reasonably expected to continue through at least the first three years of the mortgage loan.

In most cases, a borrower's income is limited to salaries or wages. Income from other sources can be considered as effective, when properly verified and documented by the lender.

Notes:

- Effective income for borrowers planning to retire during the first three-year period *must* include the amount of:
    - Documented retirement benefits
    - Social Security payments, or
    - Other payments expected to be received in retirement.
- Lenders *must not* ask the borrower about possible, future maternity leave.

2. Overtime and Bonus Income

Overtime and bonus income can be used to qualify the borrower if he/she has received this income for the past two years, and it will likely continue. If the employment verification states that the overtime and bonus income is unlikely to continue, it may not be used in qualifying.

The lender must develop an average of bonus or overtime income for the past two years. Periods of overtime and bonus income less than two years may be acceptable, provided the lender can justify and document in writing the reason for using the income for qualifying purposes.

3. Establishing an Overtime and Bonus Income Earning Trend

The lender *must* establish and document an earnings trend for overtime and bonus income. If either type of income shows a continual decline, the lender *must* document in writing a sound rationalization for including the income when qualifying the borrower.

A period of more than two years must be used in calculating the average overtime and bonus income if the income varies significantly from year to year.

4. Qualifying Part- Time Income

Part-time and seasonal income can be used to qualify the borrower if the lender documents that the borrower has worked the part-time job uninterrupted for the past two years, and plans to continue. Many low and moderate income families rely on part-time and seasonal income for day to day needs, and lenders should not restrict consideration of such income when qualifying these borrowers.

Part-time income received for less than two years may be included as effective income, provided that the lender justifies and documents that the income is likely to continue.

Part-time income not meeting the qualifying requirements may be considered as a compensating factor only.

Note: For qualifying purposes, "part-time" income refers to employment taken to supplement the borrower's income from regular employment; part-time employment is not a primary job and it is worked less than 40 hours.

5. Income from Seasonal Employment

Seasonal income is considered uninterrupted, and may be used to qualify the borrower, if the lender documents that the borrower:

- Has worked the same job for the past two years, and
- Expects to be rehired the next season.

Seasonal employment includes:

- Umpiring baseball games in the summer, or
- Working at a department store during the holiday shopping season.

6. Primary Employment Less Than 40 Hour Work Week

When a borrower's primary employment is less than a typical 40-hour work week, the lender should evaluate the stability of that income as regular, on-going primary employment.

Example: A registered nurse may have worked 24 hours per week for the last year. Although this job is less than the 40-hour work week, it is the borrower's primary employment, and should be considered effective income.

7. Commission Income

Commission income *must* be averaged over the previous two years. To qualify commission income, the borrower must provide:

- Copies of signed tax returns for the last two years, and
- The most recent pay stub.

Commission income showing a decrease from one year to the next requires significant compensating factors before a borrower can be approved for the loan.

Borrowers whose commission income was received for more than one year, but less than two years may be considered favorably if the underwriter can:

- Document the likelihood that the income will continue, and
- Soundly rationalize accepting the commission income.

Notes:

- Unreimbursed business expenses must be subtracted from gross income.
- A commissioned borrower is one who receives more than 25 percent of his/her annual income from commissions.
- A tax transcript obtained directly from the IRS may be used in lieu of signed tax returns, and the cost of the transcript may be charged to the borrower.

8. Qualifying Commission Income Earned for Less Than One Year

Commission income earned for less than one year is *not* considered effective income. Exceptions may be made for situations in which the borrower's compensation was changed from salary to commission within a similar position with the same employer.

A borrower may also qualify when the portion of earnings *not* attributed to commissions would be sufficient to qualify the borrower for the mortgage.

9. Employer Differential Payments

If the employer subsidizes a borrower's mortgage payment through direct payments, the amount of the payments:

- Is considered gross income, and
- Cannot be used to offset the mortgage payment directly, even if the employer pays the servicing lender directly.

10. Retirement Income

Retirement income must be verified from the former employer, or from Federal tax returns. If any retirement income, such as employer pensions or 401(k)s, will cease within the first full three years of the mortgage loan, the income may *only* be considered as a compensating factor.

11. Social Security Income

Social Security income must be verified by the Social Security Administration or on Federal tax returns. If any benefits expire within the first full three years of the loan, the income source may be considered *only* as a compensating factor.

Notes:

- The lender must obtain a complete copy of the current awards letter.

- Not all Social Security income is for retirement-aged recipients; therefore, documented continuation is required.
- Some portion of Social Security income may be "grossed up" if deemed nontaxable by the IRS

12. Automobile Allowances and Expense Account Payments

Only the amount by which the borrower's automobile allowance or expense account payments *exceed* actual expenditures may be considered income.

To establish the amount to add to gross income, the borrower must provide the following:

- IRS Form 2106, *Employee Business Expenses,* for the previous two years, and
- Employer verification that the payments will continue.

If the borrower uses the standard per-mile rate in calculating automobile expenses, as opposed to the actual cost method, the portion that the IRS considers depreciation may be added back to income.

Expenses that must be treated as recurring debt include:

- The borrower's monthly car payment, and
- Any loss resulting from the calculation of the difference between the actual expenditures and the expense account allowance.

C. Borrowers Employed by a Family Owned Business

1. Income Documentation Requirement

In addition to normal employment verification, a borrower employed by a family owned businesses are required to provide evidence that he/she is not an owner of the business, which may include:

- Copies of signed personal tax returns, or
- A signed copy of the corporate tax return showing ownership percentage.

Note: A tax transcript obtained directly from the IRS may be used in lieu of signed tax returns, and the cost of the transcript may be charged to the borrower

D. General Information on Self Employed Borrowers and Income Analysis

1. Definition: Self Employed Borrower

A borrower with a 25 percent or greater ownership interest in a business is considered self employed.

2. Types of Business Structures

There are four basic types of business structures. They include:

- Sole proprietorships
- Corporations
- Limited liability or "S" corporations, and
- Partnerships.

3. Minimum Length of Self Employment

Income from self employment is considered stable, and effective, if the borrower has been self employed for two or more years.

Due to the high probability of failure during the first few years of a business, the requirements described in the table below are necessary for borrowers who have been self employed for less than two years.

If the period of self employment is ...	**Then ...**
Between one and two years	To be eligible for a mortgage loan, the individual must have at least two years of documented previous successful employment in the line of work in which the individual is self employed, or in a related occupation. ***Note***: A combination of one year of employment and formal education or training in the line of work in which the individual is self employed or in a related occupation is also acceptable.
Less than one year	The income from the borrower may not be considered effective income.

4. General Documentation Requirements for Self Employed Borrowers

Self employed borrowers must provide the following documentation:

- Signed, dated individual tax returns, with all applicable tax schedules for the most recent two years
- For a corporation, "S" corporation, or partnership, signed copies of Federal business income tax returns for the last two years, with all applicable tax schedules
- Year to date profit and loss (P&L) statement and balance sheet, and

- Business credit report for corporations and "S" corporations.

5. Establishing a Borrower's Earnings Trend

When qualifying a borrower for a mortgage loan, the lender must establish the borrower's earnings trend from the previous two years using the borrower's tax returns.

If a borrower:

- Provides quarterly tax returns, the income analysis may include income through the period covered by the tax filings, or
- Is *not* subject to quarterly tax returns, or does not file them, then the income shown on the P&L statement may be included in the analysis, provided the income stream based on the P&L is consistent with the previous years' earnings.

If the P&L statements submitted for the current year show an income stream considerably *greater* than what is supported by the previous year's tax returns, the lender must base the income analysis solely on the income verified through the tax returns.

If the borrower's earnings trend for the previous two years is *downward* and the most recent tax return or P&L is *less than the prior year's tax return*, the borrower's most recent year's tax return or P&L must be used to calculate his/her income.

6. Analyzing the Business's Financial Strength

To determine if the business is expected to generate sufficient income for the borrower's needs, the lender must carefully analyze the business's financial strength, including the:

- Source of the business's income
- General economic outlook for similar businesses in the area.

Annual earnings that are stable or increasing are acceptable, while businesses that show a significant decline in income over the analysis period are not acceptable.

E. Income Analysis: Individual Tax Returns (IRS Form 1040)

1. General Policy on Adjusting Income Based on a Review of IRS Form 1040

The amount shown on a borrower's IRS Form 1040 as *adjusted gross income* must either be increased or decreased based on the lender's analysis of the individual tax return and any related tax schedules.

2. Guidelines for Analyzing IRS Form 1040

The table below contains guidelines for analyzing IRS Form 1040:

IRS Form 1040 Heading	Description
Wages, Salaries and Tips	An amount shown under this heading may indicate that the individual • Is a salaried employee of a corporation, or • Has other sources of income. This section may also indicate that the spouse is employed, in which case the spouse's income must be subtracted from the borrower's adjusted gross income.
Business Income and Loss (from Schedule C)	Sole proprietorship income calculated on Schedule C is business income. Depreciation or depletion may be added back to the adjusted gross income.
Rents, Royalties, Partnerships (from Schedule E)	Any income received from rental properties or royalties may be used as income, after adding back any depreciation shown on Schedule E.
Capital Gain and Losses (from Schedule D)	Capital gains or losses generally occur only one time, and should not be considered when determining effective income. However, if the individual has a constant turnover of assets resulting in gains or losses, the capital gain or loss must be considered when determining the income. Three years' tax returns are required to evaluate an earning trend. If the trend • Results in a gain, it may be added as effective income, or • Consistently shows a loss, it must be deducted from the total income.

IRS Form 1040 Heading	**Description**
	Lender must document anticipated continuation of income through verified assets. *Example*: A lender can consider the capital gains for an individual who purchases old houses, remodels them, and sells them for profit.
Interest and Dividend Income (from Schedule B)	This taxable/tax-exempt income may be added back to the adjusted gross income only if it • Has been received for the past two years, and • Is expected to continue. If the interest-bearing asset will be liquidated as a source of the cash investment, the lender must appropriately adjust the amount.
Farm Income or Loss (from Schedule F)	Any depreciation shown on Schedule F may be added back to the adjusted gross income.
IRA Distributions, Pensions, Annuities, and Social Security Benefits	The non-taxable portion of these items may be added back to the adjusted gross income, if the income is expected to continue for the first three years of the mortgage.
Adjustments to Income	Adjustments to income may be added back to the adjusted gross income if they are • IRA and Keogh retirement deductions • Penalties on early withdrawal of savings • Health insurance deductions, and • Alimony payments.

IRS Form 1040 Heading	Description
Employee Business Expenses	Employee business expenses are actual cash expenses that must be deducted from the adjusted gross income.

F. Income Analysis: Corporate Tax Returns (IRS Form 1120)

1. Description: Corporation

A ***Corporation*** is a state-chartered business owned by its stockholders.

2. Need to Obtain Borrower Percentage of Ownership Information

Corporate compensation to the officers, generally in proportion to the percentage of ownership, is shown on the

- Corporate tax return IRS Form 1120, and
- Individual tax returns.

When a borrower's percentage of ownership does not appear on the tax returns, the lender *must* obtain the information from the corporation's accountant, along with evidence that the borrower has the right to any compensation.

3. Analyzing Corporate Tax Returns

In order to determine a borrower's self employed income from a corporation the adjusted business income must

- Be determined, and
- Multiplied by the borrower's percentage of ownership in the business.

The table below describes the items found on IRS Form 1120 for which an adjustment must be made in order to determine adjusted business income.

Adjustment Item	Description of Adjustment
Depreciation and Depletion	Add the corporation's depreciation and depletion back to the after-tax income.
Taxable Income	Taxable income is the corporation's net income before Federal taxes. Reduce taxable income by the tax liability.

Adjustment Item	Description of Adjustment
Fiscal Year vs. Calendar Year	If the corporation operates on a fiscal year that is different from the calendar year, an adjustment must be made to relate corporate income to the individual tax return.
Cash Withdrawals	The borrower's withdrawal of cash from the corporation may have a severe negative impact on the corporation's ability to continue operating.

G. Income Analysis: "S" Corporation Tax Returns (IRS Form 1120S)

1. Description: "S" Corporation

An ***"S" Corporation*** is generally a small, start-up business, with gains and losses passed to stockholders in proportion to each stockholder's percentage of business ownership.

Income for owners of "S" corporations comes from W-2 wages, and is taxed at the individual rate. The IRS Form 1120S, *Compensation of Officers* line item is transferred to the borrower's individual IRS Form 1040.

2. Analyzing "S" Corporation Tax Returns

"S" corporation depreciation and depletion may be added back to income in proportion to the borrower's share of the corporation's income.

In addition, the income must also be reduced proportionately by the total obligations payable by the corporation in less than one year.

IMPORTANT: The borrower's withdrawal of cash from the corporation may have a severe negative impact on the corporation's ability to continue operating, and must be considered in the income analysis.

H. Income Analysis: Partnership Tax Returns (IRS Form 1065)

1. Description: Partnership

A ***Partnership*** is formed when two or more individuals form a business, and share in profits, losses, and responsibility for running the company.

Each partner pays taxes on his/her proportionate share of the partnership's net income.

2. Analyzing Partnership Tax Returns

Both general and limited partnerships report income on IRS Form 1065, and the partners' share of income is carried over to Schedule E of IRS Form 1040.

The lender must review IRS Form 1065 to assess the viability of the business. Both depreciation and depletion may be added back to the income in proportion to the borrower's share of income.

Income must also be reduced proportionately by the total obligations payable by the partnership in less than one year.

IMPORTANT: Cash withdrawals from the partnership may have a severe negative impact on the partnership's ability to continue operating, and must be considered in the income analysis.

III. Non-Employment Related Borrower Income

A. Alimony, Child Support, and Maintenance Income Criteria

Alimony, child support, or maintenance income may be considered effective, if:

- Payments are likely to be received consistently for the first three years of the mortgage
- The borrower provides the required documentation, which includes a copy of the
    - Final divorce decree
    - Legal separation agreement,
    - Court order, or
    - Voluntary payment agreement, and
- The borrower can provide acceptable evidence that payments have been received during the last 12 months, such as
    - Cancelled checks
    - Deposit slips
    - Tax returns, or
    - Court records.

Notes:

- Periods less than 12 months may be acceptable, provided the lender can adequately document the payer's ability and willingness to make timely payments.
- Child support may be "grossed up" under the same provisions as non-taxable income sources.

B. Investment and Trust Income

1. Analyzing Interest and Dividends

Interest and dividend income may be used as long as tax returns or account statements support a two-year receipt history. This income must be averaged over the two years.

Subtract any funds that are derived from these sources, and are required for the cash investment, before calculating the projected interest or dividend income.

2. Trust Income

Income from trusts may be used if guaranteed, constant payments will continue for at least the first three years of the mortgage term.

Required trust income documentation includes a copy of the Trust Agreement or other trustee statement, confirming the

- Amount of the trust
- Frequency of distribution, and
- Duration of payments.

Trust account funds may be used for the required cash investment if the borrower provides adequate documentation that the withdrawal of funds will not negatively affect income. The borrower may use funds from the trust account for the required cash investment, but the trust income used to determine repayment ability cannot be affected negatively by its use.

3. Notes Receivable Income

In order to include notes receivable income to qualify a borrower, he/she must provide

- A copy of the note to establish the amount and length of payment, and
- Evidence that these payments have been consistently received for the last 12 months through
  - Deposit slips
  - Cancelled checks, or
  - Tax returns.

If the borrower is not the original payee on the note, the lender must establish that the borrower is now a holder in due course, and able to enforce the note.

4. Eligible Investment Properties

Follow the steps in the table below to calculate an investment property's income or loss if the property to be subject to a mortgage is an eligible investment property.

Step	Action
1	Subtract the monthly payment (PITI) from the monthly net rental income of the subject property.

Step	Action
	Note: Calculate the monthly net rental by taking the gross rents, and subtracting the 25 percent reduction for vacancies and repairs.
2	Does the calculation in Step 1 yield a positive number? • If *yes*, add the number to the borrower's monthly gross income. • If *no*, and the calculation yields a negative number, consider it a recurring monthly obligation.

C. Military, Government Agency, and Assistance Program Income

1. Military Income

Military personnel not only receive base pay, but often times are entitled to additional forms of pay, such as

- Income from variable housing allowances
- Clothing allowances
- Flight or hazard pay
- Rations, and
- Proficiency pay.

These types of additional pay are acceptable when analyzing a borrower's income as long as the probability of such pay to continue is verified in writing.

Note: The tax-exempt nature of some of the above payments should also be considered.

2. VA Benefits

Direct compensation for service-related disabilities from the Department of Veterans Affairs (VA) is acceptable, provided the lender receives documentation from the VA.

Education benefits used to offset education expenses are *not* acceptable.

3. Government Assistance Programs.

Income received from government assistance programs is acceptable as long as the paying agency provides documentation indicating that the income is expected to continue for at least three years.

If the income from government assistance programs will not be received for at least three years, it may be considered as a compensating factor.

Unemployment income *must* be documented for two years, and there must be reasonable assurance that this income will continue. This requirement may apply to seasonal employment.

4. Mortgage Credit Certificates

If a government entity subsidizes the mortgage payments either through direct payments or tax rebates, these payments may be considered as acceptable income.

Either type of subsidy may be added to gross income, or used directly to offset the mortgage payment, before calculating the qualifying ratios.

5. Homeownership Subsidies

A monthly subsidy may be treated as income, if a borrower is receiving subsidies under the housing choice voucher home ownership option from a public housing agency (PHA). Although continuation of the homeownership voucher subsidy beyond the first year is subject to Congressional appropriation, for the purposes of underwriting, the subsidy will be assumed to continue for at least three years.

If the borrower is receiving the subsidy directly, the amount received is treated as income. The amount received may also be treated as non taxable income and be "grossed up" by 25 percent, which means that the amount of the subsidy, plus 25 percent of that subsidy may be added to the borrower's income from employment and/or other sources.

Lenders may treat this subsidy as an "offset" to the monthly mortgage payment (that is, reduce the monthly mortgage payment by the amount of the home ownership assistance payment before dividing by the monthly income to determine the payment-to-income and debt-to-income ratios). The subsidy payment must not pass through the borrower's hands.

The assistance payment must be:

- Paid directly to the servicing lender, or
- Placed in an account that only the servicing lender may access.

Note: Assistance payments made directly to the borrower *must* be treated as income.

D. Rental Income

1. Analyzing the Stability of Rental Income

Rent received for properties owned by the borrower is acceptable as long as the lender can document the stability of the rental income through

- A current lease
- An agreement to lease, or
- A rental history over the previous 24 months that is free of unexplained gaps greater than three months (such gaps could be explained by student, seasonal, or military renters, or property rehabilitation).

A separate schedule of real estate is not required for rental properties as long as all properties are documented on the URLA.

Note: The underwriting analysis may *not* consider rental income from any property being vacated by the borrower, except under the circumstances described below.

2. Rental Income from Borrower Occupied Property

The rent for multiple unit property where the borrower resides in one or more units and charges rent to tenants of other units may be used for qualifying purposes.

Projected rent for the tenant-occupied units *only* may:

- Be considered gross income, only after deducting vacancy and maintenance factors, and
- *Not* be used as a direct offset to the mortgage payment.

3. Income from Roommates in a Single Family Property

Income from roommates in a single family property occupied as the borrower's primary residence is *not* acceptable. Rental income from boarders however, *is* acceptable, if the boarders are related by blood, marriage, or law.

The rental income may be considered effective, if shown on the borrower's tax return. If not on the tax return, rental income paid by the boarder

- May be considered a compensating factor, and
- Must be adequately documented by the lender.

4. Documentation Required to Verify Rental Income

Analysis of the following required documentation is necessary to verify all borrower rental income:

- IRS Form 1040 Schedule E; and
- Current leases/rental agreements.

5. Analyzing IRS Form 1040 Schedule E

The IRS Form 1040 Schedule E is required to verify all rental income. Depreciation shown on Schedule E may be added back to the net income or loss.

Positive rental income is considered gross income for qualifying purposes, while negative income must be treated as a recurring liability.

The lender *must* confirm that the borrower still owns each property listed, by comparing Schedule E with the real estate owned section of the URLA. If the borrower owns six or more units in the same general area, a map must be provided disclosing the locations of the.

6. Using Current Leases to Analyze Rental Income

The borrower can provide a current signed lease or other rental agreement for a property that was acquired since the last income tax filing, and is not shown on Schedule E.

In order to calculate the rental income:

- Reduce the gross rental amount by 25 percent for vacancies and maintenance
- Subtract PITI and any homeowners' association dues, and
- Apply the resulting amount to
  - Income, if positive, or
  - Recurring debts, if negative.

7. Exclusion of Rental Income from Property Being Vacated by the Borrower

Underwriters may *not* consider any rental income from a borrower's principal residence that is being vacated in favor of another principal residence, except under the conditions described below:

Notes:

- This policy assures that a borrower either has sufficient income to make both mortgage payments without any rental income, or has an equity position not likely to result in defaulting on the mortgage on the property being vacated.
- This applies *solely* to a principal residence being vacated in favor of another principal residence. It does *not* apply to existing rental properties disclosed on the loan application and confirmed by tax returns (Schedule E of form IRS 1040).

8. Policy Exceptions Regarding the Exclusion of Rental Income from a Principal Residence Being Vacated by a Borrower

When a borrower vacates a principal residence in favor of another principal residence, the rental income, reduced by the appropriate vacancy factor, *may* be considered in the underwriting analysis under the circumstances listed in the table below.

Exception	**Description**

Exception	Description
Relocations	The borrower is relocating with a new employer, or being transferred by the current employer to an area not within reasonable and locally-recognized commuting distance. A properly executed lease agreement (that is, a lease signed by the borrower and the lessee) of at least one year's duration after the loan is closed is required. ***Note***: Underwriters should also obtain evidence of the security deposit and/or evidence the first month's rent was paid to the homeowner.
Sufficient Equity in Vacated Property	The borrower has a loan-to-value ratio of 75 percent or less, as determined either by • A current (no more than six months old) residential appraisal, or • Comparing the unpaid principal balance to the original sales price of the property. ***Note***: The appraisal, in addition to using forms Fannie Mae1004/Freddie Mac 70, may be an exterior-only appraisal using form Fannie Mae/Freddie Mac 2055, and for condominium units, form Fannie Mae1075/Freddie Mac 466.

E. Non Taxable and Projected Income

1. Types of Non Taxable Income

Certain types of regular income may not be subject to Federal tax. Such types of non taxable income include

- Some portion of Social Security, some Federal government employee retirement income, Railroad Retirement Benefits, and some state government retirement income
- Certain types of disability and public assistance payments
- Child support
- Military allowances, and

- Other income that is documented as being exempt from Federal income taxes.

2. Adding Non Taxable Income to a Borrower's Gross Income

The amount of continuing tax savings attributed to regular income not subject to Federal taxes may be added to the borrower's gross income.

The percentage of non-taxable income that may be added *cannot* exceed the appropriate tax rate for the income amount. Additional allowances for dependents are *not* acceptable.

The lender:

- Must document and support the amount of income *grossed up* for any non-taxable income source, and
- Should use the tax rate used to calculate the borrower's last year's income tax.

Note: If the borrower is not required to file a Federal tax return, the tax rate to use is 25 percent.

3. Analyzing Projected Income

Projected or hypothetical income is *not* acceptable for qualifying purposes. However, exceptions are permitted for income from the following sources:

- Cost-of-living adjustments
- Performance raises, and
- Bonuses.

For the above exceptions to apply, the income must be

- Verified in writing by the employer, and
- Scheduled to begin within 60 days of loan closing.

4. Project Income for New Job

Projected income is acceptable for qualifying purposes for a borrower scheduled to start a new job within 60 days of loan closing if there is a guaranteed, non-revocable contract for employment.

The lender *must* verify that the borrower will have sufficient income or cash reserves to support the mortgage payment and any other obligations between loan closing and the start of employment. Examples of this type of scenario are teachers whose contracts begin with the new school year, or physicians beginning a residency after the loan closes fall under this category.

The loan is *not eligible for endorsement* if the loan closes more than 60 days before the borrower starts the new job. To be eligible for endorsement, the lender must obtain from the borrower a pay stub or other acceptable evidence indicating that he/she has started the new job.

IV. Borrower Liabilities: Recurring Obligations

1. Types of Recurring Obligations

Recurring obligations include:

- All installment loans
- Revolving charge accounts
- Real estate loans
- Alimony
- Child support, and
- Other continuing obligations.

2. Debt to Income Ratio Computation for Recurring Obligations

The lender must include the following when computing the debt to income ratios for recurring obligations:

- Monthly housing expense, and
- Additional recurring charges extending ten months or more, such as
    - Payments on installment accounts
    - Child support or separate maintenance payments
    - Revolving accounts, and
    - Alimony.

Debts lasting less than ten months must be included if the amount of the debt affects the borrower's ability to pay the mortgage during the months immediately after loan closing, especially if the borrower will have limited or no cash assets after loan closing.

Note: Monthly payments on revolving or open-ended accounts, regardless of the balance, are counted as a liability for qualifying purposes even if the account appears likely to be paid off within 10 months or less.

3. Revolving Account Monthly Payment Calculation

If the credit report shows any revolving accounts with an outstanding balance but no specific minimum monthly payment, the payment must be calculated as the greater of

- 5 percent of the balance, or
- $10.

Note: If the actual monthly payment is documented from the creditor or the lender obtains a copy of the current statement reflecting the monthly payment, that amount may be used for qualifying purposes.

4. Reduction of Alimony Payment for Qualifying Ratio Calculation

Since there are tax consequences of alimony payments, the lender may choose to treat the monthly alimony obligation as a reduction from the borrower's gross income when calculating qualifying ratios, rather than treating it as a monthly obligation.

V. Borrower Liabilities: Contingent Liability

1. Definition: Contingent Liability

A contingent liability exists when an individual is held responsible for payment of a debt if another party, jointly or severally obligated, defaults on the payment.

2. Application of Contingent Liability Policies

The contingent liability policies described in this topic apply unless the borrower can provide conclusive evidence from the debt holder that there is no possibility that the debt holder will pursue debt collection against him/her should the other party default.

3. Contingent Liability on Mortgage Assumptions

Contingent liability must be considered when the borrower remains obligated on an outstanding FHA-insured, VA-guaranteed, or conventional mortgage secured by property that:

- Has been sold or traded within the last 12 months without a release of liability, or
- Is to be sold on assumption without a release of liability being obtained.

4. Exemption from Contingent Liability Policy on Mortgage Assumptions

When a mortgage is assumed, contingent liabilities need not be considered if the

- Originating lender of the mortgage being underwritten obtains, from the servicer of the assumed loan, a payment history showing that the mortgage has been current during the previous 12 months, or
- Value of the property, as established by an appraisal or the sales price on the HUD-1 *Settlement Statement* from the sale of the property, results in a loan-to-value (LTV) ratio of 75 percent or less.

5. Contingent Liability on Cosigned Obligations

Contingent liability applies, and the debt must be included in the underwriting analysis, if an individual applying for a mortgage is a cosigner/co-obligor on:

- A car loan
- A student loan
- A mortgage, or
- Any other obligation.

If the lender obtains documented proof that the primary obligor has been making regular payments during the previous 12 months, and does not have a history of delinquent payments on the loan during that time, the payment does not have to be included in the borrower's monthly obligations.

VI. Borrower Liabilities: Projected Obligations and Obligations Not Considered Debt

1. Projected Obligations

Debt payments, such as a student loan or balloon note scheduled to begin or come due within 12 months of the mortgage loan closing, must be included by the lender as anticipated monthly obligations during the underwriting analysis.

Debt payments do not have to be classified as projected obligations if the borrower provides written evidence that the debt will be deferred to a period outside the 12-month timeframe.

Balloon notes that come due within one year of loan closing must be considered in the underwriting analysis.

2. Obligations Not Considered Debt

Obligations not considered debt, and therefore not subtracted from gross income, include

- Federal, state, and local taxes
- Federal Insurance Contributions Act (FICA) or other retirement contributions, such as 401(k) accounts (including repayment of debt secured by these funds)
- Commuting costs
- Union dues
- Open accounts with zero balances
- Automatic deductions to savings accounts
- Child care, and
- Voluntary deductions.

END OF COMMON RULE

[END OF COMMON TEXT]

List of Subjects

Adoption of the Common Rule Text

The proposed adoption of the common rules by the agencies, as modified by agency-specific text, is set forth below:

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Chapter I

Authority and Issuance

For the reasons stated in the Common Preamble, the Office of the Comptroller of the Currency proposes to amend chapter I of Title 12, Code of Federal Regulations as follows:

PART 43 – CREDIT RISK RETENTION

1. The authority for part 43 is added to read as follows:

Authority: 12 U.S.C. 1 et seq., 93a, 161, 1818, and 15 U.S.C. 78o-11.

2. Part 43 is added as set forth at the end of the Common Preamble.

3. Section 43.1 is revised to read as follows:

§ 43.1 Authority, purpose, scope, and reservation of authority.

(a) Authority. This part is issued under the authority of 12 U.S.C. 1 et seq., 93a, 161, 1818, and 15 U.S.C. 78o-11.

(b) Purpose. (1) This part requires securitizers to retain an economic interest in a portion of the credit risk for any asset that the securitizer, through the issuance of an asset-backed security, transfers, sells, or conveys to a third party. This part specifies the permissible types, forms, and amounts of credit risk retention, and it establishes certain exemptions for securitizations collateralized by assets that meet specified underwriting standards.

(2) Nothing in this part shall be read to limit the authority of the OCC to take supervisory or enforcement action, including action to address unsafe or unsound practices or conditions, or violations of law.

(c) Scope. This part applies to any securitizer that is a national bank, a Federal branch or agency of a foreign bank, or an operating subsidiary thereof.

(d) Effective dates. This part shall become effective:

(1) With respect to any securitization transaction collateralized by residential mortgages, one year after the date on which final rules under section 15G(b) of the Exchange Act (15 U.S.C. 78o-11(b)) are published in the Federal Register; and

(2) With respect to any other securitization transaction, two years after the date on which final rules under section 15G(b) of the Exchange Act (15 U.S.C. 78o-11(b)) are published in the Federal Register.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

12 CFR Chapter II

Authority and Issuance

For the reasons set forth in the Supplementary Information, the Board of Governors of the Federal Reserve System proposes to add the text of the common rule as set forth at the end of the Supplementary Information as Part 244 to chapter II of Title 12, Code of Federal Regulations, modified as follows:

PART 244 — CREDIT RISK RETENTION (REGULATION RR)

4. The authority citation for part 244 is added to reads as follows:

Authority: 12 U.S.C. 221 et seq., 1818, 1841 et seq., 3103 et seq., and 15 U.S.C. 78o-11.

5. Section 244.1 is amended to read as follows:

§ 244.1 Authority, purpose, and scope

(a) Authority. (1) In general. This part (Regulation RR) is issued by the Board of Governors of the Federal Reserve System under section 15G of the Securities Exchange Act of 1934, as amended (Exchange Act) (15 U.S.C. 78o-11), as well as under the Federal Reserve Act, as amended (12 U.S.C. 221 et seq.); section 8 of the Federal Deposit Insurance Act (FDI Act), as amended (12 U.S.C. 1818); the Bank Holding Company Act of 1956, as amended (BHC Act) (12 U.S.C. 1841 et seq.); and the International Banking Act of 1978, as amended (12 U.S.C. 3101 et seq.).

(2) Nothing in this part shall be read to limit the authority of the Board to take action under provisions of law other than 15 U.S.C. 78o-11, including action to address unsafe or unsound practices or conditions, or violations of law or regulation, under section 8 of the FDI Act.

(b) Purpose. This part requires any securitizer to retain an economic interest in a portion of the credit risk for any asset that the securitizer, through the issuance of an asset-backed security, transfers, sells, or conveys to a third party in a transaction within the scope of section 15G of the Exchange Act. This part specifies the permissible types, forms, and amounts of credit risk retention, and establishes certain exemptions for securitizations collateralized by assets that meet specified underwriting standards or that otherwise qualify for an exemption.

(c) Scope. (1) This part applies to any securitizer that is:

(i) A state member bank (as defined in 12 CFR 208.2(g)); or

(ii) Any subsidiary of a state member bank.

(2) Section 15G of the Exchange Act and the rules issued thereunder apply to any securitizer that is:

(i) A bank holding company (as defined in 12 U.S.C. 1842);

(ii) A foreign banking organization (as defined in 12 CFR 211.21(o));

(iii) An Edge or agreement corporation (as defined in 12 CFR 211.1(c)(2) and (3));

(iv) A nonbank financial company that the Financial Stability Oversight Council has determined under section 113 of the Dodd–Frank Wall Street Reform and Consumer Protection Act (the Dodd–Frank Act) (12 U.S.C. 5323) shall be supervised by the Board and for which such determination is still in effect; or

(v) Any subsidiary of the foregoing. The Federal Reserve will enforce section 15G of the Exchange Act and the rules issued thereunder under section 8 of the FDI Act against any of the foregoing entities.

(3) On and after the transfer date established under section 311 of the Dodd-Frank Act (12 U.S.C. 5411), the Federal Reserve will enforce section 15G of the Exchange Act and the rules issued thereunder under section 8 of the FDI Act against any securitizer that is a savings and loan holding company and any subsidiary thereof (as defined in 12 U.S.C. 1467a).

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Chapter III

Authority and Issuance

For the reasons set forth in the Supplementary Information, the Federal Deposit Insurance Corporation proposes to add the text of the common rule as set forth at the end of the Supplementary Information as Part 373 to chapter III of Title 12, Code of Federal Regulations, modified as follows:

PART 373 — CREDIT RISK RETENTION

6. The authority citation for part [ ] is added to reads as follows:

Authority: 12 U.S.C. 1801 et seq. and 3103 et seq., and 15 U.S.C. 78o-11.

7. Section 373.1 is amended to read as follows:

§ 373.1 Purpose and scope

(a) Authority. (1) In general. This part is issued by the Federal Deposit Insurance Corporation (FDIC) under section 15G of the Securities Exchange Act of 1934, as amended (Exchange Act) (15 U.S.C. 78o-11), as well as the Federal Deposit Insurance Act (12 U.S.C. 1801 et seq.) and the International Banking Act of 1978, as amended (12 U.S.C. 3101 et seq.).

(2) Nothing in this part shall be read to limit the authority of the FDIC to take action under provisions of law other than 15 U.S.C. 78o-11, including to address unsafe or unsound

practices or conditions, or violations of law or regulation under section 8 of the Federal Deposit Insurance Act (12 U.S.C. 1818).

(b) Purpose. (1) This part requires securitizers to retain an economic interest in a portion of the credit risk for any asset that the securitizer, through the issuance of an asset-backed security, transfers, sells, or conveys to a third party in a transaction within the scope of section 15G of the Exchange Act. This part specifies the permissible types, forms, and amounts of credit risk retention, and it establishes certain exemptions for securitizations collateralized by assets that meet specified underwriting standards or that otherwise qualify for an exemption.

(c) Scope. This part applies to any securitizer that is:

(1) A state nonmember bank (as defined in 12 U.S.C. 1813(e)(2));

(2) An insured federal or state branch of a foreign bank (as defined in 12 CFR 347.202); or

(3) Any subsidiary of the foregoing.

SECURITIES AND EXCHANGE COMMISSION

For the reasons stated in the Supplementary Information, the Securities and Exchange Commission proposes the amendments under the authority set forth in Sections 7, 10, 19(a), and 28 of the Securities Act and Sections 3, 13, 15, 15G, 23 and 36 of the Exchange Act.

List of Subjects

17 CFR Part 246

Reporting and recordkeeping requirements, Securities.

For the reasons set out above, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

PART 246 — CREDIT RISK RETENTION

8. The authority citation for part 246 is added to read as follows:

Authority: 15 U.S.C. 77g, 77j, 77s, 77z-3, 78c, 78m, 78o, 78o-11, 78w, 78mm

9. Part 246 is added to read as follows:

17 CFR § 246.1

(a) Authority and purpose. This part (Regulation RR) is issued by the Securities and Exchange Commission ("Commission") jointly with the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and, in the case of the securitization of any residential mortgage asset, together with the Secretary of Housing and Urban Development and the Federal Housing Finance Agency, pursuant to Section 15G of the Securities Exchange Act of 1934 (15 U.S.C. §78o-11). The Commission also is issuing this part pursuant to its authority under Sections 7, 10, 19(a), and 28 of the Securities Act and Sections 3, 13, 15, 23, and 36 of the Exchange Act. This part requires securitizers to retain an economic interest in a portion of the credit risk for any asset that the securitizer, through the issuance of an asset-backed security, transfers, sells, or conveys to a third party. This part specifies the permissible types, forms, and amounts of credit risk retention, and establishes certain exemptions for securitizations collateralized by assets that meet specified underwriting standards or otherwise qualify for an exemption.

(b) The authority of the Commission under this part shall be in addition to the authority of the Commission to otherwise enforce the federal securities laws, including, without limitation, the antifraud provisions of the securities laws.

FEDERAL HOUSING FINANCE AGENCY

List of Subjects

12 CFR Part 1234

Government sponsored enterprises, mortgages, securities.

For the reasons stated in the Supplementary Information, and under the authority of 12 U.S.C. 4526, the Federal Housing Finance Agency proposes to add the text of the common rule as set forth at the end of the Supplementary Information as Part 1234 of subchapter B of chapter XII of title 12 of the Code of Federal Regulations, modified as follows:

CHAPTER XII – FEDERAL HOUSING FINANCE AGENCY

SUBCHAPTER B – ENTITY REGULATIONS

PART 1234 — CREDIT RISK RETENTION

10. The authority citation for part 1234 is added to reads as follows:

Authority: 12 U.S.C. 4511(b), 4526, 4617; 15 U.S.C. 78o-11(b)(2).

11. Section 1234.1 is revised to read as follows:

§ 1234.1 Purpose, scope and reservation of authority.

(a) Purpose. This part requires securitizers to retain an economic interest in a portion of the credit risk for any residential mortgage asset that the securitizer, through the issuance of an asset-backed security, transfers, sells, or conveys to a third party in a transaction within the scope of section 15G of the Exchange Act. This part specifies the permissible types, forms, and amounts of credit risk retention, and it establishes certain exemptions for securitizations collateralized by assets that meet specified underwriting standards or that otherwise qualify for an exemption.

(b) Scope. Effective [INSERT DATE ONE YEAR AFTER PUBLICATION IN THE FEDERAL REGISTER AS A FINAL RULE], this part will apply to any securitizer that is an entity regulated by the Federal Housing Finance Agency.

(c) Reservation of authority. Nothing in this part shall be read to limit the authority of the Director of the Federal Housing Finance Agency to take supervisory or enforcement action, including action to address unsafe or unsound practices or conditions, or violations of law.

§ 1234.16 [Amended]

3. Amend § 1234.16 as follows:

a. In the heading, remove the words ", commercial loans, and auto loans".

b. In the introductory paragraph, remove the words "§ 1234.17 through § 1234.20" and add in their place the words "§ 1234.19".

c. Remove the definitions of "Automobile loan", "Commercial loan", "Debt-to-income (DTI) ratio", "Earnings before interest, taxes, depreciation, and amortization (EBITDA)", "Leverage Ratio", "Machinery and equipment (M&E) collateral", "Model year", "New vehicle", "Payment-in-kind (PIK)", "Purchase price", "Salvage title", "Total debt", "Total liabilities ratio", "Trade-in allowance" and "Used vehicle".

d. Revise the definition of "Debt service coverage (DSC) ratio" to read as follows:

Debt service coverage (DSC) ratio means the ratio of:

(1) The annual NOI less the annual replacement reserve of the CRE property at the time of origination of the CRE loans; to

(2) The sum of the borrower's annual payments for principal and interest on any debt obligation.

4. Reserve §§ 1234.17, 1234.18 and 1234.20.

§ 1234.19 [Amended]

5. Amend § 1234.19 as follows:

a. In the heading, remove the words "Underwriting standards" and, in their place, add the word "Exception".

b. Add introductory text as follows: "The risk retention requirements in subpart B of this part shall not apply to securitization transactions that satisfy the standards provided in this section."

Dated: March 28, 2011

John Walsh (signed)

John Walsh,
Acting Comptroller of the Currency.

By order of the Board of Governors of the Federal Reserve System, March 30, 2011.

Jennifer J. Johnson (signed)

Jennifer J. Johnson
Secretary of the Board

Dated at Washington, D.C., this 29th of March 2011.

By order of the Board of Directors.

Federal Deposit Insurance Corporation.

Robert E. Feldman (signed)

Robert E. Feldman,
Executive Secretary

By the Securities and Exchange Commission.

Elizabeth M. Murphy (signed)

Elizabeth M. Murphy
Secretary

Date: March 30, 2011

Edward J. Demarco (signed) March 29, 2011

Edward J. Demarco,
Acting Director, Federal Housing Finance Agency

Date

By the Department of Housing and Urban Development

Shaun Donovan (signed) March 31, 2011

Shaun Donovan,
Secretary

Date