

MEMORANDUM

TO: File No. S7-14-11

FROM: Arthur Sandel
Special Counsel
Office of Structured Finance
Division of Corporation Finance
U.S. Securities and Exchange Commission

RE: Conference call with SFIG representatives

DATE: March 6, 2014

On February 20, 2014, Arthur Sandel and David Beaning of the Division of Corporation Finance and Sean Wilkoff and Igor Kozhanov of the Division of Economic and Risk Analysis participated in a conference call with the following representatives of the Structured Finance Industry Group, Inc. (“SFIG”): Sairah Burki of SFIG; Stuart Litwin of Mayer Brown LLP; Phoebe Moreo of Deloitte & Touche LLP; Ken Morrison of Kirkland & Ellis LLP; Neil Weidner of Cadwalader, Wickersham & Taft LLP; Ryan Farris of Ally Financial Inc.; and Eric Wise of RBC Capital Markets.

The following staff of other federal regulators also participated: Kevin Korzeniewski of the OCC; Kathy Russo, Phil Sloan, Rae-Ann Miller, Tom Lyons, Gene Pocase, Jacob Doyle, John Popeo, Rohit Dhruv, Silvia Ramirez and Stephen Lake of the FDIC; Donald Gabbai, David Alexander and Flora Ahn of the Federal Reserve Board; Christopher Tawa and Ron Sugarman of the FHFA; and Camille Acevedo of HUD.

The participants discussed topics related to the Commission’s August 28, 2013 joint proposed rules regarding credit risk retention. Handouts are attached to this memo.

Attachments



Risk Retention Re-Proposal

Meeting on Participations

February 20, 2014

Agenda

- What is a participation?
- Reasons to use participations
- Some Illustrations
 - Receivables pool held by issuing entity; 5% participation held by sponsor or depositor
 - Receivables pool held by sponsor or depositor; transfer of a 95% participation to issuing entity
- Proposed Definition of “Eligible Participation Interest”
- Helpful additional request

What is a Participation?

- A “participation” or a “participating interest” is a right to receive a percentage of the cash flows from an asset
- Example 1: Issuing entity owns \$1 million of receivables and grants a 5% participation to the depositor
 - When the issuing entity receives \$1 of collections on the receivables, the issuing entity would be obligated to pay 5 cents to the depositor on the following settlement date
 - The depositor would suffer 5% of all losses
- Example 2: Sponsor owns \$1 million of receivables and grants a 95% participation to the depositor, which the depositor transfers to the issuing entity
 - When the sponsor receives \$1 of collections on the receivables, the sponsor would be obligated to pay 95 cents to the issuing entity on the following settlement date
 - The sponsor would suffer 5% of all losses
- Similar to an Eligible Vertical Interest
 - A participation is a “vertical slice” of the securitized assets rather than a vertical slice of the securities sold to investors
 - Re-proposal currently permits eligible vertical interests with respect to the securities but omits a vertical interest with respect to the securitized assets

Reasons to use Participations

- The “most representative” of all representative samples
 - It’s an interest in the actual securitized pool rather than a sample of other receivables
 - Because it’s just a percentage interest in the securitized pool, there’s no concern that the retained interest won’t be “representative”
- Easy to create at low cost
 - The participation provisions can be as short as one paragraph
- Simpler disclosure; less complicated for sponsors
 - Consistent with our position on vertical interests, no need for disclosure of “fair value”
 - No need to restrict distributions

Reasons to use Participations (cont.)

- Accounting Benefits
 - Paragraph 8B of FAS 166 (§ 860-10-40-6A of the FASB Accounting Standards Codification) explicitly allows for sale accounting treatment for participations
- Regulatory capital benefits compared with other methods of risk retention
 - Under the proposed Basel Securitisation Framework, a retained interest in receivables may have a lower capital charge than a retained interest in a securitization exposure
- FDIC Safe Harbor
 - The FDIC has explicitly provided a safe harbor for participations without recourse (12 CFR 360.6(d)(1))
 - Assures that participations by banks will be respected, even in a receivership
- Bankruptcy remoteness
 - If issuing entity holds a participation, courts have recognized that participations are treated as “true sales” of the interest transferred, even in bankruptcy under appropriate circumstances
 - See, for example, *In re Coronet Capital Co.*, 142 B.R. 78 (Bankr. S.D.N.Y. 1992)
- Comparison to traditional securitizations without a participation
 - If the issuing entity holds the receivables, there are no differences
 - If the issuing entity holds a participation, similar to securitization of the underlying assets

Illustration 1:

- a. Receivables pool held by issuing entity;
- b. 5% participation held by sponsor or depositor

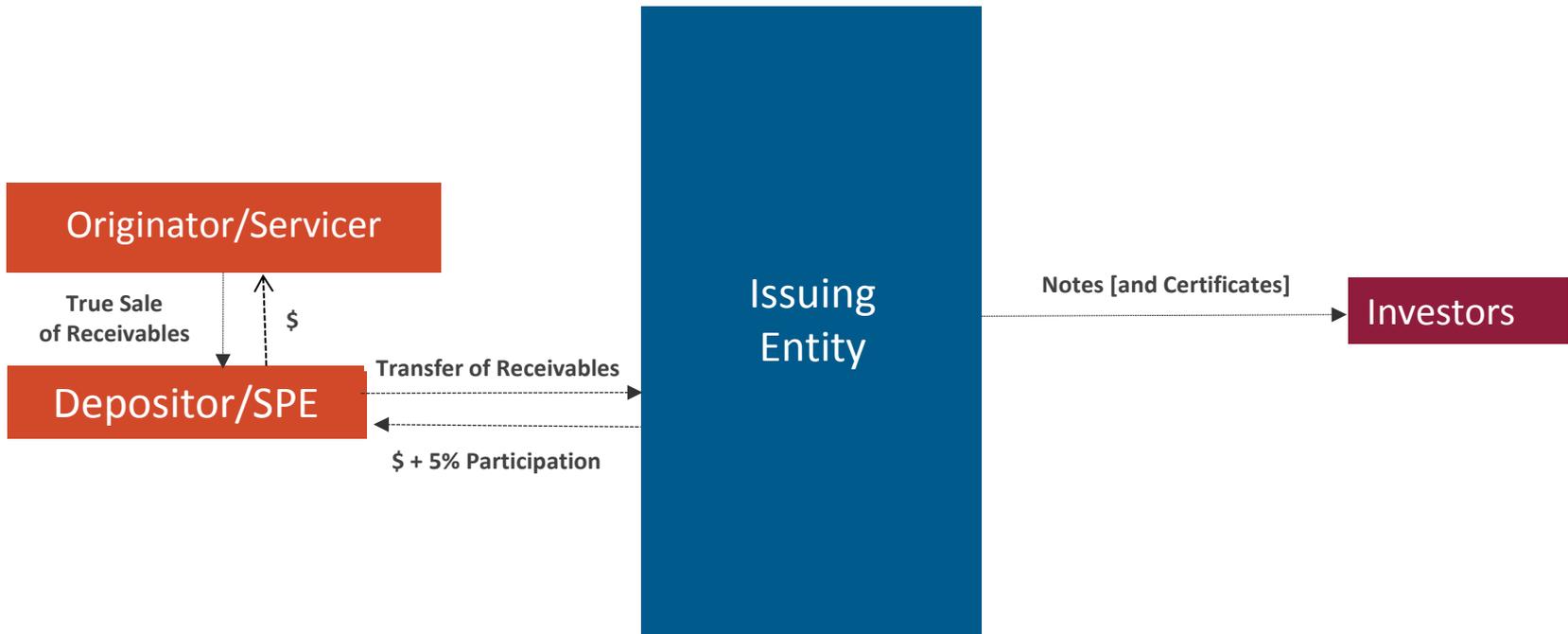
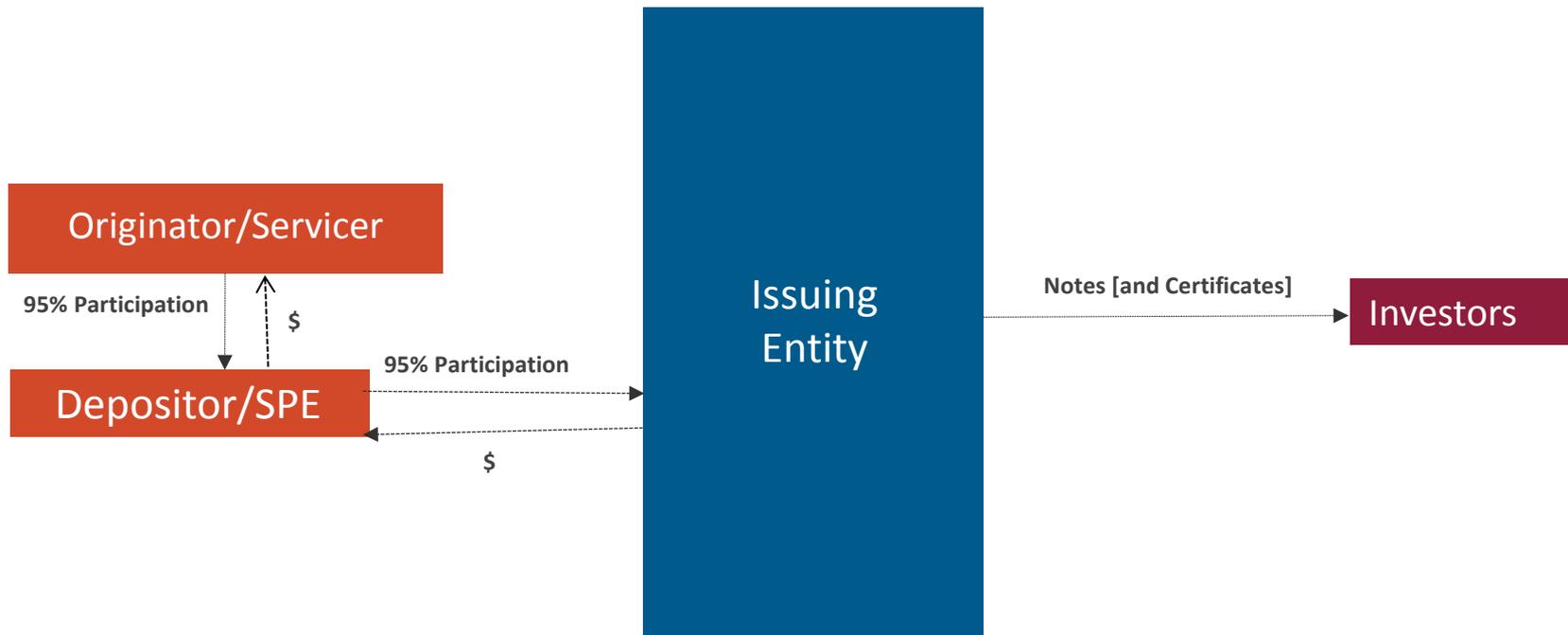


Illustration 2:

- Receivables pool held by sponsor or depositor;
- Transfer of 95% participation to issuing entity



Proposed Definition of “Eligible Participation Interest”

- An interest in an underlying asset or pool of underlying assets that:
 - (a) is an undivided percentage interest;
 - (b) constitutes either
 - (i) an owner’s interest, where the issuing entity holds a participant’s interest, or
 - (ii) a participant’s interest, where the issuing entity holds the owner’s interest;
 - (c) in respect of all rights to cash flow from the underlying assets, is *pari passu* with the interest held by the issuing entity; and
 - (d) does not provide the holder of the participant’s interest with recourse against the owner due to the lack of creditworthiness of any obligor on an underlying asset
- “Owner’s interest”
 - The interest of the owner of the underlying asset or pool of underlying assets who has granted a participation interest in each such underlying assets to another party
- “Participant’s interest”
 - The interest of a participant that has acquired a participation interest in each such underlying asset directly or indirectly from the owner of the underlying assets

Helpful Additional Request

- It would be helpful, but not essential, for the SEC to provide a limited exemption from Rule 190
 - Would allow the public offering of ABS backed by a 95% participation without registration of the participation
 - Would treat the participation as a securitization of the loans rather than as a securitization of an underlying security