

# Morgan Stanley

July 27, 2011

## VIA ELECTRONIC MAIL

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

Securities and Exchange Commission  
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Attn.: Elizabeth M. Murphy, Secretary

Board of Governors of the  
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Washington, DC 20551  
Attn: Jennifer J. Johnson, Secretary

Federal Housing Finance Agency  
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Attn.: Alfred M. Pollard, General Counsel

Federal Deposit Insurance Corporation  
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Attn.: Comments, Robert E. Feldman,  
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Department of Housing and  
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Regulations Division  
Office of General Counsel  
451 7th Street, SW, Room 10276  
Washington, DC 20410-0500

**Re: Comments on Credit Risk Retention Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010**

Ladies and Gentlemen:

As noted in our previous letter to the Securities and Exchange Commission (the “Commission”) dated November 16, 2010, we appreciate the receptiveness of the staff of the Commission to our comments on upcoming rulemaking required by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Act”). In that letter, our comments focused on the importance of improved underwriting and asset quality in facilitating the recovery of the securitization markets and helping to protect investors in asset-backed securities (“ABS”).

Section 941(b) of the Act requires that within 270 days after enactment the Commission, together with the federal banking agencies<sup>1</sup> and other specified federal agencies<sup>2</sup> (collectively, the “Agencies”) issue regulations requiring securitizers or originators to retain an economic

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<sup>1</sup> The Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Federal Reserve.

<sup>2</sup> For residential mortgages only, the Department of Housing and Urban Development and the Federal Housing Finance Agency.

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interest in a portion of the credit risk of any securitized asset. Our previous letter addressed the importance of prescribing specific underwriting criteria as part of these new regulations, which must “establish asset classes with separate rules for securitizers of different classes of assets” and “include underwriting standards . . . that specify the terms, conditions, and characteristics of a loan within the asset class that indicate a low credit risk with respect to the loan.”<sup>3</sup> As discussed in that letter, we believe that this focus on the quality of credit underwriting for specific asset classes is the key to resolving the problems with some securitization practices that have been cited as contributing most strongly to the financial crisis. We supplied data indicating that transactions collateralized by high quality assets have not suffered nearly the same magnitude of actual or projected losses as have securitizations of lower quality assets. Therefore, we suggested that risk retention should be required only where necessary and appropriate, and not applied in a uniform way to transactions in which the pool assets are of relatively high credit quality. We urged the rulemaking agencies to develop effective, specifically-tailored underwriting criteria for various asset classes that would eliminate the risk retention requirement or reduce it, where appropriate, below the 5 percent standard provided by the Act. We asked the Agencies to consider that adding an unnecessary risk retention requirement to transactions would adversely affect the economics of securitization as a funding source, which would in turn raise the cost and decrease the availability of credit to consumers and businesses.

The Agencies have now jointly proposed rules to implement Section 941(b) of the Act. We refer in this letter to the proposed rules and the accompanying supplementary information collectively as the “Proposing Release.”<sup>4</sup> This letter addresses our concerns about certain aspects of the proposed credit risk retention requirements for securitizations.

#### *Issues that Affect All Asset Classes*

##### *Each Asset Class Deserves Individualized Attention*

As we noted in our previous letter, only some asset types contributed to the financial crisis by performing more poorly than would be expected in adverse economic conditions. It is critical for any risk retention requirements to focus on those problematic asset classes and not paint every type of securitization as a problem that needs a solution. As stated by the Board of Governors of the Federal Reserve System in its report to Congress on risk retention, “[g]iven the degree of heterogeneity in all aspects of securitization, a single approach to credit risk retention

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<sup>3</sup> Section 15G(c)(2) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”).

<sup>4</sup> Credit Risk Retention, 76 Fed. Reg. 24090 (April 29, 2011).

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could curtail credit availability in certain sectors of the securitization market.”<sup>5</sup> In the still-weak economic environment, it is important that credit not be arbitrarily denied in all sectors of the securitization market because of the excesses in limited sectors of that market. Many other securitized products serve a vitally important role in providing credit in their respective markets, even though those markets are not large in size compared to the residential mortgage market. For example, as further discussed below, collateralized loan obligations (“CLOs”) are an important source of credit to small and medium sized companies that are not large enough to access the corporate bond market. Investors in investment grade CLO instruments did not suffer any losses during the financial crisis, yet the proposed rules would, in our view, effectively eliminate the viability of this market. Even within the residential mortgage market, prime mortgage loans are among the safest collateral for a securitization transaction, but we believe that the “premium capture cash reserve account” proposal would effectively eliminate them as a viable asset class.

The cost of risk retention ultimately is borne by borrowers of all loans. If the cost of risk retention is too high, securitization will be a less attractive source of credit, resulting in a less competitive loan marketplace and overall higher costs to borrowers. For the assets that were problematic in the financial crisis, such costs are justified and we support a significant risk retention obligation. However, for the asset classes that were not a problem, the costs of the proposed credit risk requirements are unnecessary and unjustified. In our view, the much more limited risk inherent in non-problematic asset classes, and even in some prime assets within the more problematic classes, does not justify the costs that would be generated by a full 5 percent risk retention obligation. We believe that for high quality assets, risk retention requirement of less than 5 percent is appropriate.

We acknowledge and appreciate the tremendous amount of work and effort put in by the Agencies in drafting the Proposed Rules. However, as acknowledged by the Federal Reserve Report implied, a single approach to risk retention could unnecessarily curtail credit to important segments of the economy. In our view, a more targeted or individualized approach would achieve the aims of the Act, while still providing borrowers with the access to credit needed for the recovery of the U.S. economy.

#### *Alternative Mechanisms to Align Incentives*

In its report to Congress on risk retention, the Board of Governors of the Federal Reserve System noted that there are various mechanisms, other than credit risk retention, that may serve

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<sup>5</sup> The Board of Governors of the Federal Reserve System, Report to Congress on Risk Retention 84 (October 2010) hereinafter “Federal Reserve Report”, available at <http://federalreserve.gov/boarddocs/rptcongress/securitization/riskretention.pdf>.

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to align the interests of securitization participants and investors. These include overcollateralization, subordination, third-party credit enhancement, representations and warranties and conditional cash flows. The Federal Reserve Report recommended that these mechanisms be considered as an alternative or complement to required credit risk retention,<sup>6</sup> and we strongly agree with this recommendation. The Federal Reserve Report also stated that a single universal approach would also not adequately take into consideration different forms of risk retention, which may differ by asset category.<sup>7</sup>

In our view, there are more effective and less disruptive means of aligning the interests of securitizers and investors than risk retention. Therefore, we urge that credit be given toward the 5 percent risk retention requirement if such other means are employed. As we expressed in our previous letter, we believe that the focus should be placed on the quality of the assets being securitized, not on imposing new and burdensome requirements on securitization structures (*e.g.*, the proposal to require premium capture cash reserve accounts). ABS securitized in any structure, no matter how time-tested, can default if the quality of the underlying assets turns out to be significantly worse than expected. In addition to giving credit towards the 5 percent risk retention requirement for the inclusion of high quality assets (which, in our view, is effectively what the Proposed Rules attempt to do through the qualifying residential mortgage and other qualified asset exemptions), other mechanisms that focus on ensuring the quality of assets (such as strong representations and warranties with respect to the assets, and more transparent disclosure regarding those representations and warranties) also should receive credit.

Representations and warranties are statements that describe the underwriting standards and other matters with respect to the assets that are the subject of a securitization. Material representations and warranties should be disclosed to investors, in order that the investors understand the characteristics of the assets supporting the ABS. In general, the originator or other seller of assets into a securitization vehicle retains 100 percent of the risk that a representation or warranty is materially inaccurate, and the seller retains 100 percent of the responsibility for any assets that do not comply in all material respects with disclosed underwriting guidelines. While as a practical matter, exceptions to the underwriting criteria must be permitted, material exceptions should be disclosed to investors. In our view, the combination of these representations and warranty mechanisms, strong underwriting criteria and disclosure of material underwriting exceptions (as discussed in our previous letter) would be the most effective and least disruptive means of aligning the interests of securitizers and investors, more so than a fixed 5 percent credit risk retention requirement.

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<sup>6</sup> *Id.* at 84.

<sup>7</sup> *Id.* at 84.

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We recognize that concerns have been raised regarding the efficiency and effectiveness of mechanisms for enforcement of representations and warranties in prior securitizations. We have participated in and support the American Securitization Forum's Project Restart and the CRE Finance Council's ("CREFC") initiatives to improve the disclosure of the underwriting process and the mechanism for enforcing representations and warranties. In our experience, investors are insisting on such improvements and the securitization industry is responding to those requirements. It is our understanding that investors would generally prefer clearer disclosure of underwriting standards and robust repurchase mechanisms to a fixed 5 percent credit risk retention requirement. Therefore, we urge that the Agencies support these initiatives by providing appropriate credit against the mandated risk retention requirements. Otherwise, the addition of risk retention on top of these improvements will serve only to increase the cost and decrease the availability of credit, without providing meaningful additional benefit to investors. Requiring strict adherence to the requirements of the Proposed Rules would, in our view, serve as a disincentive toward compliance with the industry improvements that have already begun to serve investors' interests. Investors could lose a valuable source of protection against having poorly underwritten assets collateralize their ABS.

*Strong Underwriting Guidelines as an Alternative to Credit Risk Retention*

As discussed in our previous letter to the Commission, we believe that the quality of securitized financial assets is a paramount consideration. The quality of the underwriting of the securitized assets is a primary determinant of whether losses relating to origination credit risk will be incurred by investors in a securitization. Therefore, when assets are originated pursuant to stringent underwriting guidelines, requiring credit risk retention or any other alternative means of aligning the interests of securitization participants with those of investors should be unnecessary. In enacting Section 941(c)(2) of the Act, Congress seemed to agree with our approach by expressly providing for separate underwriting standards for loans within asset classes that indicate a low credit risk. Unfortunately, the underwriting standards in the Proposing Release are so stringent that, for three of the four specific asset classes addressed, few (if any) existing loans would qualify.

A properly structured risk retention regime would incentivize origination of high quality loans and leases by providing an exemption from, or a reduced level of, risk retention for, high quality assets. On the other hand, as we discuss further below, we believe that required underwriting criteria that are too stringent will serve to discourage the origination of high quality assets. As such, proper calibration of any regulatory underwriting standards is of the utmost importance.

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*Premium Capture Cash Reserve Account*

We are greatly concerned about the Agencies' premium capture cash reserve account proposal and its potential adverse effects on the ABS markets. We believe that this proposal, which appears to have been formulated in a hasty fashion, exceeds both the mandate and legislative intent of the Act. The proposed premium capture provisions are complex, their intended application is not entirely clear, and if implemented they could strip profitability from securitizations of various types. Many transactions would not be economically viable under these rules. In our view, the focus of the risk retention rules should be on improving asset quality, not on mandating which types of structures should be permitted and which should not. We believe that this proposal is an example of the "one size fits all" solution that the Federal Reserve Report counseled against. We ask that the premium capture provisions be withdrawn.

The Proposing Release states that the premium capture provisions are intended to "adjust the required amount of risk retention to account for any excess spread that is monetized at the closing of a securitization transaction" and significantly reduce the chance that "a sponsor could effectively negate or reduce the economic exposure it is required to retain under the proposed rules."<sup>8</sup> This is a misconception of the economics of securitization. The view that the issuance of interest-only or other premium securities would negate a sponsor's retained credit risk exposure is simply incorrect. The premium capture provisions would, in our view, significantly reduce the profitability of many securitization transactions and drive securitizers out of the ABS markets.

It is rare in our experience that a proposed rule would be so harsh in its application that the rule makers themselves would state that the rule is unlikely to be applied in practice, but such is the case here. As the Agencies stated in the Proposing Release, "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."<sup>9</sup> Instead, the Agencies expect that ABS sponsors would "structure their securitization transactions in a manner that does not monetize excess spread at closing."<sup>10</sup> But those alternative structures could themselves impose substantial costs on sponsors. We are concerned that the likely effect of the premium capture provisions would be to encourage financial companies to seek alternatives to securitization, such as holding the loans on their balance sheets. This could serve to excessively concentrate mortgage risk and increase the number of banks that are "too big to fail," possibly even leading to another crisis similar to the savings and loan crisis of the 1980s and early 1990s.

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<sup>8</sup> Proposing Release, 76 Fed. Reg. 24090, at 24113.

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

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We understand that one of the Agencies' reasons for proposing the onerous premium capture requirement may be to effect changes in securitization structures that would enhance the value of the horizontal residual interest. If the purpose of the premium capture provisions is to compel securitizers to include more of the economic value of excess spread in the horizontal residual interest rather than monetizing it, we question the legitimacy of this goal. Shifting securitization economics into the non-rated portion of the capital structure behind all more senior classes would effectively create more equity in the transaction, which would be discounted at an equity-appropriate yield. This would increase borrowing costs to consumers. This does not appear to be an objective that is within the scope of Section 941(b) of the Act. To the extent that the Agencies are concerned that sponsors may structure securitizations in order to strip a retained eligible horizontal residual interest of a proportionate entitlement to cash flows, we believe that this concern can be addressed through far more limited measures than premium capture.

Although the concept of "par value" is central to the operation of the premium capture provisions, this term is not defined or explained in the proposed rules or the supplementary information.

We also understand that some of the Agencies may have a view, one not expressed in the Proposing Release, that "par value" should be interpreted not as meaning the face amount or principal amount of an ABS interest, but rather its "market value." Such an interpretation would add additional complexity to an already challenging set of rules, and could increase required risk retention far beyond what was contemplated by the Act.

Further, we understand that some of the Agencies may believe that the residual interest in a securitization should have a market value equal to 5 percent of the value of the pool assets. This is not a reasonable standard. Section 941(b) of the Act calls for regulations that, subject to exceptions and limitations, require securitizers to retain at least 5 percent of the credit risk, not market value, of securitized assets.

#### *Accounting Treatment*

Sale accounting and consolidation requirements under generally accepted accounting principles relating to issuances of ABS are addressed by Statements of Financial Accounting Standards 166 and 167 ("FAS 166 and 167"),<sup>11</sup> each adopted by the Financial Accounting

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<sup>11</sup> Statement of Financial Accounting Standards No. 166, "Accounting for Transfers of Financial Assets, an amendment of FASB Statement No. 140", and Statement of Financial Accounting Standards No. 167, "Amendments to FASB Interpretation No. 46(R)." FAS 166 is codified as part of Accounting Standards Codification Topic 860, Transfers and Servicing, and FAS 167 is codified as part of Accounting Standards Codification Topic 810, Consolidation.

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Standards Board (“FASB”) in 2009. These accounting rules together determine whether a securitizer is required to consolidate the special purpose entity (“SPE”) issuing the ABS and treat the securitized assets as assets of the securitizer.

Under FAS 166, required credit risk retention could result in the consolidation of an SPE issuing ABS with the securitizer if the incremental effect of the retention of economic risk, together with other factors (such as retention of servicing rights), results in the securitizer being considered as the primary beneficiary of the SPE (*i.e.*, having a controlling financial interest in the SPE). For the purposes of FAS 166, control of the SPE comprises both power over the SPE’s most significant activities and exposure to the economic benefits (and losses) of the SPE. As acknowledged by the Federal Reserve Report, mandated credit risk retention would expose the securitizer to the economic benefits and losses of the SPE under FAS 166. Mandated credit risk retention also could affect the capacity in which the securitizer may use its power over the SPE as either agent or a principal, which could affect the consolidation analysis under FAS 167.<sup>12</sup> It is our understanding that the major accounting firms believe that the combination of a 5 percent risk retention strip, a premium capture reserve account and servicing by the sponsor or an affiliate would necessitate consolidation of the securitization by the sponsor. This outcome would have a profoundly negative impact on capital requirements of the sponsor and the economic viability of the securitization process.

As acknowledged by the Federal Reserve Report, if credit risk retention results in a requirement for originators or securitizers to retain securitized assets on their balance sheets, this “may have negative earnings effects and may lead to higher capital charges for companies subject to regulatory capital requirements.”<sup>13</sup> In our experience, the major accounting firms have not applied FAS 166 and 167 consistently, so the accounting treatment of a particular securitization transaction has been largely determined by which accounting firm is involved in the analysis. We are concerned these disparities may lead to accounting “arbitrage” and confusion for investors when reviewing the financial statements of securitizers, where clarity and consistency of application would be more helpful. If the positions retained solely as a result of a risk retention requirement were taken into account in the consolidation and sale analyses under FAS 166 and FAS 167, the problem would be exacerbated. Therefore, we believe that any required credit risk retention should be exempted from the consolidation and sale analyses required by FAS 166 and FAS 167 and we request the Commission’s assistance in this regard.

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<sup>12</sup> Federal Reserve Report, at p. 71.

<sup>13</sup> Federal Reserve Report, at p. 67.

*Required Holding Period for Credit Risk Retention*

Under Section 941 of the Act, the credit risk retention rules for ABS are required to specify the minimum duration of the required retention. However, the proposed rules do not specifically address this minimum duration. Taken together with the proposed requirement on transfer or hedging of retained risk, we take the proposed rules to mean that a securitizer would be required to retain the required credit risk for the life of the transaction.

In the Proposing Release, the Agencies noted that the risk retention rules would “[provide] securitizers an incentive to monitor and ensure the quality of the assets underlying a securitization transaction.”<sup>14</sup> Similarly, in its recent proposal to revise its rules relating to ABS and other structured finance products (the “2010 ABS Proposal”), the Commission proposed its own risk retention requirements, stating that “[t]he theory underlying a credit risk retention requirement is that if a sponsor retains exposure to the risks of the assets, the sponsor is more likely to have greater incentives to include higher quality assets in the pool.”<sup>15</sup> In sum, even though we believe that there are better ways of achieving this objective, the purpose of risk retention requirements is to encourage origination of higher quality. Therefore, the required holding period for risk retention should be limited to the time necessary for poorly underwritten loans to surface. Otherwise, loans that become delinquent due to market forces, rather than poor underwriting, would be protected by the risk retention requirement – and we do not believe that either Congress or the Agencies intended that the risk retention requirement be used to protect investors from market risk.

For all of these reasons, we believe that the duration of any required credit risk retention should be limited to two or three years after the date of the securitization, depending on the asset type.

*Issues Specific to Residential Mortgage-Backed Securities*

The secondary mortgage markets (which commonly are used to fund mortgage originations or sell mortgage risk) currently are concentrated in institutions with explicit or implicit government guarantees (e.g., government sponsored entities (“GSEs”) such as Fannie Mae and Freddie Mac, the Federal Housing Administration and the Veterans Administration), which guaranteed over 90% of residential mortgages originated in 2010. Taxpayers ultimately are responsible for credit losses borne by assets guaranteed by these institutions. Of the less than 10% of mortgage originations remaining, most are held for investment in the portfolios of large

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<sup>14</sup> Proposing Release, 76 Fed. Reg. 24090, at 24096.

<sup>15</sup> Asset-Backed Securities, SEC Release Nos. 333-9117, 34-61858, 75 Fed. Reg. 23328, 23338 (May 3, 2010).

banks and not securitized or otherwise financed in the secondary markets. Additionally, the top five banks were responsible for over 60% of mortgage assets originated in 2010. These banks are expected to retain more loans in their portfolios as GSE jumbo conforming limits decrease, thereby increasing the mortgage exposure on their balance sheets. This most certainly will make them even more systemically important, increasing the size of institutions that are already too-big-to-fail. Almost without exception, all concerned agree that the status quo is unsustainable and that to mitigate taxpayer risk, both a level playing field for all lending institutions and a private capital markets solution eventually must emerge.

There seems to be a consensus among Congress and the Agencies that the GSEs' role in the mortgage markets should be decreased and private capital should pick up more of their share. However, meaningful GSE reform cannot occur without a revitalized private securitization market to fill the void expected to be left by shrinking GSEs. The largest banks can only fund a limited portion of that void without running up against capital constraints, the risk of over-exposure to mortgages and the specter of too-big-to-fail. If the private securitization market and the banking industry cannot adequately fund the demand for mortgages, then either GSEs' role cannot shrink or the availability of mortgage credit to consumers will be drastically curtailed. Therefore, a revitalized securitization market is the best way to encourage the origination of high quality mortgages and support the weak housing market, as well as the key to meaningful reform of the GSEs.

Unfortunately, the continuing fragility of the housing market, the uncertain regulatory environment and other factors have stunted private capital markets participation in the residential mortgage sector. Only two registered public offerings of residential mortgage-backed securities ("RMBS") have been completed since 2008.

In finalizing the required credit risk retention rules, we urge the Agencies to weigh the potential adverse effects of such requirements along with their potential benefits. Credit risk retention is but one of a multitude of new requirements that currently apply (or are proposed to apply) to RMBS and other securitizations, each of which could individually have an adverse effect on the still dormant private-label RMBS markets. In our view, the cumulative effect of these various requirements is likely to keep the private capital markets sidelined in any meaningful participation in mortgage finance. Among other things:

- Significant new requirements have been proposed by the Commission in the 2010 ABS Proposal, and have been adopted by the Federal Deposit Insurance Corporation as part of its revised securitization safe harbor rule.<sup>16</sup> These rules will increase the

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<sup>16</sup> 12 C.F.R. § 360.6.

up-front costs of doing a securitization transaction, increase the operational costs of maintaining a securitization transaction, and increase the potential liability of securitizers.

- The standards that credit rating agencies use to rate ABS in general, and RMBS in particular, have become much more stringent since the beginning of the credit crisis. This has made securitization a much less cost-effective means of raising capital for mortgage finance.
- The recent adoption of FAS 166 and 167 has made it much more likely that residential mortgage securitizations will have to be consolidated on-balance sheet, increasing the amount of regulatory capital that certain issuers must hold and eliminating an important incentive to fund mortgage originations through securitization.

Adding onerous credit risk retention rules to these already strict requirements may lead many banks to decide that private-label RMBS securitizations are not likely to be an effective method of financing mortgage loan originations. Many of them will likely have to raise a tremendous amount of new capital if they are subject to credit risk retention requirements. If risk retention requirements and capital requirements were applied to the approximately \$8 trillion in outstanding RMBS,<sup>17</sup> assuming a base credit risk retention requirement of 5 percent, securitizers would be required to have approximately \$200 billion in capital available, much of which presumably would be required to be newly raised. This increased capital requirement along with all the other requirements will, in our view, lead to significant decreases in residential mortgage origination, resulting in increased cost of borrowing and decreased availability of credit to potential homeowners, other consumer borrowers, and businesses. In addition, as GSE reform may lead to lower GSE mortgage originations and the private sector regaining market share, the lack of a functioning securitization market will lead to a concentration of mortgage risk back into the banking sector.

In any event, due to market considerations, the few recent non-GSE mortgage securitizations that have been accomplished have been very different from the transactions completed prior to the financial crisis. Among other things, investors and the credit rating agencies require significantly more disclosure and access to information. For example, in the recent Sequoia Mortgage Trust 2011-1 transaction, the disclosure documents included detailed

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<sup>17</sup> Securities Industry and Financial Markets Association, "US Mortgage-Related Securities Outstanding", November 1, 2010, available at <http://www.sifma.org/uploadedFiles/Research/Statistics/StatisticsFiles/SF-US-Mortgage-Related-Outstanding-SIFMA.xls>.

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disclosure regarding the due diligence undertaken on the underlying mortgage loan pool,<sup>18</sup> as well as loan level disclosure in the Project Restart format.<sup>19</sup> The capital structure for these deals also contained a variety of structural features designed to protect the holders of more senior classes of securities in a high-loss scenario. One example of these features is a “subordination floor” that was designed to ensure that a specific amount of subordination must be locked out from principal payment, regardless of the overall performance of the securitization transaction. To the extent that the principal balance of all classes of subordinated certificates is reduced below (for example, in the Sequoia 2011-1 transaction) 1.25% of the aggregate original principal balance as a result of principal losses and writedowns, then all subordinate classes of certificates are locked out from principal distributions until all principal amounts have been paid in full to the holders of the senior securities.<sup>20</sup> Thus, market pressures already have resulted in significant changes to the mortgage origination and securitization chain.

Finally, we note that subprime and Alt-A loans are no longer being originated in meaningful numbers. Thus, any credit risk retention requirements that are adopted will be primarily applied to prime mortgage loans, those that already are being underwritten to historically high credit quality standards.

For all of these reasons, we respectfully submit that the changes in the mortgage origination and RMBS markets since the onset of the financial crisis, the regulatory reforms already accomplished, and the reforms voluntarily undertaken by mortgage industry mitigate the need for mandatory risk retention for RMBS. We urge that the final credit risk retention rules give appropriate credit for the numerous protections and changes that already have been made by the mortgage finance industry, including changes mandated by new laws and regulations as well as those adopted voluntarily and as a result of market changes, and therefore reduce the amount of risk retention required for RMBS.

As we discuss above, we believe that loan origination quality is of paramount importance to the alignment of interests between securitizers and investors. Nevertheless, we believe that the proposed rules’ exemption for qualified residential mortgages (“QRMs”) is insufficiently flexible. The proposed definition leaves no room for the exercise of lender discretion to consider compensating factors. For example, a loan with a 50 percent down payment is inherently a much less risky loan than one with a 20 percent down payment, but the proposed definition does not

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<sup>18</sup> Preliminary Term Sheet dated February 15, 2011, available at [http://sec.gov/Archives/edgar/data/1510079/000114420411009020/v211544\\_fwp.htm](http://sec.gov/Archives/edgar/data/1510079/000114420411009020/v211544_fwp.htm).

<sup>19</sup> Free Writing Prospectus dated February 15, 2011, available at [http://sec.gov/Archives/edgar/data/1510079/000114420411011276/v212437\\_fwp.htm](http://sec.gov/Archives/edgar/data/1510079/000114420411011276/v212437_fwp.htm).

<sup>20</sup> As described in the Prospectus Supplement dated February 25, 2011, available at [http://sec.gov/Archives/edgar/data/1176320/000114420411011311/v212330\\_424b5.htm](http://sec.gov/Archives/edgar/data/1176320/000114420411011311/v212330_424b5.htm).

give any credit for the larger down payment – despite the considerable additional security gained from the larger down payment, the loan still would have to strictly comply with all of the other QRM requirements. In our view, underwriting variables should be viewed in their totality, rather than as discrete, unrelated factors. Therefore, we believe that the requirements for QRM status should be made more flexible, and should take account of the effect of compensating factors on underwriting standards.

Establishing a framework for compensating factors does not have to be complicated. For example, using our own mortgage databases, we analyzed default rates for mortgages with high FICO scores<sup>21</sup> and high LTV ratios, and for mortgages with low FICO scores and low LTV ratios. We found that both these types of mortgage loans, while not satisfying the proposed QRM definition, had default rates equal to or lower than those of loans in our database that would satisfy the QRM definition. We encourage the Agencies to run such an analysis against mortgage database that they used for the QRM definition and validate our results. Quality mortgage loans should not be excluded through over-reliance on an unnecessarily rigid formula.

We believe that the 20 percent down payment requirement in the proposed QRM definition should be reduced. In our view, the QRM definition should not categorically exclude large classes people who cannot come up with a large down payment, but are otherwise of low risk to default. Many low income, first-time and minority borrowers would have great difficulty coming up with the proposed 20 percent down payment. As discussed below, we believe that mortgages that qualify as QRMs will be more readily available to consumers than non-QRMs, and that mortgages that qualify as QRMs generally will bear lower interest rates than non-qualifying mortgages. Therefore, lowering the proposed 20 percent down payment requirement should result in the increased availability and lower cost of mortgage credit to low income, first-time and minority borrowers. In our view, that is a worthwhile public policy objective, well worth the possibility of moderately increased default rates.

The proposed QRM definition is extremely narrow, and mortgages that would qualify as QRMs currently account for only a minority portion of mortgages originated. Assuming that a significant majority of newly originated mortgage loans will require credit risk retention, this fact – coupled with the layered effect of other regulatory reform efforts – makes it very unlikely that the private capital markets will retain significant market share at anything close to prevailing mortgage rates. It is more likely that the increased costs of mortgage origination will be passed on to mortgage consumers through higher mortgage rates and decreased availability of mortgage credit.

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<sup>21</sup> According to the Proposing Release, the credit history requirements of the proposed rules were designed to be a reasonable proxy for credit score thresholds associated with low delinquency rates. Proposing Release, 76 Fed. Reg. 24090, at 24121.

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*Issues Specific to Commercial Mortgage-Backed Securities*

As described in our letter of November 16, 2010, the commercial mortgage-backed securities (“CMBS”) market has not suffered nearly the magnitude of losses as a result of the financial crisis as did the markets for RMBS and collateralized debt obligations. The CMBS market performs an important role in financing commercial real estate properties and contributes significantly to the economic development of the United States. Also, unlike the RMBS market, the CMBS market has come back to life, with approximately \$13 billion of issuance in 2010 and approximately \$40 billion in expected issuance in 2011. In our opinion, the CMBS market is not “broken” and no regulatory fix is needed in order to attract investors and get credit flowing again.

As the CMBS market has revived, underwriting standards for commercial real estate (“CRE”) loans have become more stringent and much more information has been disclosed to investors, due to both issuer initiative and investor request. For example, through the CRE Finance Council (“CREFC”), a trade association that includes all CMBS constituencies (investors, lenders, issuers, trustees, servicers, and rating agencies), participants in the CMBS industry have worked to enhance the existing CREFC Investor Reporting Package™ (“IRP”) that already had put CMBS well ahead of other asset classes with respect to the amount of information available to market participants. In addition, CMBS market participants have revamped and strengthened standardized practices for disclosure, underwriting standards and representations and warranties applicable to CRE loans. Members across all constituencies have devoted an extraordinary amount of time over the past year to working collaboratively and diligently on the completion of various market standard documents, including Model Representations and Warranties (and related enforcement mechanisms), Principles-Based Loan Underwriting Guidelines and a Standardized Annex A (*i.e.*, an initial loan-level disclosure package). We believe that the ongoing disclosure offered by the newly-enhanced IRP, combined with these three new market standards initiatives, will increase transparency and disclosure in underwriting and improve industry representations and warranties. In our view, this will go a long way toward meeting both investor demands and the objectives of the Act.

Throughout this process, the CMBS industry confirmed that enhancing disclosure and representations and warranties is the most effective and least disruptive method to align incentives and provide for meaningful risk retention by sponsors of CMBS transactions. This approach is consistent with the Federal Reserve Report, which noted that other forms of incentive alignment, including representations and warranties, could function as an alternative or

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complement to mandated risk retention.<sup>22</sup> Also, we note the recent rules adopted by the Commission pursuant to Section 943 of the Act, which strengthen the role of representations and warranties in protecting investors by requiring extensive disclosure regarding fulfilled and unfulfilled requests to repurchase assets as a result of a demand to repurchase for breach of a representation or warranty, as an example of how strong representations and warranties can serve this purpose.

Section 941(c)(1)(E) of the Act explicitly provides for a form of retention specific to CMBS (*i.e.*, the “B-piece buyer” exemption), an exemption for CRE loans that are of low credit risk (*i.e.*, the qualifying CRE loan exemption), as well as adequate representations and warranties and related enforcement mechanisms, as alternatives to a full 5 percent risk retention by the sponsor. CMBS is the only asset class for which Congress enumerated several different possible alternatives for fulfilling the Act’s credit risk retention requirements. We believe that this demonstrates Congressional acknowledgement that CMBS is different from other asset classes and, as a regulatory matter, should not be tarred by the same broad brush used to fix problems with more problematic asset classes.

Therefore, we respectfully submit that the changes in the CRE and CMBS markets since the onset of the financial crisis, the regulatory reforms already accomplished, and the reforms voluntarily undertaken by CRE and CMBS industry eliminate the need for additional mandatory risk retention for CMBS. More specifically, we believe that the use of representations and warranties that are based on the industry standard reflected in CREFC’s Model Representations and Warranties, Principles-Based Loan Underwriting Guidelines and Standardized Annex A, as periodically updated, and as negotiated and accepted by investors, should satisfy the credit risk retention mandate for a CMBS transaction. This would be particularly appropriate considering that the Act specifically contemplates that adequate representations and warranties (and related enforcement mechanisms) could be among the risk retention options for CMBS, commercial mortgages, clearly giving the Agencies the discretion to adopt such a framework.

In the alternative, we urge that the final credit risk retention rules give appropriate credit for the numerous protections and changes that already have been made by the CRE and CMBS industries (including changes mandated by new laws and regulations, as well as those adopted voluntarily and as a result of market changes). Given all of these protections and changes, we request that the Agencies reduce the amount of risk retention required for CMBS to 2 percent.

To the extent that credit risk retention is required for CMBS securitizers, the parameters of both the B-piece buyer exemption and the exemption for qualifying CRE loans, as proposed

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<sup>22</sup> Federal Reserve Report, at p. 84.

by the Agencies, are so restrictive that we do not believe they can be effectively implemented. We believe it is critical that these options for CMBS be crafted in a way that will make them viable as a practical matter. Otherwise, the risk retention rules would thwart clear Congressional intent that the Agencies develop a B-piece retention framework that builds on existing industry practice, rather than requiring a wholesale change in how the CRE and CMBS industry does business.

The following are, in our view, the most significant hurdles with the B-piece buyer exemption, as it has been proposed. Without changes to the following requirements, we believe that the B-piece buyer exemption will simply not be usable:

- We do not believe that B-piece buyers and/or their investors would be able to agree to a prohibition on the sale of the B-piece investment for the entire life of the transaction (expected to be 10 years). Such a commitment by a B-piece buyer (and its investors) likely would breach its fiduciary responsibility to its investors as we do not believe that any institutional investor would be likely to invest in a fund that gives the manager no discretion to sell the investment under any circumstance. Therefore, we think it is crucial for the proposed rules to be modified to give B-piece buyers some ability to sell the B-piece, to a “qualified transferee” that meets certain specified requirements. In this regard, we support the proposal that we expect the CREFC to file, which will allow for transferability to an appropriate party.
- We do not believe that investors (investment grade bond buyers and B-piece investors) or servicers will accept the possibility that the servicer (whether affiliated or unaffiliated with the sponsor) may be fired by an operating advisor without an affirmative vote of the investors. CREFC is expected to file with the Agencies a detailed proposal for when and how the servicer could be removed. We support this proposal, which has been vetted by CREFC’s members, which include investment-grade investors, B-piece buyers and servicers.
- We do not believe that B-piece buyers will agree to public disclosure of their purchase price.
- In our view, the B-piece buyer is in a much better position than the sponsor to ensure that it is in compliance with the requirements of the B-piece buyer exemption. In complying with any requirement of the proposed rules that the sponsor remain responsible for compliance with the requirements of the

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exemption, the sponsor should be able to rely on a representation as to compliance made by the B-piece buyer, unless it has actual knowledge to the contrary.

With regard to the exemption for qualifying CRE loans, we believe that the criteria for this exemption should be significantly broadened. As these requirements are currently written, we believe that very few, if any, CRE loans would qualify for the exemption, which we believe is contrary to Congressional intent. Even for residential mortgage loans, which suffered much greater losses than CRE loans, the QRM definition would have exempted 20 percent of historical originations. Given the much lower level of historical losses for CRE loans as opposed to residential mortgage loans, we believe that a much greater percentage of CRE loans should qualify for an exemption. We understand that the Mortgage Bankers Association is preparing a comment letter proposing a detailed qualifying loan exception for CRE loans, which we expect to support.

#### *Issues Specific to Resecuritizations*

The Proposed Rules provide for an exemption for certain resecuritization transactions. Unfortunately, the exemption provided does not cover an important product that was used well and responsibly during the financial crisis. Resecuritizations of a single bond are often used as a risk management tool, as the underlying securities can be re-tranched into different classes in order to, for example, obtain or maintain a desired credit rating for a senior tranche or distribute credit risk to sophisticated purchasers. Often, the securities used as resecuritization collateral were issued by third parties, not the sponsor of the resecuritization. Thus, the primary party whose interests the credit risk retention rules would seek to align with those of investors (*i.e.*, the originator of the underlying loans) often is not a party to the resecuritization transaction at all. Mandating a risk retention requirement for resecuritizations is more akin to an attempt to align the incentives of the group of investors (those who purchased the underlying securities in the first place) with other investors (those who would purchase the resecuritization securities). This would not promote the securitization of high quality assets, but would merely increase the cost of a valuable risk management tool and deter its use. Therefore, in our view, the credit risk retention requirements of the proposed rules should include a meaningful exemption for resecuritization of a single.

Unfortunately, the resecuritization exemption that has been proposed does not address this type of product. In order to be meaningful, the exemption for resecuritizations should permit multiple classes of ABS interests to be issued, so long as only a single class of underlying ABS is deposited into a trust that issues multiple classes of ABS interests. As discussed in our previous letter, a single asset securitization does not introduce as many complexities that a multi-asset securitization faces. In addition, we do not see any reason why the trust should not be

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permitted to hold assets other than ABS, such as cash, swaps, guaranties and other assets. Finally, securities issued prior to the date on which risk retention is required should be exempt from the requirement that the underlying securities have risk retention. Otherwise owners of legacy ABS will not be able to have access to this important risk management tool.

### *Issues Specific to Collateralized Loan Obligations*

CLOs perform a crucial role in making credit available to U.S. businesses that either do not have or only have a limited access to the corporate debt markets.<sup>23</sup> (A sample of U.S. corporations that rely on the loan market for funding is attached as Appendix A to this letter.)<sup>24</sup> For the reasons set out below, we believe that most CLOs already achieve the alignment of interests intended by Congress to be captured by Section 941(b) of the Act, and we support the adoption of a category of “eligible CLOs” as to which risk retention could be satisfied through additional means that are unique to the CLO structure.

CLOs have performed very differently from collateralized debt obligations (“CDOs”), which unlike CLOs are specifically referenced in the new definition of “asset-backed security” added to Section 3(A)(79) of the Exchange Act by the Act. As discussed more fully in our letter of November 18, 2010, while CDOs – more specifically, CDOs of ABS – have performed very poorly in the aftermath of the financial crisis, CLOs have performed and continue to perform very well. No investment-grade tranches of CLOs have suffered realized losses or writedowns. The strength of CLO structures also is acknowledged by the Federal Reserve Report, which stated that “[d]espite fairly widespread downgrades, there were only a few actual defaults [in CLOs]. Defaults in the underlying collateral – syndicated corporate loans – were limited, with CLO collateral defaults peaking at 6.5 percent in June 2009. The relative transparency of the asset pool and the relative simplicity of the structures may also have played a role, in addition to . . . credit enhancements and incentive alignment mechanisms . . . .”<sup>25</sup>

The underlying assets in CLOs are “first generation” corporate loans made to companies that otherwise would have limited access to the capital markets, if any, but which generally provide audited financial statements to lenders (including CLO managers) on an ongoing basis.

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<sup>23</sup> We are using the term “CLO” in our comment letter to mean “Open Market CLO” and not “Balance Sheet CLO”. Generally, a “Balance Sheet CLO” involves an acquisition of loans aggregated by an “agent bank” and the subsequent sale of such loans by the “agent bank” to the CLO. An “Open Market CLO” is a CLO that does not engage in such a transaction, but rather purchases loans directly from syndicators and sellers in the primary and secondary loan markets.

<sup>24</sup> Appendix A contains a list of the top 500 companies in US CLO portfolios, of which 73 percent of the companies are non-LBO companies.

<sup>25</sup> Federal Reserve Report, at 62 (footnote omitted).

These corporate loans are usually senior secured first lien loans, which have historical average losses amounting to only 0.83% (*i.e.*, a default rate of 2.78% and historical average recoveries of 70%).<sup>26</sup> These corporate loans are traded in an active secondary market, resulting in significant transparency of information to investors with regard to these loans. In fact, many of the loans owned by CLOs also are owned by public mutual funds and closed-end funds – and many CLO managers also manage loan assets in public mutual funds and closed-end funds. CLOs do not use the “originate to distribute” model of most ABS, and are more comparable to a managed private fund. The manager is effectively hired by the CLO investors to manage the investment portfolio of corporate loans on their behalf and is hired pursuant to a management agreement under which it owes a duty of care to the CLO and its investors. We are concerned that subjecting CLOs to the full risk retention requirements of the proposed rules would increase the cost of and lower the availability of credit to U.S. businesses, imposing substantial burdens without providing any commensurate benefit.

For all of these reasons, we encourage the Agencies to differentiate CLOs from ABS CDOs when regulating these two products. For regulatory purposes, we believe that the Agencies could effectively distinguish all “eligible CLOs” from CDOs based on the following required characteristics:

- The asset pool underlying the CLO is comprised of at least 90 percent senior secured syndicated loans to businesses;
- The asset pool underlying the CLO does not contain any ABS;
- The CLO is managed by an investment adviser that is registered with the Commission under the Investment Advisers Act of 1940, as amended;
- The CLO’s manager independently reviews, and individually and actively selects, each loan asset to purchase in the primary or secondary loan market, with no obligation to purchaser from any particular seller or originator; and
- The CLO manager’s compensation is tied to the performance of the CLO through a tiered fee structure, in which a majority of the compensation is required to be deferred if investors in the CLO’s rated notes are not receiving their full required interest payments.

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<sup>26</sup> Source: Moody’s Investors Services.

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All eligible CLOs meeting these requirements should be permitted to satisfy the risk retention requirements of the Act in two additional ways.

If a majority of the compensation of the manager of an eligible CLO is required to be back-end loaded, and is not paid until the investors have been fully paid, the interests of the manager will be fully aligned with the investors. This is tantamount to having "skin in the game," the clear underlying policy behind the risk retention requirements of the Act. Therefore, the full amount of this deferred compensation should be credited against any risk retention requirement for an eligible CLO.

Investors in CLO equity tranches generally have first loss exposure. Typically, the equity tranche represents 8-10 percent of the transaction, significantly higher than the 5 percent risk retention requirement called for by the proposed rules. Investors in CLO equity tranches generally are qualified institutional investors for purposes of Rule 144A under the Securities Act of 1933, as amended, and are sophisticated and informed investors well capable of performing due diligence on the CLO's assets. In essence, we believe that the equity tranche in a CLO is akin to the B-piece in CMBS. Therefore, we ask that the Agencies allow the risk retention requirements of the Act to be satisfied for eligible CLOs through the acquisition by third party of the equity tranche, similar to the way in which the proposed rules would permit their risk retention requirements to be satisfied by CMBS by means of the B-piece buyer exemption. Just as with a CMBS B-piece buyer, the CLO equity buyer would have a strong incentive to diligence each of the CLO assets in the CLO due to its first loss position. Also, as previously discussed, most CLO assets are actively traded in the secondary corporate loan market, leading to greater transparency of pricing.

In general, our comments regarding the proposed CMBS B-piece buyer exemption also should apply to any CLO equity buyer exemption. Just as we believe that the CMBS B-piece buyer should be permitted to transfer the B-piece to a qualified transferee, we believe that the buyer of the equity tranche in an eligible CLO should be permitted to transfer that interest at any time to other qualified transferees. We believe that a commitment by a CLO equity buyer to hold that equity likely would breach its fiduciary responsibility to its investors, as we do not believe that any institutional investor would be likely to invest in a fund that gives the manager no discretion to sell an investment under any circumstance. The definition of a qualified transferee should be based upon whether the transferee has invested in eligible CLO equity in the past.

As discussed earlier with respect to the duration of any required risk retention mechanism, any required holding period for CLO equity should be no more than two to three years. If the holding period is too long, that would deter sophisticated buyers of eligible CLO

equity tranches, whose liquidity needs may change from time to time. Any required holding period also should have an available exception to the extent that changes in law, tax treatment or capital charges make the continued holding of the equity tranche by the third-party investor impossible or impracticable.

Finally, we acknowledge and agree with the arguments that have been made by other organizations that the Agencies are exceeding the authority granted to them by the Act in proposing to subject CLOs to the risk retention requirements of the proposed rules. The Act mandates risk retention rules that require any “securitizer” to retain the required credit risk. The Proposing Release indicates the Agencies’ belief that the manager of a CLO transaction generally is the sponsor.<sup>27</sup> We find nothing in the legislative history of the Act that would indicate that Congress had CLO managers in mind when it drafted the definition of “securitizer.” Also, a CLO manager does not seem to fall within the statutory definition of “securitizer” – nor does any other party to a typical CLO transaction, a point which we expect to be made by the comment letter to be submitted by the Loan Syndications and Trading Association in its upcoming comment letter.

#### *Issues Specific to Tender Option Bonds*

We have reviewed a near final draft of the comment letter expected to be delivered by the Securities Industry and Financial Markets Association with respect to the impact of the proposed credit risk retention rules on tender option bond programs, and we expect to support that letter.

#### *Issues Specific to Consumer Asset and Equipment Securitizations*

As detailed in the comment letter delivered by the American Securitization Forum<sup>28</sup> and the Federal Reserve Report, as well as our previous comment letter dated November 16, 2010, the consumer ABS market (including auto, credit card and FFELP student loan securitizations) and the equipment lease and loan ABS markets withstood the stresses of the financial crisis with little or no evidence of structural problems. These transactions generally were structured with sufficient structural protections for investors and alignment of interests between securitizers and investors, even without any risk retention mandate.

The Federal Reserve Report demonstrates that consumer asset securitizations did not suffer nearly the magnitude of losses as more problematic asset classes such as RMBS and CDOs, incurring only minimal losses<sup>29</sup> even as delinquency and charge-off rates increased

<sup>27</sup> Proposing Release, 76 Fed. Reg. 24090, at 24098, n. 42.

<sup>28</sup> Available at <http://sec.gov/comments/s7-14-11/s71411-57.pdf>.

<sup>29</sup> Federal Reserve Report, at 49-50.

considerably.<sup>30</sup> In fact, since the beginning of the financial crisis, only a few consumer asset securitization transactions have been downgraded by the rating agencies, and a few even have been upgraded.<sup>31</sup> Given the strong performance of consumer ABS securitizations as compared to other assets, we believe that a “one size fits all” approach to credit risk retention is inappropriate. In our view, the credit risk retention rules required by the Act should give due credit to the strength and resilience of consumer securitization structures.

We believe that the proposed 5 percent risk retention requirement, insofar as it would apply to consumer asset securitizations, should be reconsidered. The retention of 5 percent of the risk in a transaction is a significant multiple of the lifetime expected losses in many types of consumer transactions, such as securitizations of prime auto loans and FFELP student loans (which benefit from a 97% or higher government guarantee). As detailed in the comment letter from the American Securitization Forum,<sup>32</sup> even although most consumer asset ABS issuers already retain a quite significant economic risk through mechanisms such as overcollateralization, cash reserve accounts, and retention of the subordinated residual interest and/or additional subordinated classes, none of these mechanisms would count toward the 5 percent risk retention requirement that would be imposed by the proposed rules. We believe that they should.

With respect to automobile loans in particular, the proposed definition of “qualifying automobile loan” is much too narrow – virtually no consumer automobile loans currently being originated would meet its underwriting requirements, which would make it of no practical use. We urge that this definition be revised to reflect actual loan origination practices in this market. Also, we believe that an asset pool should not have to consist entirely of qualifying automobile loans to benefit from this exemption. The sponsor of an ABS transaction with an asset pool consisting partly of qualifying automobile loans should receive a credit toward its risk retention requirement based on the proportion of these loans in the asset pool.

In sum, requiring the retention of 5 percent of the credit risk in all consumer asset and equipment securitization transactions is not justified by the performance history of these asset classes. To do so would only limit the credit available to consumers and reduce the effectiveness of securitization as a financing option, without any commensurate benefit.

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<sup>30</sup> Federal Reserve Report, at 31, 55-57.

<sup>31</sup> Federal Reserve Report, at 59.

<sup>32</sup> See footnote 26 *supra*.

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*Issues Specific to Asset-Backed Commercial Paper*

Asset Backed Commercial Paper (“ABCP”) provides a critical source of cost-effective financing for both corporate entities and consumers. The U.S. ABCP market alone provides \$369.6 billion<sup>33</sup> of financing for myriad asset classes, including trade accounts receivable, auto loans and leases and credit card receivables.

ABCP conduits that currently enjoy market access generally are structured in one of two ways, both of which benefit from 100 percent liquidity coverage. In the first currently prevalent structure, one or more regulated or sovereign-related entities assumes 100 percent of the conduit’s liquidity risk and 100% of its financed asset credit risk, through a liquidity coverage facility such as an asset purchase agreement, loan agreement, repurchase agreement or the like. These structures are known as “fully supported ABCP conduits.” In the second currently prevalent structure, one or more regulated or sovereign-related entities assumes 100 percent of the conduit’s liquidity risk through a liquidity coverage facility, and one or more regulated or sovereign-related entities assumes a portion (generally 5-10 percent) of the its financed asset credit risk through a letter of credit or similar arrangement. These structures are known as “partially supported ABCP conduits.”

For the reasons set out below, we believe that ABCP, particularly given the market success of these structures with a 100 percent liquidity backstop, already achieves the alignment of interests and “skin in the game” that Congress intended to be captured by the risk retention requirements of the Act.

As proposed, the definition of “eligible ABCP conduit” includes a 100 percent liquidity coverage component, demonstrating the Agencies’ understating that ABCP structures with 100 liquidity coverage pose a different, and significantly lesser, risk to investors than some previous structures (such as structured investment vehicles that benefited from liquidity coverage of only around 15%). The existing liquidity and credit facilities embedded within these structures are already structured to effectively transfer risk to the regulated or sovereign entities providing liquidity and credit risk coverage, and away from investors, in the event of asset credit deterioration or market disruption. These facilities did exactly that during the financial crisis – to date, no investor in ABCP that benefits from 100% liquidity coverage has suffered a loss.

Unfortunately, we believe that few ABCP conduits currently in the market – even those with 100 percent liquidity coverage – would qualify as eligible ABCP conduits under the

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<sup>33</sup> As of July 20, 2011. Federal Reserve, Statistical Releases and Historical Data, Commercial Paper Rates and Outstanding Summary, posted July 25, 2011.

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proposed rules. Most importantly, the requirement that “all interests issued by an intermediate SPV are transferred to one or more ABCP conduits or retained by the originator-seller” would eliminate most ABCP conduits that participate in transactions funded by multiple sources of financing. For example, in 2011 a large American consumer lender financed \$15 billion of secured loans through an ABCP conduit. Because some of the participants in this financing (including Morgan Stanley) were not ABCP conduits, the participating conduits could not have qualified as eligible ABCP conduits, for no reason other than that participation. This requirement seems to have nothing to do with risk retention and we believe that it could, and should, be eliminated without any adverse consequences.

ABCP conduits whose 100% liquidity coverage is provided by a sovereign or sovereign-related entity, as opposed to “regulated liquidity provider” as required in the definition, would not qualify as eligible ABCP conduits. For example, Straight-A Funding LLC, an ABCP conduit created to relieve pressure on the stalled student loan market in 2009, benefits from 100% liquidity coverage provided by the Federal Financing Bank, a non-regulated entity funded by the U.S. Department of the Treasury. This facility arguably is even safer to investors than one whose liquidity coverage is provided by a financial institution. In our view, there is no reason to exclude ABCP programs sponsored by sovereign or sovereign-related entities, and we urge that the definition of “eligible ABCP conduit” be modified accordingly.

Finally, few if any ABCP conduits currently in the market would qualify as eligible ABCP conduits if they were required to disclose the names of originator-sellers whose assets they finance. We do not believe that originator-sellers would permit their names to be disclosed in this fashion. In any event, we believe that such disclosure is unnecessary. Liquidity coverage facilities in fully supported ABCP conduits are structured to isolate ABCP investors from risks associated with the originator-seller. Liquidity coverage facilities in partially supported ABCP conduits also are structured to isolate ABCP investors from risks associated with the originator-seller; investors in ABCP issued by these conduits are still exposed to some risks associated with asset credit quality, but only after the conduit’s 5-10 percent facility has been exhausted. As a result, ABCP investors are exposed to limited risk associated with a specific originator-seller. We do not believe that ABCP investors require this information, as they have been very active in developing the current market standard for ABCP disclosure – which does not include the names of the originator-sellers of the assets

In our view, existing ABCP conduit structures that benefit from 100% liquidity coverage already address the concerns that Congress had in mind when enacting the risk retention requirements of the Act. Therefore, we ask that the definition of “eligible ABCP conduit” be modified in the respects discussed above.

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Of additional concern are the marked differences between the Agencies' approach to aligning interests of sponsors and investors and that of the Committee of European Banking Supervisors (the "CEBS"). In the release of their guidelines to risk retention under Article 122a, the CEBS indicated that an ABCP conduit's risk retention requirement may be met by liquidity facilities or letters of credit provided by the sponsor.<sup>34</sup> To impose more strict requirements on U.S. ABCP conduits would create a competitive advantage for European ABCP conduit sponsors. Also, European banks that manage ABCP conduits that finance assets in both the U.S. and European markets would be subject to markedly different risk retention standards for the same conduit structure, an undesirable result in this era of financial interconnectedness.

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<sup>34</sup> Committee of European Banking Supervisors, Guidelines to Article 22a of the Capital Requirements Directive, at 24-25 (December 31, 2010).

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As we stated in our previous letter, revitalization of the securitization markets is critical to providing credit to consumers and businesses and revitalizing the U.S. economy and the housing market. We agree that there are aspects of the securitization process that did not perform well. These need to be fixed. However, past performance demonstrates that the focus of efforts to fix the securitization market should be on ensuring the origination of high quality assets. The most effective and least disruptive way to achieve that objective is through increased disclosure of underwriting standards and robust representations and warranties. In our view, the risk retention requirements as proposed by the Agencies will have little effect on the origination of high quality assets, but will significantly increase costs and decrease the availability of credit to the U.S. economy. We strongly encourage the Agencies to re-think and re-propose the credit risk retention rules. The potential for adverse consequences to our economy is too significant to get this wrong.

We greatly appreciate your consideration of the views set forth in this letter, and we would be pleased to have the opportunity to discuss these matters further with you or with any member of the staff of any of the Agencies. Please feel free to contact the undersigned at 212-761-2080, or James Lee at 212-762-6148.

Very truly yours,

A handwritten signature in black ink, appearing to read "Stephen D'Antonio". The signature is fluid and cursive, with a long horizontal stroke at the end.

Stephen D'Antonio  
Managing Director  
Morgan Stanley & Co. LLC

## Appendix A

### Top 500 Companies in US CLO portfolios

24 Hour Fitness  
Acosta Inc  
Acxiom Corp  
Advanstar Communications Inc  
Advantage Sales and Marketing  
Aeroflex Inc  
AES Corp.  
Affinion Group Inc  
Airvana Network Solutions Inc  
Alaska Communications Systems Holdings  
Alere Inc  
AlixPartners LLP  
Alliance HealthCare Services  
Alliance Laundry Systems LLC  
Alliant Insurance Services Inc  
AlliedBarton Security Services  
Allison Transmission Inc  
Alon USA Energy Inc  
AM General LLC  
AMC Entertainment Inc  
AMC Networks Inc  
American Rock Salt Company  
American Seafoods Group LLC  
Ameristar Casinos  
AMF Group  
Amscan Holdings, Inc.  
AmWINS Group Inc  
Anchor Glass Container Corp  
Applied Systems Inc  
Aramark Corp  
Ardent Health Services Inc  
Arizona Chemical Company  
Armored AutoGroup  
Armstrong World Industries Inc  
Aspect Software Inc  
Astoria Generating Company  
Asurion Corporation  
Atlantic Broadband Finance LLC  
Attachmate Corporation  
Audio Visual Services Corp.  
AutoTrader.com  
Avaya Inc  
Avis Budget Car Rental LLC  
AWAS Aviation Holdings  
Axcan Pharma Inc  
Baker Tanks

Bass Pro Shops LLC  
Bausch & Lomb Inc  
Beacon Sales Acquisition  
Berry Plastics Corp  
Bicent Power  
Big West Oil  
Biomet Inc  
BLB Management Services Inc  
Blount Inc  
BNY ConvergEx Group LLC  
Bolthouse Farms Inc  
Bombardier Recreational Products  
Booz Allen Hamilton  
Boston Generating LLC  
Brand Aquisition Corp  
Brenntag AG  
Bresnan Communications LLC  
Brickman Group Holdings Inc  
Bright Horizons Family Solutions Inc  
Brock Holdings III Inc  
BRSP LLC  
Bucyrus International Inc  
Burger King Corp  
Burlington Coat Factory Warehouse Corp  
Bushnell Performance Optics Inc  
BWAY Corp  
Cablevision Systems  
Calpine Corp  
Cannery Casinos  
Capital Automotive LP  
Carestream Health Inc  
Carmike Cinemas Inc  
Catalina Marketing Corp  
CB Richard Ellis Services Inc  
CCC Information Services  
CCS Income Trust  
CDW Corp  
Cebridge Connections Inc  
Cedar Fair LP  
Celanese Inc  
Cellular South  
Centaur Gaming  
Central Parking Corp  
Cenveo Corp  
CG JCF Corp  
Charter Communications Entertainment LP  
Chemtura  
Chrysler Group  
Cinemark USA Inc  
CIT Group Inc

Citadel Broadcasting  
Citco Group  
CITGO Petroleum Corp  
Claire's Stores Inc  
Clarke American  
Clear Channel Communications  
ClubCorp Inc  
CMP Susquehanna  
Coach America Holdings Inc  
CommScope Inc  
Community Health Systems Inc  
Compass Minerals Group Inc  
Conseco Inc  
Consolidated Communications Inc  
Consolidated Container Co  
Constellation Brands Inc  
Contech Construction Products Inc  
ConvaTec Inc  
Covanta Energy Corp  
CPG International Inc  
CRC Health Corporation  
Crown Castle International Corp  
Culligan International Company  
Custom Building Products  
DAE Aviation Holdings Inc  
Darling International Inc  
Datatel Inc  
David's Bridal  
Davita, Inc.  
Dean Foods Co  
Del Monte Corp  
Delphi Corporation  
Delta Air Lines Inc  
Deluxe Entertainment  
Dex Media East LLC  
Dex Media West LLC  
DineEquity Inc  
DJO Finance LLC  
Dole Food Company Inc  
Dollar General Corp  
DSW Holdings Inc  
Dunkin Brands Inc  
DynCorp International Inc  
Dynegy Holdings Inc  
Education Management LLC  
Education Media & Publishing Group  
Edwards (Cayman Islands II) Ltd  
EL AD IDB Las Vegas LLC  
Emdeon Business Services LLC  
Emergency Medical Services Corp

Endo Pharmaceuticals Inc  
EnergySolutions LLC  
Entegra Power Group  
EPD Inc  
Epicor Software/Eagle Parent  
EquiPower Resources Holdings  
EVERTEC Inc  
Exopack LLC  
Fairmount Mineral Ltd  
Fairpoint Communications  
Federal Mogul Corp  
Fender Musical Instruments  
Fenwal Inc  
Fidelity National Information Services Inc  
Fifth Third Processing Solutions LLC  
First Data Corp  
Fontainebleau Resorts  
Ford Motor Company  
FoxCo Acquisition LLC  
Frac Tech Services LLC  
Freescale Semiconductor  
Fresenius Medical Care AG  
Fresenius SE  
FTD Inc  
GateHouse Media Operation Inc  
Gavilon Group LLC  
Generac Power Systems Inc  
General Chemical  
General Nutrition Centers Inc  
GenOn Energy  
Gentiva Health Services Inc  
Georgia-Pacific Corp  
Getty Images Inc  
Gibson Energy  
Ginn Clubs  
Global Brass and Copper Inc  
Global Tel Link Corp  
Golden Living (Drumm)  
Golden Nugget Inc  
Goodman Global Holdings Inc  
Goodyear Tire & Rubber Co  
Graceway Pharmaceuticals  
Graham Packaging Co  
Graphic Packaging International  
Gray Television Inc  
Great Atlantic & Pacific Tea Company  
Grifols SA  
Grosvenor Capital Management LLP  
GSI Group Inc  
Guitar Center Inc

Gymboree Corporation  
Hanger Orthopedic Group, Inc.  
Hanley-Wood Inc LLC  
Harbor Freight Tools USA Inc  
HarbourVest Partners LP  
Harlan Sprague Dawley Inc  
Harrah's Entertainment Inc  
Harron Communications Corp  
Hawaiian Telcom Communications Inc  
Hawker Beechcraft Acquisition Company LLC  
HCA - The Healthcare Company  
HCR ManorCare Services  
HD Supply Inc  
Health Management Associates Inc  
Helix Energy Solutions Group Inc  
Herbst Gaming Inc  
Hercules Offshore LLC  
Hertz  
Hexion Specialty Chemicals Inc  
HGI Holding Inc  
HHI Holdings LLC  
Hillman Group  
HIT Entertainment Inc  
Houghton International Inc  
HUB International Ltd  
Hubbard Radio LLC  
Huish Detergents Inc  
Huntington Ingalls Industries, Inc.  
Huntsman ICI Chemicals LLC  
IAP Worldwide Services  
IASIS Healthcare Corp  
IMG Worldwide Inc  
IMS Health Inc  
Ineos Holdings Ltd  
InfoGROUP Inc  
Infor Global Solutions  
Insight Midwest LP  
Intelsat Jackson Holdings  
Interactive Data Corp  
International Lease Finance Corp  
Intersil Corp  
inVentiv Health Inc  
iPayment Inc  
IPC Acquisition Corp  
Isle of Capri Casinos Inc  
ISP Chemco Inc.  
iStar Financial Inc  
Itron Inc  
J. Crew Group  
Jacobson Companies

Jarden Corp  
JBS USA  
JMC Steel Group  
Jo-Ann Stores  
JohnsonDiversey Inc  
JRD Holdings Inc  
KAR Auction Services Inc  
Key Safety Systems Inc  
Kik Custom Products Inc  
Kindred Healthcare, Inc.  
Kinetek Industries Inc  
Knology Inc  
Kronos  
Kyle Acquisition Group  
La Paloma Generating Co LLC  
Lamar Media Corp  
Language Line LLC  
Las Vegas Sands Inc  
Laureate Education Inc  
Lawson Software Inc  
Lender Processing Services Inc  
Leslie's Poolmart Inc  
Level 3 Communications  
LifePoint Hospitals Inc  
Live Nation Entertainment Inc  
LNR Property  
Local Insight Yellow Pages Inc  
Local TV  
Lodgenet Entertainment Corp  
Longview Power  
LPL Holdings  
MacDermid Inc  
Manitowoc Company  
MDA Information Products  
MedAssets Inc  
Mediacom  
Mediacom Broadband  
Medpace Inc  
MEG Energy Corp  
Merrill Corp  
Metaldyne Corp  
MetroPCS Inc  
Michael Foods, Inc.  
Michael's Stores Inc  
Microsemi Corp  
Midcontinent Communications  
Millennium Inorganic Chemicals  
Miramax Film NY LLC  
Mitchell International  
Mold Masters

Momentive Performance Materials  
MoneyGram Payment System  
Mood Media Corp  
Motor City Casino  
Movie Gallery Inc  
MSCI Inc  
Multiplan Inc  
Mylan Laboratories Inc  
Nalco Company  
National Bedding Company  
National CineMedia LLC  
National Equipment Services  
National Mentor Holdings  
NBTY Inc  
NCI Building Systems Inc  
NCO Financial Systems  
NDS Group  
NE Energy Holdings Inc  
Neiman Marcus Group Inc  
Nelson Education LTD  
NEP II Inc  
Network Solutions  
New Customer Service Companies  
Newport Television LLC  
Nexeo Solutions  
Noranda Aluminum  
Nortek Inc  
North Las Vegas  
Northern Star Holdings Generation  
Novelis  
NPC International Inc  
NRG Energy  
NTELOS Inc  
Nuance Communications  
Nusil Technology  
Nuveen Investments Inc  
NXP Semiconductors  
O2  
Oceania Cruise Holdings  
Octavius/Caesars Entertainment  
OneLink Communications  
Open Solutions, Inc  
Open Text Corporation  
OpenLink Financial Inc  
Orbitz Worldwide Inc  
OSI Restaurant Group  
Oxbow Carbon and Minerals LLC  
Ozburn-Hessey Holding Company  
Pantry Inc  
Peach Holdings

Pelican Products, Inc.  
Penton Media Inc  
PETCO Animal Supplies Inc  
Petroleum Geo Services ASA  
Pharmaceutical Technologies and Services  
Philadelphia Newspapers LLC  
Phillips-Van Heusen Corporation  
Pierre Foods Inc  
Pilot Travel Centers LLC  
Pinafore  
Pinnacle Foods Corp  
Polypore  
PQ Corporation  
Protection One Alarm Monitoring Inc  
QCE LLC  
Quad/Graphics Inc  
Quebecor Media Inc  
Quintiles Transnational Corp  
R.H. Donnelley Corp  
Race Point Power  
Radio One Inc  
RBS WorldPay Inc  
RCN Cable LLC  
Realogy  
Regal Cinemas Corp  
Remy International Inc  
Renal Advantage Holdings Inc  
Rent-A-Center-Inc  
Revlon Consumer Products Corp  
Rexnord LLC  
Reynolds & Reynolds  
Reynolds Group Holding  
RGIS Holdings LLC  
Rite Aid Corp  
Rock-Tenn Company  
Rockwood Specialties Group Inc  
Roundys Inc  
Rovi Corporation  
Royalty Pharma Finance Trust  
Sabre Inc  
Safenet Inc  
Sally Holdings Inc  
Savers Inc  
SAVVIS Inc  
SBA Finance  
Scitor Corp  
SeaWorld Parks & Entertainment  
Sedgwick CMS Holdings Inc  
Select Medical Corporation  
Seminole Tribe of Florida

Sensata Technologies  
Sensus Metering Systems Inc  
Sequa Corp  
ServiceMaster Co  
Sheridan Production Partners  
SI Organization Inc  
Sidera Networks  
Six Flags Theme Parks  
Skilled Healthcare Group Inc  
SkillSoft PLC  
Smart & Final Inc  
Solutia Inc  
Sorenson Communications Inc  
Southern Pacific Resource Corp  
Spanish Broadcasting System  
Spansion  
Spectrum Brands Inc  
Spirit Aerosystems Inc  
Spirit Finance Corp  
Sports Authority Inc  
Springboard Finance LLC  
Springleaf Financial Funding  
Springs Window Fashions LLC  
Sprouts Farmers Market, LLC.  
SRAM LLC  
SS&C Technologies Inc  
Star West Generation  
Styron  
Summit Entertainment LLC  
Summit Materials KY Acquisition LLC  
Sungard  
Sunquest Information Systems Inc  
SuperMedia Inc  
Supervalu Inc  
Surgical Care Affiliates  
Swett & Crawford  
Swift Transportation Co Inc  
SymphonyIRI Group Inc  
Synagro Technologies Inc  
Syniverse Technologies Inc  
Tank Intermediate Holding Corp  
TASC Inc  
Tegant Holding Corp  
Telcordia Technologies Inc  
Telesat  
Tenneco Automotive  
Thomsons Learning Co  
Time Warner Telecom Inc.  
TowerCo Finance LLC  
Town Sports

Toys R Us  
TPF Generation LLC  
Transaction Network Services  
TransDigm Inc  
Transfirst Holdings Inc  
Transtar Holding Company  
TransUnion LLC  
Travelport  
Tribune Company  
TriZetto Group Inc  
TWCC Holding Corp  
TXU Corp  
UCI International Inc  
United Airlines Inc  
United Surgical Partners  
Univar NV  
Universal Health Services Inc  
Univision Communications Inc  
UPC Financing Partnership  
URS Corp  
US Airways Group Inc  
US Foodservice Inc  
US Investigations Services Inc  
US TelePacific Corp  
USI Holdings Corp  
Vanguard Health Systems  
Venetian Macao  
Verifone Inc  
Verint Systems Inc  
Vertafore Inc  
Visant Corp  
VNU Group  
VWR International Inc  
Walter Industries Inc  
Walter Investment Management  
Warner Chilcott  
Waste Industries USA  
Weight Watchers International Inc  
Wendy's/Arby's Restaurants LLC  
Wenner Media LLC  
Wesco Aircraft Hardware Corp  
West Corp  
Western Refining Company  
White Birch  
WideOpenWest Finance LLC  
Willbros Group Inc  
Wilton Paper Crafts Inc  
Windstream Corporation  
Wolf Hollow  
Wyle Services Corp

Wynn Las Vegas  
Yankee Candle Company Inc  
Yell  
Zuffa LLC