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August 1, 2011

BY ELECTRONIC MAIL

Department of the Treasury
Office of the Comptroller of the Currency
250 E Street, SW., Mail Stop 2-3
Washington, DC 20219
Re: Docket No. OCC-2011-0002

Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
Re: File No. S7-14-11

Jennifer J. Johnson, Secretary Board of
Governors of the Federal Reserve
System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Re: Docket No.R-1411

Alfred M. Pollard, General Counsel
Attention: Comments/RIN 2590-AA43
Federal Housing Finance Agency
Fourth Floor
1700 G Street, NW
Washington, DC 20552
Re: RIN 2590-AA43

Robert E. Feldman, Executive Secretary
Attention. Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Re: FDIC RIN No. 3064-AD74

Regulations Division
Office of General Counsel
Department of Housing and Urban
Development
Office of General Counsel
451 7th Street, SW, Room 10276
Washington, DC 20410-0500
Re: Docket No. FR-5504-P-01
Proposed Rule: Credit Risk Retention

Re: Proposal to Establish Credit Risk Retention Requirements
76 FR24090 (April 29, 2011)

Ladies and Gentlemen:

The American Bankers Association (ABA)[1] and the ABA Securities Association[2] (the Associations) are pleased to respond to the request for comment by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation (the “Banking Agencies”), the Securities and Exchange Commission (the

[1] The American Bankers Association represents banks of all sizes and charters and is the voice for the nation’s $13 trillion banking industry and its 2 million employees. ABA’s extensive resources enhance the success of the nation’s banks and strengthen America’s economy and communities. Learn more at www.aba.com.

[2] ABASA is a separately chartered affiliate of the ABA that represents those holding company members of the ABA that are actively engaged in capital markets, investment banking, and broker-dealer activities.

"SEC" or the "Commission"), and the Federal Housing Finance Agency and the Department of Housing and Urban Development (collectively, the "Agencies")[3] on the Agencies' joint proposal to implement the requirements of section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act or DFA).[4] Section 941 generally requires securitizers of asset-backed securities (ABS) to retain an economic interest in a portion of the credit risk of those transactions. It further directs the Agencies to craft exceptions to the risk retention requirements that incent securitization participants to originate soundly underwritten assets and align the interests of participants with investors, consistent with improving access to credit on reasonable terms.

ABA represents both small and large banks that participate actively in the securitization market both as originators and securitization issuers. ABASA represents the largest banks that are active in capital markets. Our members are involved in all aspects of securitization transactions, from origination, much of which is performed by small banks, to sponsoring and issuing ABS.

At the outset, the Associations recognize the difficulty within the very compressed time frame mandated by Congress of trying to craft complex regulations for credit risk retention that will have significant, and potentially severe, consequences for the manner in which diverse types of securitization transactions are structured. We appreciate the extraordinary amount of time and resources the Agencies have devoted to developing the proposal. In particular, we appreciate the Agencies' efforts to take into account the diversity of assets that are securitized, the structures historically used in securitizations, and the manner in which sponsors may have retained risk. And, we are grateful that the Agencies have extended the comment period to provide the industry with additional time digest this complex rulemaking.

The Associations acknowledge that some sectors of the securitization market performed very poorly in the recent past and that the financial crisis exposed serious flaws in the securitization process. From a credit risk perspective, the major problems that arose in the securitization market during this time were concentrated in securities backed by various types of residential mortgage loans (RMBS), in securitizations that invested in RMBS, and to a lesser degree in commercial mortgage-backed securities (CMBS). However, as recognized by the Federal Reserve Board in its *Report to Congress on Risk Retention* (FRB Report), while nonconforming prime RMBS, nonprime RMBS, and CMBS experienced significant credit rating downgrades between 2007 and 2010 and the likelihood of default increased significantly, "other ABS categories have very few or no securities rated likely to default." [5] We believe that such analysis should be given significant weight as the Agencies continue their deliberations so that the rules implementing Section 941 are appropriately targeted to the practices Congress intended to be addressed.

[3] References to "the Agencies" in this letter, means the appropriate Agencies having rulewriting authority with respect to any particular aspect of the proposed rules.
[4] Pub. L.111-203 (2010). Section 941(b) adds new Section 15G to the Securities Exchange Act of 1934, as amended (Exchange Act).
[5] *See*, Board of Governors of the Federal Reserve System, *Report to Congress on Risk Retention* at 49 (Oct. 2010), available at http://federalreserve.gov/boarddocs/rptcongress/securitization/riskretention.pdf.

The Associations further urge the Agencies to take note of the numerous types of transaction structures the market has developed to reflect distinct features of the various classes of assets that are securitized, relevant legal regimes and investor preferences. We believe that regulations that are intended to address a particular type of ABS transaction or structure may well not transfer readily to other types of ABS transactions.

Indeed, the heterogeneity of the securitization market was recognized by the Federal Reserve Board in its Congressionally mandated study of the market:

"Thus, this study concludes that simple credit risk retention rules, applied uniformlyacross assets of all types, are unlikely to achieve the stated objective of the [Dodd-Frank] Act—namely, to improve the asset-backed securitization process and protect investors from losses associated with poorly underwritten loans … Given the degree of heterogeneity in all aspects of securitization, a single approach to credit risk retention could curtail credit availability in certain sectors of the securitization market. A single universal approach would also not adequately take into consideration different forms of credit risk retention, which may differ by asset category. Further, such an approach is unlikely to be effective in achieving the stated aims of the statute across a broad spectrum of asset categories where securitization practices differ markedly. … In light of the heterogeneity of asset classes and securitization structures, practices and performance, the Board recommends that rulemakers consider crafting credit risk retention requirements that are tailored to each major class of securitized assets.[6]

SUMMARY CONCLUSION

As discussed more fully below, the Associations strongly believe that the proposal as currently drafted is so flawed that it must be withdrawn and re-issued. We believe that fundamental concepts in the proposal, such as how to measure the retained risk, are so unclear that it is impossible for the industry to provide well-reasoned responses to those critical aspects of the proposal. In addition to the lack of clarity, we believe that without significant changes the proposal will have a destructive impact on securitization markets and the availability of credit to consumers and businesses, and we have provided detailed comments to address our concerns. The proposed Premium Capture Cash Reserve Account (PCCRA) is but one example of the fatal flaws in the proposal. By increasing the base risk retention requirement of "five percent" to "five percent plus all of the securitizer's and originator's profit as well as a significant percent of their cost basis in the underlying assets," the PCCRA will effectively render most securitizations uneconomically untenable.

Moreover, the exceptions to the risk retention requirements fail to comport with Congressional intent with respect to the narrowness with which they are crafted. Section 941 granted the Agencies significant discretion when promulgating their regulations to establish the scope of the Qualified Residential Mortgage (QRM) exemption, and to employ a range of amounts of retained economic interests from zero percent to five percent that would be reflective of the underwriting

[6] FRB Report at 3, 83-84.

standards of particular assets, and finally, to exempt entire classes of assets where warranted. Yet, the proposal reflects an "all or nothing" approach to the retention requirements with zero percent retention for very narrowly crafted asset classes, and five percent retention for all other assets, with nothing in between. These narrow qualified asset exemptions are not workable, with the result that five percent retention will become the standard, leading ultimately to a constriction of credit for otherwise creditworthy borrowers. While Section 941 applies the risk retention rules to all ABS, not just to MBS, we believe the performance of non-MBS sectors throughout the financial crisis should be given significant weight in the Agencies' deliberations and use of their exemptive authority.

In addition, the Associations believe the risk retention rules must be viewed in a holistic perspective that takes into account additional Dodd-Frank and other rulemakings that, taken collectively, may magnify the impact of the risk retention rules. This is particularly the case in the context of securitizations collateralized by residential mortgages, a market currently experiencing wholesale transformations in applicable regulations. These changes include a regulatory overhaul in light of Title XIV of the Dodd-Frank Act as well as other regulatory initiatives to further regulate residential mortgages that predate that Act. Beyond regulations directly impacting classes of collateral, the risk retention requirements will necessarily interact with current and future Basel capital requirements and accounting rules. As a result, a risk retention requirement that, on its face, appears to be workable, may nonetheless make securitization transactions economically unfeasible.

Given the critical importance of a robust securitization market to provide the business and consumer credit necessary for a healthy economy, the Associations urge the Agencies to conduct appropriate economic analyses of the proposal with respect to the impact on private securitization markets and the expected long-term increased costs of credit to consumers and small businesses. Those analyses should inform the Agencies' deliberations as the rulemaking process moves forward. The recent economic figures issued by the federal government showing the weakness of the economic recovery provide an additional reason for the Agencies to take the time to reach the best balance in the rule. Otherwise, the markets will continue to display a lack of confidence that securitization will provide an ongoing funding option for businesses dependent on the creation of consumer and other receivables.

We provide below our comments on the proposal as we understand it. Our concerns fall into the following general categories:

- The proposal lacks sufficient clarity concerning the measure of the retained risk such that the industry is unable to provide meaningful comments on the feasibility and economic impact of the proposal. In addition, the proposal needs many wholesale revisions, and we have provided detailed comments on those aspects which we believe are flawed. For both of these reasons, the Associations believe that a re-proposal is both necessary and critical to ensure that the final outcome is both well understood by all parties and workable for the numerous types of assets that are securitized. Given the cumbersome and, no doubt lengthy, process for interpretations of a final rule, it is absolutely essential that the industry be given the opportunity to comment on a clearly understood proposal so that a final rule does not raise an undue number of interpretive questions.

- The Agencies should conduct appropriate economic analyses to evaluate the impact of this or any other version of the proposal on (1) the securitization market and (2) the availability and pricing of credit to both businesses and consumers.
- The QRM standard should be redefined to give due consideration to the effects it will have on the availability and price of mortgage credit to low- and moderate-income applicants.
- The PCCRA should be eliminated if securitization is to be restored as a viable funding source.
- The various permissible forms of risk retention should be restructured and additional options included to make them workable.
- The risk retention requirement should sunset a reasonable time after the asset is originated given the declining relevance of the original underwriting on loan performance as years go by.
- The other qualified asset exemptions provided in the proposal must be re-written to ensure that they are workable.

Collectively, we believe the necessary changes are so substantial as to warrant a re-proposal after additional consultation with industry participants. Given the time-consuming and burdensome interagency process specified in the proposal for seeking interpretations, exceptions, waivers, *etc*., it is imperative that the Agencies provide final rules that are clear and straightforward to ensure that the industry will be able to understand what is required of it and be able to comply.

While Congress sought to strengthen underwriting standards and properly align incentives in the securitization market, it sought to do so to ensure that the private securitization market would be a robust source of funding. As drafted, the proposal will only end up unduly restricting credit for consumers and businesses, to the overall detriment of our economy. Accordingly, it is critical that the Agencies balance the development of risk retention requirements with the need to ensure that the private securitization market is restored as a viable funding mechanism A re-proposed rule, developed with industry input and proper economic analyses, will not hinder the return of the private securitization market and will help loan originators to provide credit – and particularly mortgage credit – to borrowers at a reasonable cost.

We note further that revitalization of the private RMBS market is a crucial element in the current national policy debate over the future of Fannie Mae and Freddie Mac and the objective of significantly reducing reliance on them. There is a growing consensus that efforts must be undertaken to reinvigorate the private RMBS market and begin a measured reduction of the role of the GSEs in the marketplace. The rule as proposed would make this more difficult by essentially ceding large segments of the RMBS market which do not meet the Qualified Residential Mortgage exception to the GSEs for the foreseeable future.

BACKGROUND

The Dodd-Frank Act was enacted in the wake of the financial crisis that exposed substantial flaws in the securitization processes of originating, packaging, rating, structuring and selling ABS, particularly those collateralized by residential mortgages. Congress intended Section 941 to incent participants in the securitization processes to improve underwriting practices and align the interests of those participants more closely with the interests of investors. Congress further directed the Agencies to provide for a range of exceptions that, among other criteria, ". . . *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."[7] [Emphasis added.] Indeed, while it is clear that Congress was concerned primarily with the "originate to distribute" model for securitization of residential mortgages,[8] Congress recognized in Section 941 that asset classes other than RMBS could warrant differing exemptions or treatment.

> The Committee expects that these regulations will recognize differences in the assets securitized, in existing risk management practices, and in the structure of asset-backed securities, and that regulators will make appropriate adjustments to the amount of risk retention required…. The Committee believes that regulators should have flexibility in setting risk retention levels, to encourage recovery of securitization markets and to accommodate future market developments and innovations, but that in all cases the amount of risk retained should be material, in order to create meaningful incentives for sound and sustainable securitization practices.[9]

To achieve that alignment and incent prudent underwriting, Section 941 requires the Agencies to jointly implement rules to require sponsors to retain an economic interest of not less than five percent of the *credit risk* for any asset-backed security[10] unless the originator meets underwriting standards to be prescribed by the Agencies. The sponsor may not hedge the retained interest with respect to credit risk.

In addition, however, the Dodd-Frank Act directly addressed mortgage underwriting standards in Title XIV which requires the establishment of an "ability to repay" standard and exceptions for a "Qualified Mortgage."[11] The American Bankers Association has filed comments on proposed rules implementing these provisions recommending the establishment of a safe harbor for those

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[7] Section 941(e)(2)(B).
[8] FDIC Press Release, Statement of FDIC Chairman Bair on Credit Risk Retention Notice of Proposed Rulemaking (March 29, 2011), available at http://www.fdic.gov/news/news/press/2011/statement03292011.html.
[9] *See*, Senate Report No. 111-176,at 130, available at http://banking.senate.gov/public/_files/Comittee_Report_S_Rept_111_176.pdf.
[10] Section 941 establishes an alternative definition of "asset-backed security" (an "Exchange Act ABS") that is broader than the existing definition set forth in the Commission's Regulation AB as well as a definition for the term "securitizer" which is, generally, an issuer of Exchange Act ABS or a person who organizes and initiates an Exchange Act ABS transaction by transferring assets to the issuer.

[11] Dodd-Frank Act Title XIV, Sections 1411, 1412 and portions of 1414.

loans on which the lender has demonstrated sound underwriting and a documented ability to repay the loan.[12]
Congress further directed both the Federal Reserve Board and the Treasury Department, in coordination with the Financial Stability Oversight Council, to conduct studies of the impact of the risk retention requirements[13]

The proposal provides a range of permissible forms of retention that sponsors may choose from in meeting the risk retention requirements including:

- Retention of a "vertical slice" of each class of interest issued in the securitization;
- Retention of an "eligible horizontal residual interest" in the securitization;
- Use of "L-shaped" risk retention, which combines both vertical and horizontal forms;
- In the case of revolving asset master trusts, retention of a "seller's interest" that is generally *pari passu* with the investors' interest in the revolving assets supporting the ABS;
- Retention in its portfolio of a "representative sample" of assets equivalent to the securitized assets; and
- Other risk retention options that purport to take into account the manner in which risk retention often has occurred such as in connection with the issuance of commercial mortgage-backed securitizations (CMBS).

The proposal also mandates a premium capture cash reserve account, which requires any proceeds from an issuance in excess of par value to be placed in a cash reserve account at the time of issuance. These cash funded amounts absorb all losses for the life of the transaction.

The proposal sets forth various exemptions, including exemptions based on certain "qualified" loans such as the QRM and qualifying automobile loans, qualifying commercial real estate loans and qualifying commercial loans and certain resecuritizations. As required by Section 941, the proposal also prohibits the sale or transfer of the retained interest by the sponsor except to a consolidated affiliate, and generally prohibits hedging by the sponsor, a consolidated affiliate or the issuer with respect to the credit risk of the retained interest. However, hedging against interest rate risk would be permitted.

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[12] See ABA Comment letter on Ability to Repay/Qualified Mortgage proposal available at http://www.aba.com/NR/rdonlyres/DC65CE12-B1C7-11D4-AB4A-00508B95258D/72928/cl_RegZ2011July.pdf

[13] *See* FRB Report; Timothy F. Geithner, Chairman, Financial Stability Oversight Council, *Macroeconomic Effects of Risk Retention Requirements* (January 2011 (FSOC Study), available at Retention Requirements (January 2011) available at

http://www.treasury.gov/initiatives/wsr/Documents/Section%20946%20Risk%20Retention%20Study%20%20(FINAL).pdf

DISCUSSION

1 THE AGENCIES SHOULD RE-ISSUE THE PROPOSAL

The Associations strongly believe that the proposal is so unclear with respect to critical provisions that industry participants cannot provide fully reasoned, meaningful responses to the Agencies with respect to those provisions. In particular, the intent of the Agencies with respect to measurement of the interests required to be retained through par value or market value is not at all understood by the industry. It is unclear exactly what meaning the Agencies themselves ascribe to the term “par value,” which is undefined in the proposal. In industry parlance, “par value” is the equivalent of the “face value” of bonds. However, in discussions with the industry, it seems that the Agencies may be using the term to mean “market value.” This valuation is critical to determining the amount of the retained interest required to be held if the issuer chooses the horizontal, L-shaped, ABCP originator-seller and CMBS B-piece buyer forms of retention. This valuation is, in turn, critical to assessing the economic viability of future securitization transactions that will have to comply with these rules, particularly with respect to the premium capture cash reserve account.

In addition, the proposal needs many wholesale revisions, and we have provided detailed comments on those aspects which we believe are flawed. For both of these reasons, the Associations believe that a re-proposal is both necessary and critical to ensure that the final outcome is both well understood by all parties and workable for the numerous types of assets that are securitized. Given the cumbersome and, no doubt lengthy, process for interpretations of or adjustments to a final rule, it is absolutely essential that the industry be given the opportunity to comment on a clearly understood proposal so that a final rule does not raise an undue number of interpretive questions.[14]

While we appreciate the extension of the comment deadline, that extension does nothing to mitigate the lack of clarity in the proposal. The Congressionally mandated deadline has now passed, and we believe the better course of action by far is to ensure that there is a clear understanding of Agencies’ intent with respect to the rules implementing Section 941. Because these rules are of such extraordinary complexity with broad consequences for the entire securitization market and, indeed, borrowers and the economy, we believe it imperative that the Agencies take the time necessary to ensure that the rules do not cripple the private securitization market. Accordingly, we urge the Agencies to withdraw the current proposal or, alternatively, treat it as an advance notice of proposed rulemaking.

We further urge the Agencies to establish a dialogue with industry participants, such as through roundtables on particular asset classes, and re-propose the regulations in a manner that is straightforward and clear to facilitate compliance by the industry. As the FSOC Study concluded,

[14] *See*, 76 *Fed. Reg.* 24090 at 24097.

the risk retention rules should "[p]rovide greater certainty and confidence among market participants" with clear rules to help them accurately price risk.[15]

2. THE AGENCIES SHOULD CONDUCT ECONOMIC ANALYSES OF THE COSTS AND BENEFITS OF THE PROPOSAL

The Associations believe that the Agencies should conduct economic analyses of the costs and benefits of the proposed regulation, with particular focus on the impact on consumers. On one hand, it is clear that borrowers and investors in the securitization markets will benefit from the improved underwriting standards that are the key goal of the risk retention requirement of Section 941. However, those benefits will extend broadly across the economy only if the costs attendant to risk retention lead to a revitalized securitization market that can provide the credit needed to fuel our economy. While Congress clearly envisioned reforms to the securitization market generally, and the RMBS market in particular, we do not believe their intention was to stifle this critical source of credit to the economy. Rather, we believe Congress was fully cognizant of that fact that banks simply do not have the capacity to fund the economy's credit needs through deposits.

Indeed, Congress indicated the need to balance the costs and benefits of the risk retention requirement in the standards included in Section 941 which directed the Agencies to ensure that exemptions not only ensure high quality underwriting but also "improve the access of consumers and businesses to credit on reasonable terms."[16] In addition, the FSOC Study, stated that "[a]s the Agencies promulgate regulations for risk retention as required by Section 941, they should seek to develop a framework that will balance the benefits of risk retention against its potential costs— incentivizing originators and securitizers to be conscious of the risk in the underlying assets that they are originating or distributing, while not unduly raising the cost of credit."[17] The FRB Report also raised concerns about the impact on small originators, urging the Agencies to "[c]onsider the potential effect of credit risk retention requirements on the capacity of smaller market participants to comply and remain active in the securitization market.[18] Yet, the proposal does not contain in-depth analyses of the concerns set forth in both the FSOC Study and the FRB Report.

As discussed more fully herein, the Associations believe that the proposal will reduce the availability of credit, particularly to low-income consumers. It is widely recognized that the imposition of risk retention requirements will increase the cost of credit generally. However, the Associations believe that the narrowly drawn exemptions included in the proposal in conjunction with the imposition of the PCCRA are likely to make many securitization transactions

[15] FSOC Study at 18.
[16] Section 941(3)(2)(B). *See also*, Senate Report No. 111-176 at 130.
[17] FSOC Study at 18.

[18] FRB Report at 84.

uneconomical. This is particularly the case with the restrictive QRM exemption, which will have a harmful impact on consumers who, although creditworthy, cannot meet the QRM standard and will find credit available only at higher rates.

Accordingly, before proceeding further, the Associations strongly urge the Agencies to conduct the economic analyses necessary to determine the impact of the proposal on the availability and costs of credit to consumers and businesses.

Finally, we note that on July 11, 2011 President Obama signed an Executive Order directing "independent regulatory agencies", including the Securities and Exchange Commission, the Board of Governors of the Federal Reserve System, and several other[19] federal agencies, to comply, to the extent permitted by law, with Executive Order 13563.[20] That Executive Order directed federal agencies, other than independent regulatory agencies, to engage in a cost-benefit analysis, with the participation of the public, of proposed and existing regulations and to develop means to better coordinate regulation across multiple agencies. We believe these Executive Orders provide additional support for our request for appropriate economic analyses of the proposal.

3. THE AGENCIES SHOULD CONSIDER THE INTERACTION OF RISK RETENTION WITH OTHER REGULATORY REQUIREMENTS

The Associations strongly believe that, in addition to the specific requirements of Section 941, the Agencies must take into consideration the interaction of other factors which will affect the impact of the risk retention rules on market participants and, ultimately, borrowers. Indeed, as stated in the FRB Report, "Retention requirements that would, if imposed in isolation, have modest effects on the provision of credit through securitization channels could, in combination with other regulatory initiatives, significantly impede the availability of financing. In other instances, rulemakings under distinct sections of the Act might more efficiently address the same objectives as credit risk retention requirements."[21]

For example, with respect to mortgages, the risk retention proposal cannot be viewed in isolation from the numerous other rules that have been adopted that affect not only the underwriting requirements for loans, but more broadly dramatically increase the likelihood that those mortgage loans that are made will be repaid. These include most notably, the "qualified mortgage" provision in DFA Title XIV that will establish "ability to pay" criteria for mortgages, mortgage loan officer compensation, escrows, appraisals, TILA changes and others. These various rules are addressed more fully in our discussion of the Qualified Residential Mortgage exemption.

[19] The text of the Executive Order is available at http://www.whitehouse.gov/the-press-office/2011/07/11/executive-order-regulation-and-independent-regulatory-agencies.
[20] The complete text of Executive Order 13563 is available at http://www.whitehouse.gov/the-press-office/2011/01/18/improving-regulation-and-regulatory-review-executive-order.

[21] FRB Report at 84.

Beyond regulations directly impacting classes of collateral, the risk retention requirements will necessarily interact with current and future regulatory capital and accounting requirements. As a result, a risk retention requirement that, on its face, appears to be workable, may nonetheless make securitization transactions economically unfeasible. One such example is the additional retention that would be imposed under the PCCRA as drafted, which would lead to consolidation on a bank's balance sheet of securitized assets, with attendant implications for additional required capital. In addition, concerns have been raised about whether transactions for which a PCCRA is required will qualify for a legal true sale opinion. Such opinions are a critical element of a securitization transaction to assure investors that the collateral is bankruptcy remote, i.e., that if the sponsor files for bankruptcy, the collateral is not part of the sponsor's bankruptcy estate. For many law firms providing such opinions, the amount of the retained interest will be a key factor in whether they can provide a true sale opinion. In addition, the inability to transfer the retained interest and limited financing options are significant factors that are considered in whether a true sale opinion may be given.

4. THE QUALIFIED RESIDENTIAL MORTGAGE STANDARD SHOULD BE REDEFINED

Section 941 of the Dodd- Frank Act requires the regulators to jointly define a "qualified residential mortgage" or QRM. Securities backed exclusively by assets meeting the QRM definition will be exempt from risk retention requirements. The regulators were charged with taking into consideration "underwriting and product features that historical loan performance data indicate result in a lower risk of default."

As a general rule, we believe that the QRM standard needs to be reconsidered and re-proposed to conform more closely to the Qualified Mortgage (QM) standard proposed by the Federal Reserve Board and which will ultimately be implemented by the Consumer Financial Protection Bureau (CFPB). We note that Section 941 of Dodd/Frank requires that the QRM definition cannot be broader than the QM definition and question the rationale and appropriateness of seeking to define QRM before the QM has been finalized. Logic would seem to dictate that before a subset (the QRM) can be determined, the full set (QM) must be firmly established. While a rule certainly can be implemented before the QM is finalized and then altered when the QM rule is finalized, a better public policy approach would be to ensure that a workable QM definition is in place before attempting to implement a QRM subset.

Beyond the public policy argument for defining QM prior to defining QRM, we also believe that the QRM definition should much more closely track the QM definition. At their core, both definitions were intended to improve underwriting – largely through better determinations of borrowers' ability to repay and through restrictions on loan features to more traditional, simplified and understandable attributes. The QM will ultimately define the outer boundaries of what constitutes an acceptable loan – loans going beyond the QM definition will carry such potential severe liability that they are unlikely to be made. While the QRM was envisioned as a high quality, low risk subset of loans, regulation and market forces have so narrowed the scope of lending that most loans being made today are safe, sound and low risk loans. It is therefore arguable that virtually all loans falling into the QM category should also qualify for QRM status. If the universe of loans is now well underwritten, without non-traditional or dangerous features, and which pose low risk to borrowers, it is hard to justify quarantining off a further subset of loans into a QRM status – resulting in higher costs and less credit availability.

Further, the QM proposal is far superior in many aspects to the QRM proposal in that the QM proposal provides underwriting discretion to loan originators while the QRM proposal leaves originators little discretion. Where the QM proposal requires originators to establish and document a borrower's ability to repay using a range of measurements – including debt to income ratios, employment status and history and credit history, the QRM rule uses a hard and fast formulation – including a minimum 20 percent down payment, strict debt-to-income ratios, and severe and narrowly defined credit history restrictions. The QRM approach replaces traditional underwriting with a strict formula which can potentially result in perverse outcomes where borrowers who are a poor credit risk nevertheless qualify for QRM status while others who are good credit risks cannot qualify.

The QRM as proposed will restrict credit and increase borrower costs unnecessarily. If applied broadly, most loans currently being made would not qualify for QRM status thereby increasing costs for borrowers and limiting credit. While credit MAY be available for those who cannot meet the QRM, it will come at a higher cost reflecting the costs to originators and securitizers in retaining the 5 percent risk.

The QRM also ignores changes already made in the marketplace (and required under new regulations and statutes), such as new appraisal standards, Truth in Lending Act changes, Loan Originator compensation rules, Higher Priced Mortgage Loan rules, the Mortgage Disclosure Improvement Act, the SAFE Act (requiring loan originator licensing or registration), as well as major disclosure changes under the Real Estate Settlement Procedures Act and others. The result of these changes is that most loans originated today are well underwritten, high quality loans. Nevertheless, most loans still would not qualify for QRM status if applied as proposed.

A recent Andrew Davidson and Co. study of recent vintage (high quality) Freddie Mac portfolio loans indicates that only approximately one third would qualify for QRM status if applied today.[22] The Federal Housing Finance Authority (FHFA) also has data reaching a similar conclusion and confirming that the recent vintage GSE book of business is high quality with only a small probability of default.[23] We note as well that the number of mortgage loans identified in these studies as being eligible for the proposed QRM status would have been close to zero had those studies identified loans with underlying documents containing the required servicing standards as loan documents.

[22] See Andrew Davidson and Co. Pipeline Issue 97, May, 2011 available at: http://www.aba.com/aba/documents/MortgageLending/DavidsonMemoMay2011.pdf.
[23] See FHFA Mortgage Market Note 11-02 of April 11, 2011 available at: http://www.fhfa.gov/webfiles/20686/QRM_FINAL_ALL_R41111.pdf.

Our following comments discuss the specific criteria included in the proposed QRM definition and which the vast majority of our members believe are overly restrictive and do not comply with the statutory intent behind risk retention. We urge that the entire approach to QRM be reconsidered and more closely aligned with the QM proposal. We offer these comments on the specifics of the proposal to better delineate our concerns and to demonstrate why the adoption of an approach closer to the QM proposal should be considered.

a. Down payment requirements

The proposal requires a high down payment requirement of 20 percent, with even higher levels of 25 percent for refinance loans and 30 percent for cash out refinance loans.

The high down payment requirements run counter to the intent of Congress, which specifically considered and rejected including a down payment requirement in the statute. It is notable that the sponsors of the QRM provisions, Senators Landrieu, Hagan and Isakson wrote to the regulators on February 19, 2011 stating "although there was discussion about whether the QRM should have a minimum down payment, in negotiations during the drafting of our provision, we intentionally omitted such a requirement." Additionally, on May 26th of this year, those Senators, joined by over 350 Members of the House and Senate, sent a letter to your agencies indicating that the QRM requirements on down payments went beyond Congressional intent and were too restrictive.[24]

Regardless of the rather clear Congressional intent against including down payment requirements, the proposal includes such a requirement. The FAQ's accompanying the proposal argue that "Default rates increase noticeably among loans used to purchase homes with loan-to-value ("LTV") ratios above 80 percent. The precise size of this increase and the LTV ratio at which it occurs are likely to vary 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."

Unfortunately, the regulators have not been willing to make publicly available the data referenced in the FAQs so respondents are left in the position of attempting to prove a negative. While it may be true that loans with higher LTVs have poorer performance than those with lower LTVs, the fact that this performance varies over time (as the FAQs admit) suggests that performance may in fact hinge upon other factors than LTV. For instance, better underwritten and documented loans with higher LTVs perform better than poorly underwritten and documented loans, regardless of LTV. Using LTV as a major linchpin in determining qualification for QRM status – without providing significant data – is therefore questionable at best, especially when taking into consideration the negative impact such a requirement will have on borrowers' ability to meet such an LTV test.

[24] See Congressional letter of May 26, 2011 available at: http://hagan.senate.gov/files/images/SenateQRMLetter.pdf.

Borrowers who maintain good credit but who lack substantial down payments will be forced into more expensive mortgages under the proposal. Loans falling outside the QRM designation will require more capital and additional costs associated with the retention of risk. These costs will be passed on to borrowers (if the private market even offers loans outside of the QRM standard).

The Center for Responsible Lending (CRL) has determined that, based upon the latest available data, it would take the average American Family 16 years to save a 20 percent down payment – assuming that the family directs every penny of savings toward the down payment. The following table from CRL details the savings needed for a family with the 2010 average annual income of $50,474 to purchase a home valued at $172, 900 (the average median 2010 home price according to the National Association of Realtors). If the family saved $2625 per year (at a 5.2% savings rate – the current annual savings rate) it would take that family 16 years to be able to make a down payment of 20 percent.

Table 1

Years for Median Income Family to Save for Down Payment

	20% Down Payment	10% Down Payment	5% Down Payment	3.5% Down Payment
Median Sales Price	$172,900	$172,900	$172,900	$172,900
Down payment + Closing Costs (est. @ 5%)	$41,496	$25,071	$16,858	$14,394
# of Years Needed to Save @national saving rate of 5.2% of gross household income ($2625per year)	16 years	9.5 years	6.5 years	5.5 years

Source: Center for Responsible Lending Issue Brief, *Don't Mandate Large Down Payments on Home Loans*.

The effect will be to drive otherwise credit worthy borrowers to higher cost loans or to government backed loan program like FHA or temporarily at least to Fannie Mae and Freddie Mac loans while in conservatorship – an outcome which raises other problems detailed below.

The proposed rule runs counter to the Congressional intent of improving underwriting, instead imposing an underwriting requirement that is so onerous that it will increase costs, or deny credit entirely, or force otherwise credit worthy borrowers into already over strained government backed programs.

The proposal would also harm existing homeowners who wish to refinance. CoreLogic, Inc. has determined that nearly 25 million current homeowners would be shut out of the QRM definition (and thus face higher costs or inability to access credit) because they do not have 25 percent equity in their home.

While there is no debate that higher down payments result in better loan performance, *ceteris paribus*, there is also ample evidence to show that low down payment mortgages which are well underwritten and documented have more than manageable default rates. Both Moody's Analytics and CoreLogic, Inc. have demonstrated that lower down payment requirements have only moderate impact on default rates, while changes to other underwriting and loan features, such as reduced documentation, subprime credit and negatively amortizing loans have dramatically more likelihood of increasing defaults.

The table below from Moody's Analytics shows how foreclosure risk increases according to certain loan attributes.

Table 2:

Incremental Foreclosure Risk by Loan Attribute

Negatively amortizing ARM	3-4 times
Reduced documentation	3 times
Subprime credit	2-3 times
Non-owner occupied	2-3 times
Amortizing ARM	1.5-2 times
Over 45% total debt-to-income	1.5 times
Cash-out refinance	1.5 times

Incremental risk relative to the performance of the base loan shown in Table 1 that is similar in all respects except for the risk factor being analyzed.

Source: MGIC

The following data from CoreLogic, Inc. shows the effect of increasing the down payment requirement from five percent to 10 percent and from five percent to 20 percent on loans made between 2002 and 2008, and the impact such increases would have on borrowers' ability to meet the QRM definition.

While the reduction of the default rate is minimal (especially compared with the changes in default rates based upon other loan attributes as detailed by Moody's), the impact on borrowers' ability to meet QRM is dramatic.

Table 3

QRM: Impact of Raising Down Payments Requirements on Default Rates and Borrower Eligibility

Origination Year	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Reduction in default rate* by increasing QRM down payment from 5% to 10%	0.2%	0.1%	0.3%	0.3%	0.2%	0.5%	0.2%
Proportion of borrowers not eligible for QRM by moving from 5% to 10% Down	5.2%	4.3%	5.5%	4.6%	4.8%	6.7%	5.7%
Reduction in default rate* by increasing QRM down payment from 5% to 20%	0.6%	0.3%	0.7%	0.8%	0.8%	1.6%	0.6%
Proportion of borrowers **not eligible** for QRM by moving from 5% to 20% Down	16.9%	14.5%	19.4%	19.2%	19.1%	20.1%	18.0%

* Default = 90 or more days delinquent, plus in process of foreclosure, plus loans foreclosed.

The proposed QRM ignores compelling data that demonstrate that sound underwriting and product features, like documentation of income and type of loan, have a much larger impact on reducing default rates than do high down payments. ABA's member banks support sound underwriting taking into account all borrower attributes, of which the down payment amount is a significant but not necessarily decisive factor. In general, we believe that a reasonable minimum down payment amount similar to that currently being required by the Federal Housing Administration should be considered. Requirements greater than this put homeownership too far out of reach for otherwise qualified borrowers. Therefore, we urge that the down payment requirements be reconsidered.

b. Mortgage Insurance

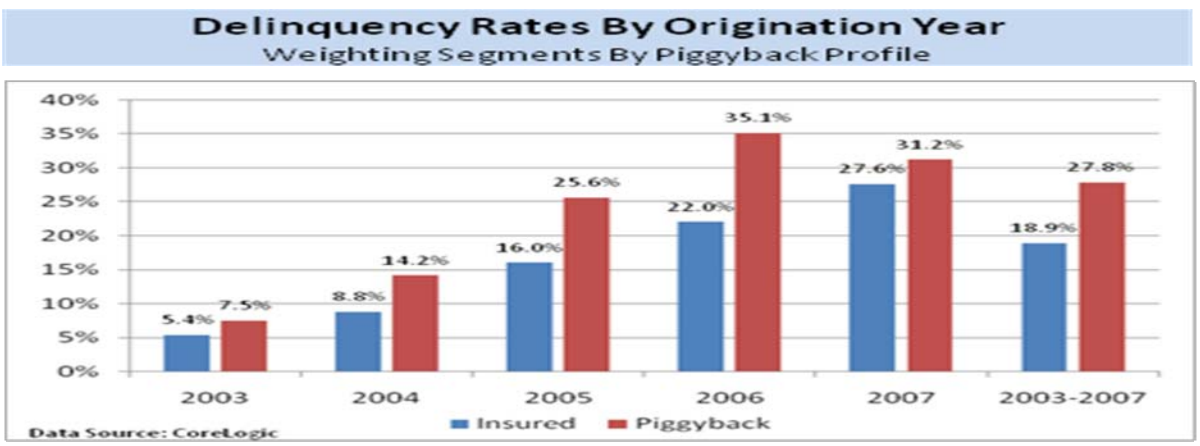
In crafting the QRM, Congress directed the Agencies to take into consideration "product features that historical loan performance data indicate result in a lower risk of default, such as… (iv) mortgage guarantee insurance or other types of insurance or credit enhancement obtained at the time of origination, to the extent such insurance or credit enhancement reduces the risks of default.[25] However, the Agencies claim that they considered the role of private mortgage insurance (PMI) but found that it does not reduce the potential for borrower default and thus ignored the existence of PMI as a factor in a loan qualifying for QRM status.

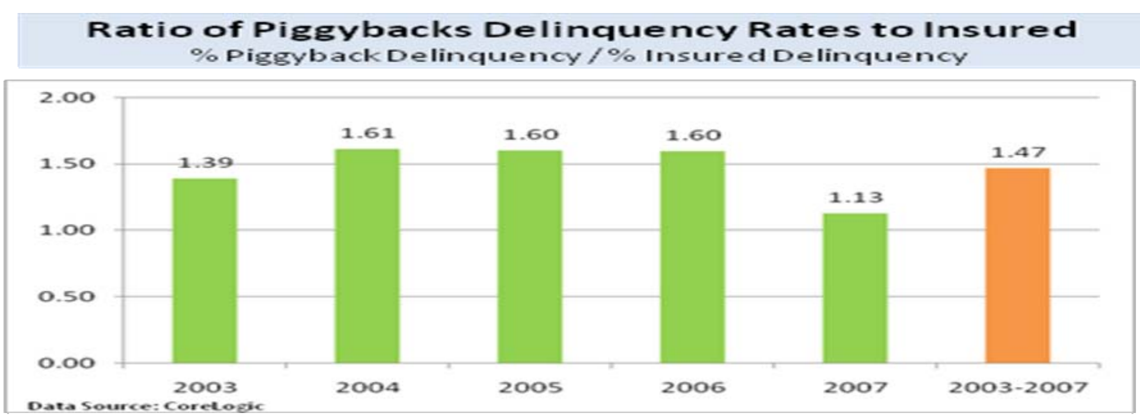
As an initial matter, the very phrasing of the statute suggests that Congress believed PMI to reduce the likelihood of default and that it should have an impact on whether a mortgage is granted QRM status. This interpretation is supported by the fact that over 163 Members of the House of Representatives wrote on May 31, 2011, a letter noting that "the law recognizes that

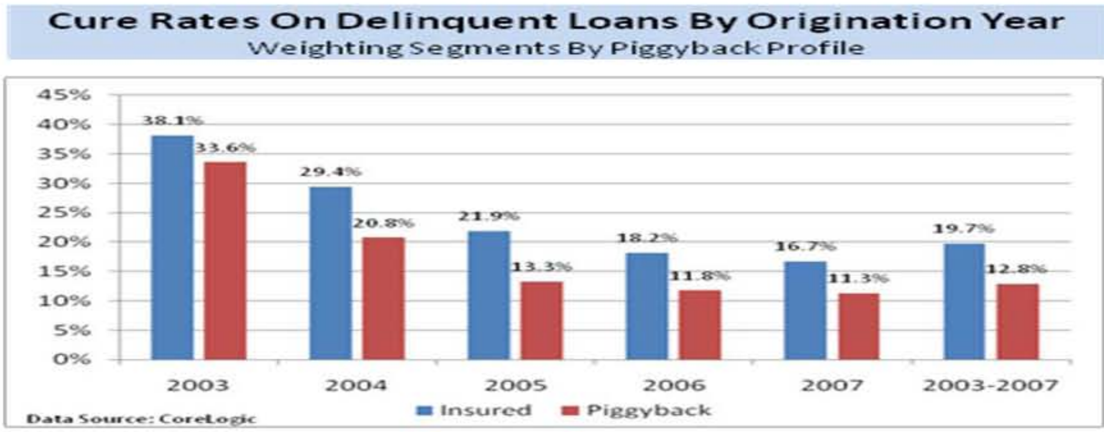
[25] 15 U.S.C. Sec. 78o-11(e)(4)(B).

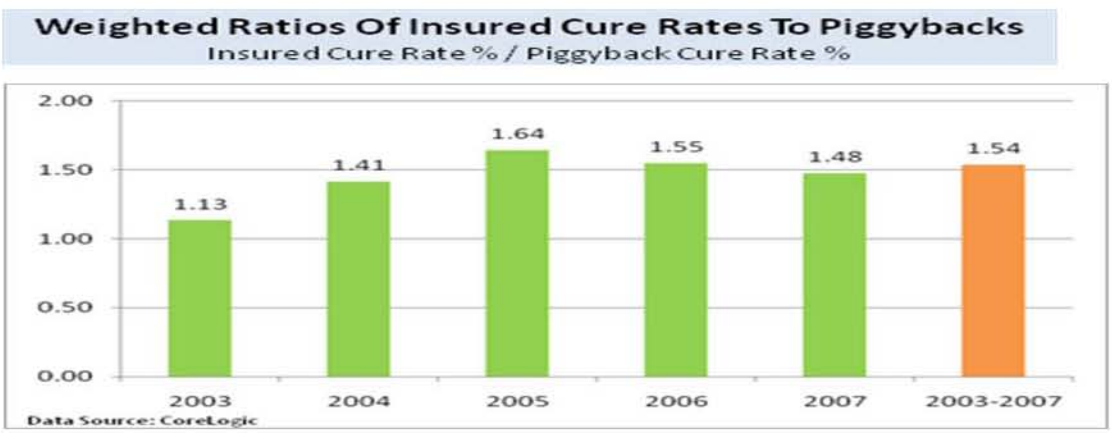
private capital does not exclusively come from a lender or an investor, it can be provided by a private mortgage insurer. The QRM regulations should reflect this important reality, which was Congress' intent in clarifying this point in the Act." Even the Agencies acknowledge that PMI has at the very least an indirect impact on protecting borrowers from default. This is because mortgage insurers' independent underwriting standards provide greater credit risk discipline for lenders and serves as a second underwriting for PMI loans. In addition, private capital committed by PMI provides an incentive to work with borrowers and investors to prevent foreclosures.

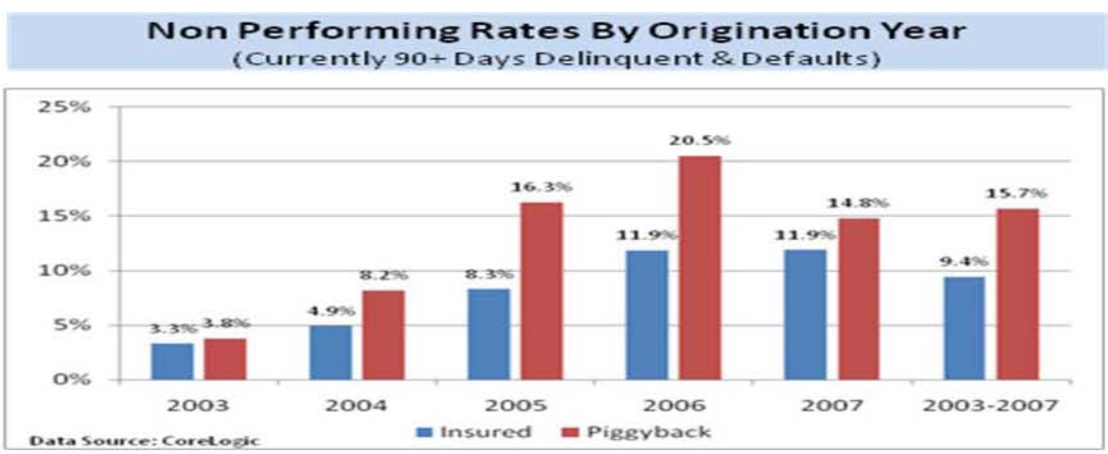
Perhaps more important than Congressional intent - the Mortgage Insurance Companies of America (MICA) has put forward data (also from CoreLogic) which shows that on low down payment loans, those with PMI have a lower risk of default than comparable piggyback (uninsured) loans. According to the MICA data, insured loans became delinquent 32 percent less frequently, cured 54 percent more frequently, and have performed 65 percent better than comparable piggyback loans.

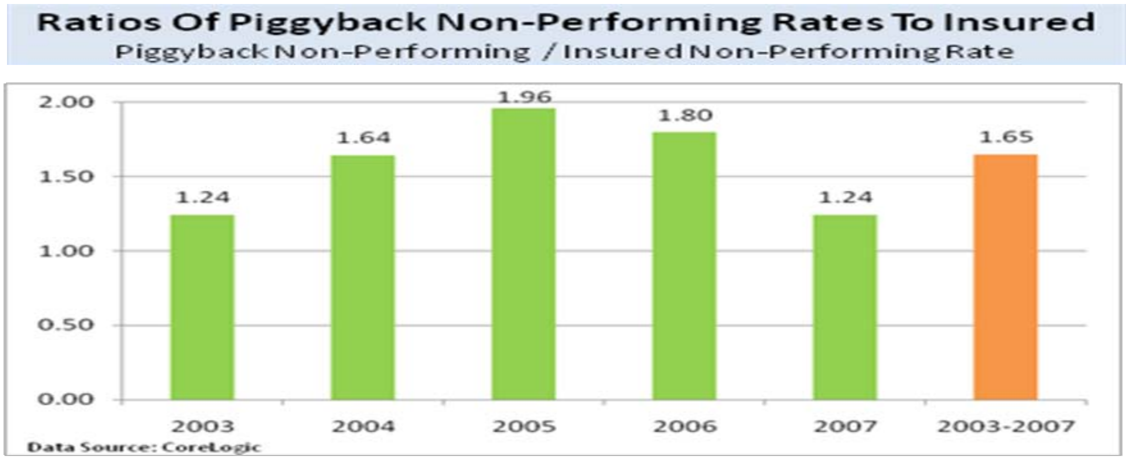





Cure Rates On Delinquent Loans By Origination Year
Weighting Segments By Piggyback Profile
45%
40%
35%
30%
25%
20%
15%
10%
5%
0%
38.1%
33.6%
29.4%
20.8%
21.9%
13.3%
18.2%
11.8%
16.7%
11.3%
19.7%
12.8%
2003
2004
2005
2006
2007
2003-2007
Insured
Piggyback
Data Source: CoreLogic


Weighted Ratios Of Insured Cure Rates To Piggybacks
Insured Cure Rate % / Piggyback Cure Rate %
2.00
1.50
1.00
0.50
0.00
1.13
1.41
1.64
1.55
1.48
1.54
2003
2004
2005
2006
2007
2003-2007
Data Source: CoreLogic


Non Performing Rates By Origination Year
(Currently 90+ Days Delinquent & Defaults)
25%
20%
15%
10%
5%
0%
3.3%
3.8%
4.9%
8.2%
8.3%
16.3%
11.9%
20.5%
11.9%
14.8%
9.4%
15.7%
2003
2004
2005
2006
2007
2003-2007
Insured
Piggyback
Data Source: CoreLogic



Given both this data and the clarification of Congressional intent, we strongly urge the regulators to reconsider the applicability of private mortgage insurance as a factor in determining QRM status. PMI provides significant benefit in offsetting potential losses and in helping borrowers with low down payments qualify for loans. It should be considered as an offsetting factor which might help to reduce down payment requirements for QRM status.

c. Debt to income ratios

The proposed QRM definition requires a borrower to have a "front-end" debt-to-income ratio (the ratio of the borrower's monthly housing debt to the borrower's monthly gross income) that does not exceed 28 percent. The borrower's back end ratio (total monthly debt to monthly gross income) cannot exceed 36 percent. The Associations believe that these ratios are unworkable, and will result in QRM loans being more difficult and expensive for otherwise low risk borrowers to obtain. Instead of setting such hard and fast ratios, we strongly urge the regulators to provide for more lender discretion, and here the proposed QM standard should serve as the guide. Under the QM proposal, creditors must assess the consumer's repayment ability taking into account one of the following—the ratio of total debt obligations to income, or the income the consumer will have after paying debt obligations. The proposed QM rule does not identify maximum DTI or minimum residual income level; the proposal only states that the creditor may look to widely accepted government and non-government underwriting standards.

- Note that the creditor is permitted to use both a monthly DTI and monthly residual income test, and can choose which of these to consider in applying the ability-to-repay standard.
- The creditor may consider compensating factors to mitigate a higher DTI or lower residual income.
- Once again, creditors may use widely accepted government and non-government underwriting standards, but no specific standards are required.

In contrast, the proposed QRM rule sets such strict and inflexible standards, not just for DTI, but also for down payment and other factors, that the proposed rule effectively takes underwriting decisions away from the originator and replaces them with a strict formula which may result in unusual and inappropriate results. This is particularly true with regard to credit history issues as discussed in the next paragraph.

d. Credit history

The credit history restrictions included in the proposal are some of the most strict and severe in the proposal. Borrowers who are 30 days or more past due on any debt obligations would be ineligible for a QRM loan, as would borrowers who were more than 60 days past due on any debt obligation within the last two years. Additionally there are restrictions that borrowers would not qualify for a QRM loan if they had property repossessed or foreclosed upon or been a debtor in a bankruptcy case in the last three years. The proposal explains that the regulators determined, based upon historical data that the credit score of a borrower was a significant indicator ability to repay. We do not disagree with this assessment. However, we do disagree strongly with the criteria the proposal used to substitute for an actual credit score. We recognize and understand the regulators' reluctance to utilize any specific credit scoring mechanism provided by a privately owned entity as a factor in meeting regulatory requirements. It is not appropriate for a regulation to specify or mandate the use of any privately owned device, method or mechanism. However, it is not unreasonable for a regulation to stipulate that borrowers must meet certain minimum standards as demonstrated by the use of an empirically derived, demonstrably and statistically sound, credit scoring mechanism or mechanisms. Reliance on predictive analytics is already the accepted practice in the marketplace and has helped transform the industry into one that is marked by efficiency, objectivity and accuracy. If the QRM is to include credit history standards, then objective methodologies that meet empirically derived, demonstrably and statistically sound credit scoring mechanisms (including credit scores) should be a part of the final rule.

The proposal, in seeking to substitute the above listed criteria for credit scoring mechanisms, replaces correlation of credit score to default risk (which is widely accepted as known and proven) with correlation of default risk to specific credit history factors which cannot be shown to be known or proven. In fact, quite the opposite is true. One credit scoring company, Fair Isaac Corporation (FICO), has researched the QRM credit history standards and found them to be less than sufficiently predictive. In their research, they found that the minimum FICO score that met the QRM delinquency standards was as low as 472. The maximum FICO score that failed to meet the QRM delinquency standards was as high as 845. With a general FICO range between 300 (poor credit risk) and 850 (excellent credit risk) it is readily apparent that a borrower with a near perfect score of 845 should be QRM eligible, while one with a score as low as 472 should likely not qualify. The median FICO score for a US borrower today is 713. This demonstrates that the proposed approach could lead to the inclusion of many high credit risk borrowers as well as to the exclusion of borrowers who represent an excellent credit risk – the wrong result on both counts.

We also have great concerns about the impact of replacing automated underwriting (via a credit scoring mechanism) with a manual review of credit files, which compliance with the proposed rule would require. Doing so will impose increased expenses on lenders, which ultimately will be passed along to borrowers, increasing the cost of all loans. Doing so will also require more time, slowing the loan process, and likely will result in more human error, and less transparency in the securitization market.

For these reasons we recommend that the credit history criteria be eliminated from the definition of QRM. Instead, we recommend that the model followed in the QM proposal be adopted. Under the QM proposed rule, creditors may look to widely accepted governmental and non-governmental underwriting standards to define and verify "credit history." Creditors may consider factors such as the number and age of credit lines, payment history, and any judgments, collections, or bankruptcies. To verify credit history, a creditor may look to credit reports from credit bureaus, or other nontraditional credit references contained in third-party documents, such as rental payment history or public utility payments. The proposed QM standard provides lenders with a number of options for verifying credit history, and most importantly, does not require replacement of credit scoring mechanisms with specific credit history requirements which will increase compliance burden and likely reduce accuracy, transparency and effectiveness of credit history reviews.

e. Additional issues raised by the QRM proposal

In addition to the extensive concerns we have regarding the definition of the QRM, we also think it important to comment on two additional concerns raised by the proposed rule: the inclusion of loan servicing standards; and the impact of the proposed rule on the resolution of the conservatorship of the Government Sponsored Enterprises, Fannie Mae and Freddie Mac.

(1) Servicing standards

The Associations are gravely concerned with the inclusion of servicing standards for loans meeting the requirements of the QRM. Neither the legislative history nor the plain language of the Dodd-Frank Act provides any evidence that Congress intended to include servicing standards as a part of risk retention. Nevertheless, the proposed rule mandates that loan documents include policies and procedures that require commencement of loss mitigation efforts after 90 days of delinquency; allow for loan modifications if the resulting net present value would be greater than foreclosure; address how the lender will service any second lien loan on the same property (if the lender services both loans); and include servicing compensation arrangements that are consistent with the creditor's commitment to engage in loss mitigation activities. Lenders must also agree to not transfer servicing to any servicer who does not maintain such policies and procedures.

Simply stated, the QRM proposal is not the time or the place for these standards. As noted above, there is no legislative mandate to include them, and doing so runs counter to order and common sense. As the regulators have noted in the release accompanying the proposed rule, interagency guidance on servicing standards is being undertaken. To implement servicing standards as a part of this rule, for only QRM loans, takes a piecemeal approach that will have the ironic effect of imposing servicing standards only on the most high quality, low risk loans (if the goals of the QRM are met). Meanwhile, other loan products go without servicing standards, or may face different or conflicting standards when the guidance is rolled out. A far better approach would be to introduce such standards on a uniform and consistent basis and to provide notice and comment on a unified proposal.

Additionally, including servicing standards in the loan documents creates numerous problems which will likely increase the cost and reduce the availability of loans. Most mortgage lenders use loan forms tailored to the requirements of the GSEs and federal housing agencies. If different forms incorporating servicing standards are required for QRM loans, those loans will be more costly and less fungible, as it is unclear if loans with such terms will gain broad market acceptance. Lenders may be unwilling to adopt multiple forms and so may reject QRM loans, and investors may choose not to purchase QRM loans – or require a higher yield on QRM loans because of the uncertainty generated by the servicing requirements.

Finally, we would also note that imposing servicing standards as part of the QRM exacerbates concerns we have, which are expressed below, about the proposal driving loans to the GSEs. The proposal exempts loans sold to the GSEs during conservatorship from risk retention requirements – including the servicing standards. This will undoubtedly drive more business to the GSEs as loans sold to them will not have to comply with these standards. This puts the private market at a further disadvantage and makes revitalization of the private secondary market that much more difficult.

Servicing standards should be a matter of regulatory compliance only and should be applied across all loan types, not just QRM loans. As the proposal notes, federal regulators are in the process of developing uniform national standards. Imposing servicing standards under the QRM only complicates and undermines that effort. Servicing standards should be proposed and considered separately from the QRM definition.

(2) Impact on resolution of the conservatorship of the GSEs

As noted above, the proposed rule would exempt loans sold to Fannie Mae and Freddie Mac while they remain in conservatorship from the risk retention requirements, whether they meet the QRM definition or not. We acknowledge that this exemption is not unwarranted, given that the GSEs' guaranty is backed by the United States while they remain in conservatorship. Furthermore, we acknowledge that the exemption is necessary to ensure no further disruption in the fragile mortgage markets unless significant aspects of the underlying proposal – specifically the QRM definition and the premium capture requirement – are changed.

If the proposed rule is not significantly revised it will likely result in a tiered mortgage market where borrowers who have less than perfect credit or who do not meet the GSEs' standards will pay substantially more than those lucky enough to qualify for QRM status. QRM loans will likely carry the lowest interest rates, due to the fact that they will be perceived to have the best credit risks (whether that perception is true or not is another matter) and because they will be less costly to originate because they are exempt from risk retention. Borrowers who do not qualify under QRM or GSE standards MAY still be able to obtain credit, if originators are willing to hold those loans – or a percentage of the risk of those loans – on their books. Under the proposed rule, these borrowers may not actually be greater risks than QRM or GSE conforming borrowers, but instead may be borrowers with good credit history who simply do not fit the arbitrary QRM requirements included in the rule.

The extremely conservative terms of the proposed QRM definition (and, as discussed above, the fact that only approximately 30 percent of current GSE purchased loans would meet the credit criteria in that definition) combined with the risk retention requirements themselves, will provide a significant competitive advantage to the GSEs and will greatly inhibit the return of the private securitization market. Borrowers who do not qualify for QRM status, but who do meet GSE requirements will be able to borrow at a lower rate due to the GSE exemption. While this is good for borrowers – and necessary if the QRM is not altered – it is bad public policy if the goal is to re-engage the private market.

The proposed rule will make it vastly more difficult to end the conservatorship of Fannie and Freddie and to shrink FHA back to a more rational portion of the mortgage market.

In order to develop a healthy private mortgage market and reduce the role of the government in backing loans, private label loan securitizations will have to be fostered. But if Fannie and Freddie can now buy loans without risk retention, it will put private securitizers at a sizable disadvantage. Lenders looking for private securitizations will be required either to only make loans with at least 20 percent down, or hold risk against the loans they sell to private investors. If they have the option to sell to Fannie or Freddie without retaining risk and without meeting QRM, the market will certainly continue to favor the GSEs – at least as long as they remain in conservatorship. But that situation, everyone agrees, is unsustainable over the long term. That means that eventually these rules will apply to a much, much larger segment of the mortgage market. If and when that happens fewer borrowers will qualify for loans to purchase or refinance a home.

Thus, the proposal grants a large segment of the residential mortgage market to the GSEs for the foreseeable future and perpetuates their market dominance.

A more prudent and logical course would be to subject the GSEs to a substantially revised risk retention proposal which properly aligns the requirements of both QRM and GSE eligibility standards – based, as we have argued elsewhere in this comment, on the standards set forth in a final QM/Ability to Repay rule. There may be reasonable distinctions made between the QM qualifying loans and QRM loans (such as a minimum down payment requirement for QRM loans), but the QRM subset should not be dramatically smaller than the QM set. Furthermore, the GSE qualifying standards should ultimately be virtually the same as the QRM standards, based upon the premise that assets which are safe enough for purchase by the GSEs (and backed by U.S. taxpayers) should also be safe enough to be sold to sophisticated investors without additional risk retention. To do otherwise cedes a significant portion of the RMBS market to the GSEs (and prolongs their conservatorship) for the foreseeable future.

Finally, the proposed exemption for loans sold to Fannie Mae and Freddie Mac also flies in the face of Congressional intent, as the Dodd/Frank Act specifically did not exclude the GSEs from risk retention requirements. It is only the conservatorship status which allows the regulators the "free pass" to exempt much of the current mortgage market from the overly restrictive QRM requirements.

This is simply one more reason that the proposed rule should be withdrawn and re-proposed after the QM definition is finalized, which will ultimately define the mortgage market. When the rule is re-proposed, it should be much closer in content and approach to the QM rule as currently proposed.

5. PERMISSIBLE FORMS OF RISK RETENTION

The Associations appreciate the Agencies' efforts to provide flexibility in the permissible forms of risk retention and to accommodate existing securitization structures. Nonetheless, we believe substantial modifications will be required to ensure that industry participants are able to comply with the regulatory requirements. Critically, as discussed below, we strongly believe the premium capture cash reserve account should be eliminated if we are to restore a robust private securitization market.

In particular, while Section 941 applies the risk retention rules to all ABS, not just to MBS, we believe the performance of non-MBS sectors should be given significant weight in the Agencies' deliberations and use of their exemptive authority. Risk retention requirements that may be appropriate and feasible in mortgage securitizations may be wholly inappropriate for securitizations of other types of assets with entirely different securitization processes and structures and that did not experience the problems that existed in MBS market. Indeed, a number of asset classes performed as would be expected during such a severe economic downturn, but are now near pre-crisis levels. The Agencies should use their exemptive authority to decrease retention levels commensurate with performance.[26]

a. The Premium Capture Cash Reserve Account should be eliminated

In addition to the requirement to retain an economic interest in one of the permissible forms of risk retention (retained interest), the proposal requires that any proceeds in excess of par be captured in a separate account that will available to cover first losses on the underlying assets until the related ABS interests are paid in full.[27] Under the proposal, the PCCRA would be held in a first-loss position ahead of the retained interest. The preamble to the proposal states that the purpose of the premium capture provision is to prevent sponsors of the securitization from "reduc[ing] 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," presumably by extracting all of their profit on the transaction up front.

We believe that the PCCRA as constructed in the proposal will virtually preclude an issuer's ability to recover the costs of originating the underlying loans, including out-of-pocket costs such as appraisals and title insurance, operating expenses, and transaction expenses, let alone realize profits from the securitization, until the end of the transaction which, in the case of RMBS, could

[26] FRB Report at 49.
[27] 76 *Fed. Reg.* 24090 at 24113.

be as long as 30 years.[28] Indeed, such costs are reflected in the price paid by the sponsor to the originator, with the result that the sponsor's cost basis in a given loan is typically greater than par. In turn, the sponsor recoups its cost basis in the originated loans (which exceeds the par value of the bonds) through the sale of premium and interest only securities. The PCCRA provision, however, does not consider whether the sponsor purchased the asset at a premium and thus is not making a profit on the securitization, or whether the "premium" in fact reflects out-of-pocket third-party costs advanced by the originator, such as filing fees or title insurance costs.

To the extent securitization transactions can be executed with the proposed PCCRA requirements, we believe the PCCRA will result in originators either (1) passing origination costs on to borrowers or (2) incurring these expenses with no opportunity to recoup the costs until most of the loans are paid in full. This would require securitizers to increase interest rates to borrowers to justify the transformation of up-front profit (and, in many cases, basis) into long dated risk cash flows. It can be expected that small originators that lack the ability to hold these costs until the deal is completed will, of necessity, pass these origination costs on to their borrower in the form of higher fees.

Our members have indicated that the PCCRA will render most existing securitization structures economically unworkable.[29] Not the least of their concerns is the consequence for a sponsor of holding exposure to the securitization in excess of the five percent retained interest. The end result is likely to be that sponsors will not be able to achieve accounting sale treatment which would lead to consolidation of the securitized assets on the balance sheet of the sponsor. In the case of a bank sponsor, such consolidation will, in turn, result in higher regulatory capital requirements and reduce their ability to lend at any rates.

Finally, concerns have been raised about whether transactions for which a PCCRA is required will qualify for a legal true sale opinion. Such opinions are a critical element of a securitization

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28 The Associations note that the comment letter from Bank of America incorporate a more comprehensive explanation of mortgage origination, mortgage market dynamics and the role of securitization transactions, and rather than repeat them here we make note that our comments should be read in the context of that common understanding of those dynamics. Bank of America Comment Letter at 13, available at http://www.sec.gov/comments/s7-14-11/s71411-139.pdf.

29 In testimony before the Senate Banking Subcommittee on Securities, Insurance, and Investment on May 18, 2011, Lisa Pendergast, President of the Commercial Real Estate Financial Council, analogized the effect of the PCCRA as follows: "An analogy, for example, would be to consider if the rule were applied to your local sandwich shop owner. The owner, for example, spends money up front - say $1000 - to purchase bread, meat, cheese, mustard and other sandwich making supplies. He then sells all his sandwiches to customers for $3000, a gross profit of 2000. He uses that profit to pay his workers; buy more sandwich supplies and to invest in his business. However, under the PCCRA, he can only collect the cost of the sandwich on the day he sells it to his customer. The net profit of $2000 must go into an escrow account, and cannot be put to use for 10 years. Under this business strategy, it is difficult to imagine that many delis would be left open in the country." Hearing on: "The State of the Securitization Markets," *available at* http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=674bbc54-83bb-45c6-9e10-67188045100b.

transaction to assure investors that the collateral is bankruptcy remote, i.e., that if the sponsor files for bankruptcy, the collateral is not part of the sponsor's bankruptcy estate. In addition, such opinions are critical to obtaining credit ratings for the transaction. For many law firms providing such opinions, the amount of the retained interest will be a key factor in whether they can provide a true sale opinion. Moreover, the inability to transfer the retained interest and limited financing options are significant factors that are considered in whether a true sale opinion may be given.

In addition, the PCCRA provision may pose indirect risks for regional banks. Currently, regional banks are able to diversify the risks of originating assets concentrated in their local geographies or industries by selling them into the secondary market. To the extent such transactions are no longer cost effective due to the risk retention requirements in general and the PCCRA specifically, such regional banks may find themselves with loans concentrated in local economies that raise safety and soundness concerns.

Finally, the costs entailed in incorporating the PCCRA may have a disproportionate impact on small originators and aggregators who may find access to the secondary market unavailable to them. This result would seem to be directly contrary to policies espoused by the Federal Reserve System, the Departments of Treasury and Housing and Urban Development, and the Financial Services Oversight Council.[30] To the extent that a securitization transaction is able to incorporate a required PCCRA,[31] it will clearly result in increased costs to borrowers or a disproportionately high interest rate. For example, locking premium rate in the PCCRA would likely prevent originators from offering borrowers rate locks for the period between application and funding.

In summary, the Associations strongly believe that the PCCRA should be eliminated. As currently constructed, the PCCRA virtually eliminates sponsors' incentives to sell assets into the secondary markets and will stifle the re-emergence of securitization markets for many assets. For those transactions that manage to go forward incorporating a PCCRA, the costs will be passed on to borrowers through increased costs and fees. Rather than restarting the private securitization market, implementation of the PCCRA provision may well sound its death knell by eliminating securitization as a viable funding mechanism for many issuers.

b. Vertical risk retention

[30] *See*, FRB Report at 84; FSOC Study at 18; Department of the Treasury and Department of Housing and Urban Development, *Reforming America's Housing Finance Market: A Report to Congress* at 14 (Feb. 2011), *available at* http://www.treasury.gov/initiatives/Documents/Reforming%20America's%20Housing%20Finance%20Market.pdf.

[31] We understand that there is significant uncertainty in the industry both as to the intent of the PCCRA provision and its calculation based on "par value." There is speculation that the motivation for including the PCCRA in the proposal may have been to prohibit inclusion in securitization structure of interest-only tranches that pay no interest until after a "step-up" date, subject to certain conditions being met. This step-up appears to be viewed as akin to pulling out an equity cushion from underneath the other senior note investors. If, in fact, that is the case, there may be other less onerous and appropriately targeted mechanisms to address regulator concerns.

The Associations support the use of a vertical risk slice as an acceptable method of risk retention. Under the proposal, a sponsor holding a vertical slice would retain at least five percent of each class of ABS interests issued as part of the transaction. The sponsor would be required to retain at least five percent of the par value (if any), fair value and number of shares or units of each class of ABS interest, regardless of whether the class has a par value, was issued in certificated form, or was sold to unaffiliated investors. This form of risk retention would align the interests of the sponsor and investors, regardless of the priority of payments of principal and interest allocated to any particular class. Moreover, a sponsor who also is a servicer or an affiliate of the servicer of the assets and who owns a portion of each class of ABS interests would have little incentive to take actions for the benefit of a single class of interests. Additionally, it seems likely sale accounting treatment will be available for securitizations by a sponsor (including one that is the servicer or is affiliated with the servicer) who retains a five percent vertical slice. The vertical risk slice is easy to calculate, thereby facilitating transparency to investors and review and monitoring by the Agencies.

We encourage the Agencies to adopt as an additional permissible form of risk retention, a variant of the vertical slice – a participation interest in each *asset* backing an issuance of ABS rather than five percent of each *ABS interest* issued in an ABS transaction. The issuing entity would hold a 95 percent portion of the asset with the sponsor holding the remaining five percent interest. Both interests would share equally, on a pro rata basis, in all principal and interest payments, expenses of the issuing entity and losses on the assets.[32] Because all assets would be serviced under the same pooling and servicing agreement, there would be no differences in how the participation interest held by the sponsor would be serviced. We believe that the use of participation interests aligns the interests of the sponsor and investors in the same manner as does the vertical slice. In addition, it would avoid the concern that smaller originators that may hold the retained interest may not be eligible under federal securities laws to hold privately placed ABS interests.

The Associations agree with the comments of the American Bar Association (Bar Association) that having the sponsor sell 100 percent of the asset to the issuing entity and receive a five percent participation interest from the issuing entity would minimize questions as to who the "owner" of the asset is in connection with the enforcement of remedies following default by the obligor. This would also eliminate the issue of whether a 95 percent participation interest sold to the issuing entity is a separate "security" that must itself be registered under federal securities laws.[33] If a pooled asset is itself a security, then under Regulation AB and related rules, additional registration requirements would apply that would be unduly burdensome.[34]

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[32] Moreover, a participation interest would obviate related issues with respect to the transfer of the retained interest to an originator. Because the Agencies have required that the sponsor and originator hold the risk in the same form, a position with which we disagree, issues may arise if a sponsor holds a vertical slice of interests that have been thus, could be shut out of the secondary market. However, smaller originators would be able to hold a participation interest.

[33] Bar Association Comment Letter at 16, available at http://www.sec.gov/comments/s7-14-11/s71411-133.pdf.

[34] *See, e.g.*, Asset Backed Securities, Securities Act Release No. 8518, 70 *Fed. Reg*. 1506, 1529, n. 173 (Dec. 5, 2005).

Moreover, we believe the Agencies would have no difficulty monitoring the retention because the participation interests would be appropriately documented in the transaction documents and would be disclosed in the offering documents for the transaction.

c. Horizontal risk retention

The proposal would permit a sponsor to satisfy the risk retention requirement by holding 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 entity that are issued as part of the securitization transaction. According to the proposal, 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. As discussed above, given the uncertainty in the industry as to the meaning of "par value" as used in the proposal, the Associations believe the better course of action is to re-issue the proposal with clear definitions so that an appropriate response may be crafted.

(1) Interest-only first loss class

The Associations urge the Agencies to permit as an "eligible horizontal residual interest" the retention by the sponsor of an interest-only or primarily interest-only first loss class with no stated principal amount as a valid form of risk retention. Under the proposal such a class would not be recognized because an eligible horizontal residual interest must at closing be "in an amount that is equal to at least five percent of the par value of all ABS interests in the issuing entity." This requirement is not in keeping with the language of Section 945 of the Dodd-Frank Act, which instructs the Agencies to issue rules to require a sponsor to retain five percent of the "credit risk" of the assets being securitized. The statute does not require sponsors to retain a specified percentage of the principal amount of the transaction.

The net present value of interest only and primarily interest-only residual securities represent a real economic value that is known to the sponsor of any securitization at the time of closing. If the cash flow that would otherwise be owed to such securities is first used to cover any losses on all other offered securities, such an interest is in the same economic position as a security that is entitled to principal payments. The type of entitlement (principal or interest entitlement of the security) and the source of the entitlement (principal or interest on the underlying assets) should not matter. All that should matter is that the securitizer has five percent of the risk associated with the securitized assets at stake. This optionality would not lessen the securitizer's economic exposure; it would instead only offer proper recognition for the securitizer's true economic value at stake and prevent securitizers from being forced to produce less efficient securitization structures for the sake of technical rule compliance.

We urge the Agencies to amend the proposal to permit as an eligible horizontal residual interest a first loss interest only and primarily interest-only class, and we support the comments of the

American Securitization Forum (ASF) and the Securities Industry and Financial Markets Association (SIFMA) with respect to this class.[35]

(2) Additional subordinate classes

As proposed, the definition of "eligible horizontal residual interest" appears to be limited to a single ABS interest that, among other things, has "the most subordinated claim to payments of both principal and interest by the issuing entity. [36] The Associations note that in many securitization transactions the sponsor may retain an interest that, while not subordinate to the horizontal interest, is subordinate to any senior tranche. We believe that it is appropriate for such classes of interest to satisfy the horizontal risk retention requirement. Accordingly, we request that the Agencies amend the proposal to per permit an "eligible horizontal residual interest" to be comprised of one or more ABS interests that in the aggregate are subordinate to all other interests in the transaction.

The Associations believe that the treatment of such interests by the European Union (EU) in Article 122a,[37] which establishes risk retention requirements for institutions doing business in the European Union, is instructive.[38] The *Guidelines to Article 122a of the Capital Requirements Direc*tive[39] appear to recognize that a horizontal or first loss risk retention requirement can be satisfied in a number of ways, including: (1) synthetically, for example by the sponsor entering into a total return swap with the ABS issuer; (2) by a deferred purchase price mechanism; (3) by overcollateralization or similar structure (which appears not to require the overcollateralization to be on the sponsor's balance sheet; and (4) by letters of credit or guarantees. The first-loss tranche referred to in Article 122a and the Guidelines appears to be the equivalent of the proposal's eligible horizontal residual interest.

The Associations urge the Agencies to work with their EU counterparts to harmonize the eligible horizontal residual interest and the first-loss tranche so that U.S. institutions are not disadvantaged *vis a vis* EU-regulated institutions.

Finally, the Associations support the comments of the Bar Association with respect to the eligible horizontal residual interest. In particular, we agree with their position with respect to

(1) the prohibition on receipt of unscheduled payments of principal until all other ABS interests in the issuing entity are paid in full and (2) that the prohibition would have the effect of increasing the percentage of the eligible horizontal residual interest above five percent as the

[35] ASF Comment Letter at 38, available at http://www.sec.gov/comments/s7-14-11/s71411-57.pdf;; SIFMA Comment Letter at 46, available at http://www.sec.gov/comments/s7-14-11/s71411-79.pdf.
[36] 76 *Fed. Reg.* 24090 at 24157.
[37] Directive 2009/111/EC of the European Parliament and of the Council of 16 September 2009.
[38] Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 and Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006.
[39] Committee of European Banking Supervisors, *Guidelines to Article 122a of the Capital Requirements Directive* (Dec. 2010), *available at* http://www.eba.europa.eu/cebs/media/Publications/Standards%20and%20Guidelines/2010/Application%20of%20Art.%20122a%20of%20the%20CRD/Guidelines.pdf.

related portfolio of assets is reduced.[40] Accordingly, we urge the Agencies to amend the proposal to permit the holder of the eligible horizontal residual interest to receive its proportionate share of all prepayments of principal received.

(3) Horizontal Cash Reserve Account

In lieu of retaining an eligible horizontal residual interest, the proposal permits a sponsor to establish and fund, in cash, at the closing of a securitization transaction, a horizontal cash reserve account in the same amount as the eligible horizontal residual interest, subject to certain conditions.[41] The Associations believe this alternative provides welcome flexibility to sponsors.

Similar to the eligible horizontal residual interest, the proposal would appear to prohibit unscheduled payments of principal from the account. As noted above, we believe this restriction would fix the amount of this account at the same time the related portfolio of assets is reduced. This would, in effect, increase the percentage of risk retention represented by the account, which we believe is unwarranted. Accordingly, the Associations urge the Agencies to amend the proposal to permit such unscheduled payments of principal to be released from the horizontal cash reserve account in the same way that releases are made based upon receipt of scheduled payments (i.e., that amounts be released in amounts proportionate to the amounts of all prepayments of principal received).

d. L-Shaped risk retention

The proposal would permit sponsors to retain the required residual interest in the form of an L-shaped option which is a combination of vertical risk retention and horizontal risk retention. The Associations believe this alternative provides welcome flexibility to sponsors. However, the proposal would permit the risk to be retained only in equal shares, ostensibly to make each portion large enough to affect the sponsor's incentives. We disagree with this limitation.

We urge the Agencies to amend the proposal to permit the required retained interest to be held in any combination permitted forms – not just the vertical and horizontal forms. This flexibility is important to accommodate the variables that may be present in any given securitization transaction, including the capability of the sponsor or an appropriate third party to hold the required retention. Thus, for example, a sponsor of a revolving asset master trust should be able to satisfy the base requirement by combining the seller's interest with a horizontal interest. Similarly, the sponsor of a CMBS transaction should be able to hold a vertical or other interest if the third-party B piece buyer is unable to hold the full five percent horizontal interest.

e. Representative sample

The proposal would permit a sponsor to satisfy the risk retention requirement by retaining a randomly selected representative sample of assets that is equivalent, in all material respects, to the assets that are securitized. We understand the Agencies' position that a representative sample

[40] Bar Association Comment Letter at 22.
[41] 76 *Fed. Reg.* 24090 at 24102.

would completely align the sponsor's interest with those of investors. However, as proposed, we believe this option is both unduly complex and unworkable for many transactions. For example, placing the minimum size of the pool at 1000 assets effectively eliminates this as an option for many smaller issuers generally, and for securitization transaction such as commercial mortgage loans or jumbo prime residential mortgage loans which typically are backed by pools with fewer assets. Moreover, the restriction prohibiting the servicer's servicing personnel from being able to know the identity of the owner of the retained (versus the securitized) assets create problems in MBS transactions where loan modifications may require owner approval.
The Associations believe a workable alternative to the representative sample would be the use of a random sample. We support the recommendation of the ASF to permit the use of a randomly selected sample of loans equal to five percent (by principal balance) of the loans selected for a particular securitization pool.[42]

An additional alternative to the representative sample could be retention of a five percent *pari passu* pro rata interest in each asset in the pool, and we support ASF's recommendations with respect to this alternative.[43]

f. Other permissible forms of risk retention

The proposed rules provide for a number of other permissible forms of risk retention. The Associations appreciate the effort by the Agencies to accommodate existing practices in various types of securitizations. Nonetheless, a number of changes are required to make the rules workable for the current market.

(1) Revolving asset master trusts

With respect to revolving asset master trusts collateralized by loans or other extensions of credit that arise under revolving accounts, the proposal would permit the sponsor to meet the 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. We understand that the proposal was intended to comport with existing practices, and we appreciate those efforts. However, as drafted, the proposal does not take into sufficiently reflect current structures and practices in the industry in many areas, such as the use of issuance trust structures. The Associations support the comments of the ASF and the Bar Association with respect those necessary changes that will make the proposal more closely reflect this and other current practices.[44]

In addition, the Associations believe that credit and charge card issuers should be able to avail themselves of a variety of forms of risk retention, including a combination of the seller's interest (which represents a vertical slice) and a horizontal retained interest, thus approximating the L-

[42] ASF Comment letter at 51.
[43] *Id.* at 52.
[44] ASF Comment letter at 109; Bar Association Comment Letter at 27.

shaped risk retention option in the proposal. We further believe that credit and charge card issuers should be permitted to vary the form of retention throughout the required holding period. The Associations support the comments of ASF with respect to this option.[45]

(2) Commercial Mortgage-Backed Securities

With respect to commercial mortgage-backed securities, the proposal would permit the sponsor to satisfy its risk retention obligation if a third party purchaser (the so-called B-piece buyer) acquires an eligible horizontal residual interest in the issuance. As constructed, the Associations believe this form of risk retention will not be workable for the vast majority of CMBS securitizations. Accordingly, we support the recommendations of the Commercial Real Estate Finance Council with respect to these provisions.

6. Transfer of Risk Retention

Under the proposal, the sponsor of a securitization transaction is solely responsible for complying with the risk retention requirements. However, the proposal would, with certain restrictions, permit (but not mandate) the sponsor to transfer a portion of its risk retention obligation to the originator of the assets.[46] The risk retention may be transferred to the originator only if certain conditions are met including:

- Risk retention may be transferred only to originators that have contributed at least 20 percent of the assets in the pool;
- Transfer is permitted only for the vertical and horizontal forms of risk retention;
- Both the sponsor and originator must hold the retained interest in the same manner and subject to the restrictions on hedging, transferring and pledging;
- An originator must acquire and retain a minimum of 20 percent of the aggregate risk retention otherwise required to be maintained by the sponsor (but the originator's portion may not exceed the ratio of the unpaid principal balance of the pool assets originated by it to the aggregate unpaid principal balance of all of the assets in the securitized pool); and
- An originator who holds the risk retention on a portion or the pool is nonetheless responsible for compliance across all assets in the pool, not just the assets it originated.

a. Impact on Small Lenders

The Associations support the proposed requirement that transfer of risk retention from a sponsor to an originator *not* be mandatory. As the Agencies recognize, mandatory transfer would raise significant concerns about the impact on small originators who might not be able to obtain funding to retain risk positions.

[45] ASF Comment letter at 115.
[46] 76 *Fed. Reg.* 24090 at 24114.

We disagree, however, with the Agencies' statements in the proposal that there is no concern about credit availability through small community banks because the risk transfer is limited to firms that originate 20 percent or more of the pool. In fact, there is significant concern from our smaller members that the 20 percent risk transfer threshold could, have the effect of locking them out of the private securitization market. We believe it likely that sponsors will seek to use their market power to pass along some of their risk retention requirements to originators so that, like the sponsors, the originators have skin in the game. To the extent an originator could not meet the 20 percent threshold, the sponsor could simply exclude such an originator from the securitization. Therefore, the 20 percent risk transfer requirement could have the effect of locking out smaller market participants with sponsors unwilling to do business with originators who could not share the risk.

Even if sponsors were willing to purchase loans from originators that were ineligible to hold risk due to the 20 percent threshold, clearly we would expect there to be a pricing difference for an originator that was unable to share in the risk retention because the secondary market would simply pass along the risk through increased pricing.

We believe that the ability of small originators to continue to participate in securitization is best addressed by eliminating the 20 percent threshold and permitting originators to hold the retained interest in the form of a participation interest in each asset that it originated. We believe it likely that sponsors will provide two-tiered pricing, with one price for originators that share in the retention requirement and a different price for those that don't. An originator that agrees to share the risk retention would retain a five percent participation interest in each of the assets it originates. The issuing entity would then retain the remaining interest in the assets.

Finally, we note a concern that even when smaller originators are able to retain some of the risk from securitizations, they may have difficulty managing the complex securities. The result here would be that smaller institutions might come under heightened regulatory scrutiny for handling these complex tranches. This would drive up costs and even further limit smaller originators' ability to participate in the secondary market. Again, the Associations believe that the use of participation interests would appropriately address this concern.

b. Form of Risk Retention

Moreover, our members strongly disagree that (1) the retention options should be limited to a vertical slice or a horizontal slice and (2) both sponsor and originator must hold the retained risk in the same manner. We believe it is particularly important that sponsors and originators need not use the same form of risk retention. As noted earlier, if a sponsor of privately placed securities holds the retained risk in a vertical slice, a smaller originator may not satisfy the requirements of federal securities laws to hold the privately placed securities. The Agencies have already agreed that at the vertical and horizontal forms can be combined in an L-shaped slice, and we see no reason for limiting the forms of retained risk in a transfer situation.

c. Compliance Issues

Finally, the Agencies have asked whether an originator should be responsible only for the assets it has originated. We strongly believe that this limitation is appropriate. Our smaller members would be unwilling to accept retention of risk for the entire pool of assets when they have no control over the quality of the other assets in the pool. This would place an impossible due diligence burden on smaller originators, and an expensive one even on larger originators. As noted above, participation interests could be used to satisfy the risk retention requirement without exposing the originator to the risk of loss on pool assets it did not originate.

The proposal further requires that where a sponsor has allocated some portion of the risk to an originator, it remains responsible for compliance with the risk retention rules and must notify investors in the event an originator fails to comply with the rules. We think this requirement is unworkable. For example, a sponsor simply would not know whether an originator has violated the hedging rules. Rather, we believe the sponsor's duty should be satisfied so long as the transactions documents contain representations and warranties and covenants requiring the originator to comply with the risk retention requirements and report non-compliance to the sponsor.

7. THE RETAINED INTEREST SHOULD NOT BE REQUIRED TO BE HELD FOR THE LIFE OF THE TRANSACTION

The Associations urge the Agencies to provide that the risk retention requirement be permitted to sunset a reasonable period after the issuance of the securitization. While Congress intended to incent lenders and issuers to originate prudently underwritten loans, that incentive – risk retention – works only to the extent losses may be avoided as a result of higher underwriting standards. The risk of default due to poor underwriting is most present closest to the time of asset origination, and diminishes over time. Thereafter, losses are most likely to be the result of economic changes or the borrower's particular situation, rather than as a function of underwriting.

We believe that a sunset provision would realize Dodd-Frank's policy objective of incenting prudent underwriting while, at the same time, substantially reducing both the cost and negative effects of this proposal. A risk retention sunset would allow originating institutions to engage in meaningful transfer of mortgage credit risk off their balance sheet, greatly reduce the potential amount of capital that originators facing risk retention would need to hold while still preserving the incentives to maintain solid underwriting standards and procedures.

We note that other issuer trade associations support limiting the time to hold the require credit risk to two or three years. The Associations concur with those assessments.

8. QUALIFIED ASSET EXEMPTIONS

a. Exceptions for CRE loans, commercial loans, and automobile loans

(1) Partial risk retention should be allowed for mixed pools (*i.e.* qualifying and non-qualifying assets)

As directed by section 15G(c)(1)(B)(ii) of the Exchange Act, the proposed rules include exceptions for CRE loans, commercial loans, and automobile loans that meet certain underwriting standards (qualifying assets). The Agencies have chosen to apply these exceptions only when a securitization is exclusively collateralized by qualifying loans. However, section 15G(c)(1)(B)(ii) does not require that a securitization be fully backed by qualifying loans in order for an exemption to apply.[47]

At the outset, the Associations believe that the risk retention requirements for sponsors should be based on the portion of assets in a mixed pool that do not meet the applicable qualified asset criteria. For example, if a $100 pool consists of $10 of qualifying loans and $90 of non-qualifying loans, the risk retention requirement should be 5 percent of $90, or $4.5. The all-or-nothing approach proposed by the Agencies could lead to lower quality and less diverse assets being securitized. High quality assets are often included into securitized pools to boost the overall credit quality of a pool. Requiring full risk retention for mixed pools serves as a disincentive to boost the credit quality of a pool and thereby reduces investor demand.

Furthermore, the all-or-nothing approach put forward by the Agencies could also lead to fewer qualifying assets being originated. As described later in this letter, the criterion for qualifying assets is extremely strict and we believe that few assets will meet the underwriting criteria set forth by the Agencies. As a result, the all-or-nothing approach could lead to qualifying assets lingering on a securitizer's or originator's balance sheet until they have enough qualifying assets to support an ABS offering. While these assets linger, the securitizer or originator would bear the cost of holding and financing these loans. This cost could discourage the origination of qualifying assets.

The Associations urge the Agencies to adopt partial risk retention requirements for mixed pools that consist of qualifying and non-qualifying assets. We believe this type of regime would be easy to administer and enforce and would be transparent to investors.

(2) The Agencies should provide for a pool wide approach based on weighted averages

The Associations believe that the proposal's focus on loan origination characteristics to determine creditworthiness should be supplemented with a pool wide exception approach.

[47] While section 15G(c)(1)(B)(i) appears to require an all-or-nothing approach in the context of qualified residential mortgages, section 15G(c)(1)(B)(ii), which relates to CRE loans, commercial loans, and automobile loans, does not contain similar language.

Exceptions for ABS collateralized by CRE loans, commercial loans, and automobile loans, should be developed based upon pool wide weighted averages of specified pool characteristics. We believe that such exceptions would encourage origination of higher quality loans and better quality pools. The industry and investors are comfortable with this approach which is generally in line with the TALF program, where, for example, weighted average FICO Scores were used to distinguish between prime and subprime automobile loans. We believe that agencies have the authority to allow pool-based exceptions under section 15G(c)(1)(G)(i)[48] and section 15G(e)(1) and (2),[49] and we urge the Agencies to act.

(3) Qualifying CRE loans and commercial loans

The proposed regulations provide that asset-backed securitizations where the underlying assets are limited to qualifying commercial real estate loans and commercial loans would not be subject to risk retention requirements. However, the proposed exemptions from credit risk retention for qualifying commercial real estate loans and commercial loans are unrealistically strict. It is unlikely that the exemptions for qualifying commercial loans and commercial real estate loans will be used at all in CLO or CMBS transactions. In our view, the loans that would be exempted under these rules are not the sorts of loans that are, were, or likely ever will be securitized, for economic and other reasons. While we understand the Agencies' desire to limit exemptions to high quality assets, it is unclear that the CMBS or CLO markets suffered significantly from the practices that affected the RMBS market. We do not believe that all previous CLO and CMBS transactions, nearly all of the collateral for which would not be "qualified," are defective.
In addition to making appropriate changes in the proposed lending criteria, the Agencies should adopt more realistic criteria to support a partial exemption from the risk retention requirements described above.

(4) Qualifying automobile loans

In general, the Associations believe that the requirements of a qualifying auto loan set forth in the proposal are overly prescriptive. The NPR sets forth too many requirements, many of which are inconsistent with current practice. In fact, the auto loan requirements appear to resemble the residential mortgage underwriting criteria in a number of respects, even though mortgages are fundamentally a different product. We do not believe that the requirements for a qualifying auto loan set forth in the proposal are workable. We urge the Agencies to amend the proposal so that the qualifying criteria are consistent with current industry practice.
At a minimum, we urge the Agencies to:

- Remove the proposed 20% down payment requirement. Such a requirement is overly restrictive in a market where 100% financing is commonplace.

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[48] Section 15G(c)(1)(G)(i) provides for a total or partial exemption of any securitization as may be appropriate in the public interest and for the protection of investors.
[49] Section 15G(e)(1) and (2) provides for an exemption or adjustments that help ensure high quality underwriting standards and improve the access of consumers and businesses to credit on reasonable terms.

- Remove the proposed requirement that the holder of the loan or its agent maintain physical possession of the title. The provision is inconsistent with many state laws that require the title be delivered to the owner of the vehicle, not a secured party.
- Remove the proposed 60-month term maximum. This provision is shortsighted and doesn't consider technological developments in the auto industry. As technology improves, the average life of cars has been extending. The original maturity of an auto loan should be allowed to extend beyond 60 months without triggering risk retention to mirror the increased average life of a car.

(5) The rules should look through resecuritizations to determine risk retention

The Agencies are proposing to exempt certain resecuritization transactions from the risk retention requirements if two conditions are met: (i) the ABS collateralizing such exempt transactions be limited to ABS which complied with, or was exempted from, the risk retention rules, and (ii) only a single class of ABS interest is issued and such ABS equals 100% of the principal and interest on the ABS collateralizing such resecuritization ABS. We believe that the requirements under the NPR are overly restrictive and would result in risk retention for most resecuritizations. We fundamentally believe that resecuritizations should not be subject to risk retention if the underlying securities comply with, or are exempt from, the risk retention rules. By their nature, resecuritizations do not directly impact the underwriting of the loans backing the underlying securities. Therefore, requiring risk retention for resecuritzation will not improve underwriting.

We urge the Agencies to adopt a "look-through" approach to exempt resecuritizations. The Agencies' rules should look through the resecuritization structure to see if the underlying securities comply with, or are exempt from, the risk retention rules. If the underlying security complied with, or are exempt from, the risk retention rules, no additional risk retention should be required for the resecuritization. To achieve this, the Agencies should remove the proposed requirement that a resecuritization be structured so that only a single class of ABS interest is issued.

b. FFELP loans should be exempt from risk retention

The Associations believe that ABS backed by loans issued pursuant to the Federal Family Education Loan Program (FFELP) should be exempted from the risk retention requirements. The proposal fully exempts any securitization transaction if the asset-backed securities issued are collateralized solely by assets that are fully insured or guaranteed by the United States or an agency of the United States. However, FFELP loans are often partially guaranteed (97 to 100 percent) as a result they do not meet the exception.[50]

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[50] The loans are guaranteed for 100 percent of principal and accrued interest against death, disability, discharge in bankruptcy or the crime of identity theft. Loans originated prior to October 1, 1993 are guaranteed as to 100 percent of principal and accrued interest if the borrower defaults; those originated on or after October 1, 1993 but before July 1, 2006, are guaranteed as to 98 percent of principal and accrued interest if the borrower defaults; loans

FFELP loans were originated by commercial banks, savings-and-loan associations, credit unions, pension funds, certain non-profit organizations and state Agencies. Effective July 1, 2010, President Obama and Congress eliminated this program in favor of direct federal lending. However, many thousands of FFELP loans remain outstanding.

Notwithstanding the fact that most of the credit risk associated with each FFELP loan is guaranteed by a state agency and reinsured by an agency of the Federal Government, the proposed rules would require that a sponsor satisfy the risk retention requirements in any securitization of FFELP loans after the effective date of the new rules. We believe that this is an inappropriate result, and we ask the Agencies to revise §__.21 of the proposed rules to exempt securitizations of FFELP loans.

Section 15G(c)(1)(G)(ii) of the Exchange Act requires that the risk retention regulations provide for "a total or partial exemption for the securitization of an asset issued or guaranteed by the United States or any agency of the United States," as the Agencies jointly determine to be "appropriate in the public interest and for the protection of investors." In light of the exemptions from the risk retention requirements provided for other securitizations for which less credit protection is provided,[51] we believe that it is wholly consistent with the public interest and investor protection not to impose a risk retention requirement on securitizations collateralized by FFELP loans.

CONCLUSION

In conclusion, the Associations strongly believe that the proposal as currently drafted is so flawed that it must be withdrawn and re-issued. We believe that fundamental concepts in the proposal, such as how to measure the retained risk, are so unclear that it is impossible for the industry to provide adequately well-reasoned responses and that without significant changes the proposal will have a destructive impact on the securitization market and the availability of credit to consumers and businesses. Specifically, we are concerned that:

- The risk retention rules have not taken into account additional regulation under Dodd-Frank and other rulemakings that collectively may magnify the impact of the risk retention rules - especially in the case of securitizations collateralized by residential

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originated on or after July 1, 2006 but before July 1, 2010, are guaranteed as to 97 percent of principal and accrued interest if the borrower defaults.

[51] We note, for example, that pursuant to Section 15G(e)(3)(B) of the Exchange Act, which provides for the exemption of "any residential, multifamily, or health care facility mortgage loan asset, or securitization based directly or indirectly on such an asset, which is insured or guaranteed by the United States or an agency of the United States," the Agencies have provided in proposed Section §__.21(a)(1)(i) for exemption of such transactions as securitizations of mortgage loans guaranteed by the Department of Veterans Affairs (the "VA"). As noted in the Proposing Release, the VA guarantees "between 25 percent and 50 percent of lender losses in the event of residential borrower defaults" Proposed Rule at 24136.

mortgages, a market currently experiencing wholesale transformations in applicable regulations. Beyond regulations directly impacting classes of collateral, the risk retention requirements will necessarily interact with other changes in capital requirements and rules determining what constitutes a true sale. As a result, the risk retention requirements as proposed may make securitization transactions economically unfeasible.

- The exceptions to the risk retention requirements fail to comport with Congressional intent with respect to the narrowness with which they are crafted. The Agencies have failed to exercise the significant discretion granted in Section 941 to establish the scope of the QRM exemption, and to employ a range of amounts of retained economic interests from zero percent to five percent that would be reflective of the underwriting standards of particular assets, and finally, to exempt entire classes of assets where warranted. The proposal reflects an "all or nothing" approach to the retention requirements with zero percent retention for very narrowly crafted asset classes, and five percent retention for all other assets, with nothing in between.

- The QRM proposal was apparently drafted with little consideration of the QM and Ability to Pay requirements in Title XIV of the Dodd-Frank Act. The QM requirements not only control the scope of QRM, but also will have profound effects that align the interests of borrowers and lenders. The lack of coordination with and consideration of QM requirements contributed to profound flaws in QRM standards as proposed.

- The proposed Premium Capture Cash Reserve Account (PCCRA) would make most securitizations economically untenable.

We urge the agencies to withdraw the proposal and reissue it, taking into consideration the comments above. In summary, a re-proposal should provide more clarity and an economic analysis to evaluate the impact of the proposal on (1) the securitization market and (2) the availability of credit to both businesses and consumers. The QRM standard should be redefined and more closely aligned with both the QM standard being finalized by the Consumer Financial Protection Bureau and with applicable GSE eligibility standards. The PCCRA should be eliminated if securitization is to be restored as a viable funding source. The various permissible forms of risk retention should be restructured and expanded to make them workable. The risk retention requirement should terminate after a reasonable time, and the other qualified asset exemptions provided in the proposal must be re-written to ensure that they are workable.

Finally it is critical that the Agencies balance the development of risk retention requirements that implement Congressional intent to better align incentives with the need to ensure that the private securitization market is restored as a viable and robust source of funding. To do otherwise will most certainly result in an unnecessary restriction in credit for consumers and businesses, to the overall detriment of our economy. If these goals are balanced correctly in a re-proposed rule, risk retention will not hinder the return of the private securitization market, which will help loan originators to provide credit –and particularly mortgage credit – to borrowers at a reasonable cost. Given the fragility of the overall U.S. economy, and particularly of the mortgage markets, it is essential that risk retention be implemented in a balanced, reasonable, and effective manner.

The American Bankers Association and the ABA Securities Association stand ready to assist as this process moves forward.

Thank you for the opportunity to comment on this proposal.

Sincerely,

Robert R. Davis

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