American SECURITIZATION FORUM

June 10, 2011

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Re: RIN 1557-AD40; 7100 AD 70; 3064-AD74; 3235-AK96; 2590-AA43; 2501-AD53

Ladies and Gentlemen:

The American Securitization Forum ("ASF")[1] appreciates the opportunity to submit this letter in response to the request of the Joint Regulators for comments regarding their notice of proposed rulemaking (the "Proposed Regulations") entitled "Credit Risk Retention" (RIN 1557-AD40; 7100 AD 70; 3064-AD74; 3235-AK96; 2590-AA43; 2501-AD53),[2] issued pursuant to Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank"). Section 941 requires the Federal Deposit Insurance Corporation (the "FDIC"), the Federal Reserve Board of Governors (the "Board"), the Office of the Comptroller of the Currency (the "OCC"), the Securities and Exchange Commission (the "SEC") and, in the case of a securitization of any "residential mortgage asset," the Federal Housing Finance Agency ("FHFA") and the Department of Housing and Urban Development ("HUD" and collectively,

[1] The American Securitization Forum is a broad-based professional forum through which participants in the U.S. securitization market advocate their common interests on important legal, regulatory and market practice issues. ASF members include over 330 firms, including issuers, investors, servicers, financial intermediaries, rating agencies, financial guarantors, legal and accounting firms, and other professional organizations involved in securitization transactions. The ASF also provides information, education and training on a range of securitization market issues and topics through industry conferences, seminars and similar initiatives. For more information about ASF, its members and activities, please go to www.americansecuritization.com.

[2] *See* http://edocket.access.gpo.gov/2011/pdf/2011-8364.pdf.

the "Joint Regulators") to jointly implement rules to require any securitizer to retain an economic interest in a portion of the credit risk for any asset that the securitizer, through the issuance of an asset-backed security, transfers, sells or conveys to a third party. ASF supports reforms within the securitization market and we commend the Joint Regulators for seeking industry input on this critically important issue. Over the past decade, ASF has become the preeminent forum for securitization market participants including investors, issuers and broker-dealers, among others, to express their views and ideas. ASF was founded as a means to provide industry consensus on market and regulatory issues, and we have established an extensive track record of providing meaningful comment to various regulators on issues affecting our market. We are hopeful that the comments included in this letter will assist the Joint Regulators in crafting regulations that ultimately meet the goals of Dodd-Frank while also promoting a vibrant securitization market.

ASF supports efforts to align the incentives of originators and securitizers with those of securitization investors and we believe these incentives should encourage the application of sound underwriting standards by both the originator and securitizer in connection with the assets that are securitized. We believe that risk retention can aid in achieving this goal so long as the requirements are tailored to each asset class, taking into consideration that the forms of credit risk retention may differ by asset type. This fundamental premise was outlined in a series of preliminary comment letters that ASF submitted to each of the Joint Regulators last year. In preparing the Proposed Regulations, the Joint Regulators undertook the complex task of evaluating the diverse characteristics of securitized assets and the structures historically used in securitizations. We applaud the hard work of the Joint Regulators in developing the Proposed Regulations and their efforts to tailor the proposed rules to each asset class and securitization structure. However, we believe that the time-intensive task of creating risk retention rules that both protect investors and encourage a robust and efficient securitization market is far from complete.

Finally, we note that the Joint Regulators announced on June 6, 2011 an extension of the deadline for comments from June 10, 2011 to August 1, 2011. While we appreciate the extra time the Joint Regulators are giving the public to respond to their current proposals, ASF is submitting the bulk of our comments today after two months of thoughtful deliberation and discussion by our dedicated member institutions, outside counsel and staff. ASF believes it is critically important for the Joint Regulators to appropriately implement the risk retention portion of Dodd-Frank and we strongly urge them to reconsider their proposals and offer a new set of proposed rules that better align the incentives and needs of borrowers, lenders and investors.

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I. Introduction

The ASF has long been supportive of further methods to align the incentives of issuers and investors of mortgage- and asset-backed securities and we very much appreciate the hard work the Joint Regulators have put into developing the Proposed Regulations. In drafting the Proposed Regulations, the Joint Regulators have indicated that they have taken into account the diversity of assets that are securitized, the structures historically used in securitizations, and the manner in which securitizers may have retained risk. Despite the efforts of the Joint Regulators, significant work still needs to be done to evolve the Proposed Regulations into workable solutions. What is at stake is the risk of significant reductions in the availability of auto loans, mortgages, student loans, credit cards, and commercial credit all across America. Given that many engines of the U.S. economy are still sputtering and unemployment remains extremely high, the ASF advocates strongly that these rules not overreach to attempt to "fix" sectors of the securitization markets that did not see any losses during an extreme economic downturn and instead are now powering economic revival in some areas of the economy. Attempts to realign incentives in many types of securitization structures, where those incentives have demonstrated through strong performance to be well-aligned between issuer and investor, only serve to risk harm to the American economy, American consumer and to investors.

Last year, ASF submitted a series of preliminary comment letters to each of the Joint Regulators supporting the proposal of risk retention requirements that are tailored to each major asset class, including residential mortgage-backed securities, auto ABS, ABCP, credit card ABS, student loan ABS and corporate debt repackagings. In these comment letters, our membership sought to highlight the intricacies of each of these asset classes and stress the need for risk retention requirements that permit tailoring of the retention forms to each class of securitized assets. The views set forth in these preliminary comment letters were consistent with the Dodd-Frank Act's directive to implement "separate rules for securitizers of different classes of assets" and reflected the primary recommendation of the Board of Governors of the Federal Reserve System in its October 2010 Report on Risk Retention, in which it stated: "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."[3] In addition, the Financial Stability Oversight Council, chaired by Treasury Secretary Timothy F. Geithner, indicated in its January 2011 study that a risk retention framework should "[a]lign incentives without changing the basic structure and objectives of securitization transactions; [p]reserve flexibility as markets and circumstances evolve; and [a]llow a broad range of participants to continue to engage in lending activities, while doing so in a safe and sound manner."[4]

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[3] The Federal Reserve Study, available at http://federalreserve.gov/boarddocs/rptcongress/securitization/riskretention.pdf, pg. 3, 83-84.

[4] The FSOC Study, pg. 3, available at: http://www.treasury.gov/initiatives/wsr/Documents/Section%20946%20Risk%20Retention%20Study%20%20%28FINAL%29.pdf.

We believe that the Proposed Regulations missed the mark in many key areas and failed to achieve the recommendations of the risk retention studies mandated by Dodd-Frank. As set forth in this letter, we believe that the Proposed Regulations will need to be substantially revised to promote a healthy securitization market. While we appreciate the Joint Regulators provision of an extended comment period for the Proposed Regulations, given the complexity of the various sectors of the securitization market, the highly detailed fixes outlined in this letter, the material nature of the proposed changes and controversies surrounding them, we continue to believe that a re-proposal is necessary to ensure that the Joint Regulators get the final risk retention rules right.

II. Impact on Mortgage Finance

A. Premium Capture

The proposed premium capture rule exceeds the mandate and legislative intent of Dodd-Frank by adding on to the 5% risk retention requirement the entire value of ABS issued in a securitization over par— effectively nullifying the securitizer's entire return on the transaction. The rule as proposed will have pervasive effects on securitization and borrowers, including assuring the accounting consolidation of the securitization onto the balance sheet of the securitizer regardless of the risk retention form employed and higher capital requirements for all institutions, especially insured depository institutions.

The premium capture rule also fails to take into account the cost of origination of loans, including out-of-pocket costs such as appraisals and title insurance, as well as the originator's overhead and profit on sale. In addition, the rule would interfere with an originator's or sponsor's ability to use interest rate hedges during the period between origination and securitization, which would likely prevent originators from offering borrowers rate locks for the period between application and funding. Finally, the harsh impacts of the premium capture rules will be most severe for low and moderate income borrowers with less than prime credit histories, because securitizations of loans to such borrowers create significant amounts of excess spread. This will result in credit being less available to, and more expensive for, low to moderate income mortgage borrowers.

Most disturbing, however, is that the premium capture rule as currently proposed eliminates virtually all incentives to securitize for institutions other than those that securitize purely for financing. Institutions with other sources of funding will move away from securitization altogether, resulting in a constriction of credit and an increased cost of capital. A reduced availability of credit would put more negative pressure on home values and, in turn, creating more walk away borrowers and further reduce the trillions of dollars of outstanding ABS that investors currently own.

ASF has been informed by representatives of one of the Joint Regulators that the intent of the premium capture rule was only to ensure that the value of the 5% risk retention, specifically if held as a horizontal slice, is in fact worth at least 5% of the fair value of all securities backed by the pool. If this is indeed the case, our issuer and investor members suggest that all relevant portions of the Proposed Regulations be re-proposed to fully reflect this alternative meaning, so that market participants may have actual proposed language on which to provide comment. Depending on the form of this alternative provision, many of the grave consequences outline above could be alleviated.

B. Accounting Considerations

Our accounting committee has indicated that vertical slice retention, in and of itself, would likely not cause the sponsor to consolidate the assets of the securitization issuer, even if the sponsor or an affiliate is acting as servicer. However, this conclusion is dependent on the sponsor owning no more than 5% of each tranche and a higher percentage of retention could change the analysis and require consolidation. In fact, by effectively adding the value of the excess spread to a 5% vertical slice risk retention, the premium capture rule would likely cause the total risk retention to be viewed as a significant interest and result in consolidation (assuming servicing is retained by an affiliate of the sponsor). This in turn would require radically higher capital requirements, especially for insured depository institutions.

Additionally, it is important to note that the application of the premium capture rule alone could cause the loss of sale treatment in transactions where the sponsor is affiliated with the servicer, even if (such as in the case of representative sample retention) no securities are retained. This result will be dependent on whether the amount retained in the premium capture cash reserve account is deemed to be a significant interest, but because the interest will be in a first loss position, even a small percentage will likely be considered significant.

C. Qualified Residential Mortgage

The highly conservative nature of the QRM definition will likely limit the availability, and increase the cost, of mortgage credit to consumers, particularly to those with low to moderate incomes. In light of the risk retention requirements that will exist upon the securitization of non-QRM loans, these loans will certainly feature higher interest rates, more points and fees and more onerous terms than QRM loans. The Proposing Release indicates that approximately 19.79% of all loans purchased or securitized by the GSEs during the period 1997 - 2009, and approximately 30.52% of loans in 2009 alone, would have met the QRM criteria. In the current market, even highly creditworthy borrowers are continuing to experience difficulties in obtaining mortgage financing, as uncertainty in the world financial markets in general and the mortgage market in particular make obtaining credit difficult. This problem will be substantially exacerbated, and the availability of mortgage credit to consumers will suffer, if the QRM definition is not expanded to include a greater percentage of the mortgage market.

Furthermore, the QRM exemption to the risk retention requirements is only available if all the loans underlying the securitization are QRMs. This requirement effectively splits the securitization market into transactions backed by QRMs and transactions backed by non-QRMs. We are concerned that it may not be possible for sponsors to originate QRMs in numbers sufficient to generate the critical mass of loans necessary for economically efficient securitizations, which would invariably increase the cost of such loans. This is particularly true in light of the very stringent definition of QRM proposed by the Joint Regulators.

In order to alleviate this risk and ensure economically efficient securitizations, we urge the Joint Regulators to establish a "QRM blend" exception from the standard 5% risk retention requirement. A QRM blend exception would allow QRMs to be included in a pool that also contains non-QRMs, in a way that effectively preserves the 0% risk retention requirement on the QRM portion of the pool. We believe that this exception would be consistent with the statutory framework of the Dodd-Frank Act.

Issuers believe that a QRM blend exception could only be effective if they were permitted to construct a securitization in which some portion but not all of the loans in a pool meet the QRM criteria and the 5% risk retention requirement would be ratably reduced by the proportion of the total pool that meets the QRM standards. Such a partial exemption would be in keeping with the risk retention mandate of Dodd-Frank, because sponsors would still have the incentive to originate loans in accordance with safe underwriting standards. In a blended pool, loans originated so as to comply with the strict underwriting standards of the QRM definition would effectively have no risk retention requirement. Loans originated in accordance with underwriting standards that did not meet the QRM criteria would effectively be subject to a 5% risk retention requirement. The percentage of risk retention for the pool as a whole would be equal to the weighted average of each loan's effective risk retention requirement. This would meet all the goals of the risk retention rules, while at the same time maintaining the feasibility of securitizing QRMs and avoiding the increased costs to borrowers that would follow if such securitizations were not economically efficient.

D. Future of the GSEs

Since the time the GSEs were placed into conservatorship, their economic significance has only increased, and they, along with FHA, guarantee 95% of American mortgages, as the private label MBS market continues to lie dormant. Recently, however, policymakers have begun to reconsider the future of these institutions and the broader question of whether the federal government should continue to play a major role in the nation's housing finance market. On February 11, 2011, the Obama Administration released its plan for reforming America's housing finance market, which called for a winding down of the GSEs and reviewed measures to encourage the return of private capital to the market, such as reducing conforming loan limits and increasing guarantee fee pricing.

The Proposed Regulations would impose significant burdens on issuers of private label MBS but provide that the implicit 100% taxpayer guarantee is a suitable form of skin in the game for the GSEs, effectively exempting them from the Proposed Regulations (including the premium capture rule). This has sparked considerable criticism from many in Congress who believe the proposed GSE exemption extends well beyond the Joint Regulators' mandate under Dodd-Frank.

We are concerned that the very conservative terms of the proposed QRM definition, taken together with the risk retention requirements, the premium capture rule and the resulting accounting issues, will provide a significant and undue competitive advantage to the GSEs over private market participants. Securities guaranteed by the GSEs will be able to be securitized free from the risk retention requirements irrespective of whether such securities are QRMs, which will result in the non-QRMs loans backing such securities having lower costs to borrowers and more attractive terms than similar loans offered by private market participants. This will have the effect of increasing the portion of the residential mortgage market dominated by the GSEs, further entrenching the importance of their role in such market. This will make it substantially more difficult for Congress to carry out its efforts to restructure or wind down the GSEs, since a substantial percentage of consumers will be wholly dependent on the GSEs to provide them with affordable mortgage financing.

In our view, the best way to level the playing field and avoid increasing the role of the GSEs in the residential mortgage market is to reduce the impact of the risk retention requirements on private market participants. Reconciling the QRM criteria with the GSE requirements and permitting the use of "QRM blend" pools as described above would enable private market participants to compete on more equal terms with the GSEs for most of the mortgage market comprised of prime borrowers.

E. Servicing Standards

The inclusion of servicing standards in the QRM definition goes well beyond the legislative intent of Dodd-Frank and its mandate for including criteria relating to underwriting and product features. There is no evidence, either in the legislative history or the language of Dodd-Frank, that Congress intended to include servicing standards as part of risk retention rules. In fact, incorporating servicing standards into the QRM definition would have the peculiar result of regulating the servicing of the highest quality borrowers, those with the least risk of encountering servicing issues or needing loss mitigation, while the bulk of the market, consisting of borrowers with a greater need for loss mitigation, would be left unregulated.

We understand and appreciate the regulatory imperative for national servicing standards that address the above issues and our members are generally supportive of this effort. But, as noted in the Joint Regulators' proposing release, there is a separate interagency effort among certain Federal regulators to develop national servicing standards that will apply to all servicers of residential mortgage loans. We believe that this effort should not be rolled out on a piecemeal basis, and that the QRM definition is not the right time and place for even a limited preview of these criteria. The key to success for such criteria is that they should be universal. We frankly believe that it is just not good public policy to apply these nascent and still developing standards to a small fraction of new originations.

We also believe that compliance with the national servicing standards under development should be a matter of regulatory compliance only and not included in the loan documents as proposed. Such a requirement would create unnecessary risks for investors and increase moral hazard in the case of unscrupulous borrowers.

F. Seasoning Exemption

We believe that the Joint Regulators should establish an exemption from the risk retention requirements for loans that were originated a significant period of time prior to securitization. These "seasoned" loans have established payment histories with borrowers who have demonstrated their ability to repay. Lenders who are securitizing seasoned loans have already retained 100% of the risk of such loans during the period in which the loans were most likely to experience performance problems. We note that the Joint Regulators have the authority to adopt a seasoned loan exemption pursuant to the provisions of Dodd-Frank.

Our issuer and investor members agree that a seasoning exemption for RMBS is appropriate but they differ on the prescribed length of time. Our issuer members suggest that the seasoning period be no longer than two years for all loans. For fully amortizing fixed rate loans, investors suggest that loans that have been outstanding and performing for three years should be exempt. For ARM loans, investors believe the time period should be dependent upon the initial reset, which, depending on the terms of the loan, may cause payment shock. They believe a prudent approach would be to exempt ARM loans that have fully performed and have been outstanding at least one year after the initial reset.

G. Hedging, Transfer and Financing Restrictions

We are generally supportive of the hedging, transfer and financing restrictions set forth in the Proposed Regulations. However, we believe that it is appropriate for a sponsor to be permitted to hedge, transfer or finance its retained interest in an RMBS transaction free of these restrictions after a specified period of time has elapsed from the issuance of the ABS. Sponsors will be motivated to originate assets with good credit characteristics knowing that they will retain a portion of the risk of default on those assets for a substantial period of time. This is especially true since historically the assets underlying RMBS transactions are more likely to default early in their terms, and become less likely to default as they become more seasoned. Our issuer members propose that this time period be no longer than two years. Our investor members suggest that this time period be the later of 5 years or when the pool is reduced to 25% of its original principal balance.

III. Failure to Incorporate Market Practices

The commentary in the Proposing Release specifically indicates that the Proposed Regulations for ABCP and credit card ABS are meant to track current market practices. However, there are numerous parts of the Proposed Regulations that are, in fact, not at all consistent and would cause detrimental effects on those markets.

A. ABCP

We are proposing to expand the permitted forms of horizontal risk retention for ABCP under the Proposed Regulations to include unfunded credit enhancement in the form of unconditional and irrevocable letters of credit and other similar credit facilities provided by regulated entities. Such unfunded credit enhancement has earned investor confidence over the ABCP market's 30-year history, including during the most recent financial crisis, and would permit most asset-backed commercial paper programs to continue to operate as they currently do. Moreover, this form of risk retention is allowed under Article 122A of the Capital Directive of the European Union, but is proposed not to be allowed under the U.S. retention rules. We also suggest making technical corrections to the provisions of the Proposed Regulations relating to "eligible ABCP conduits." Our proposed corrections are designed to better align the provisions in the Proposed Regulations with existing ABCP program structures and practices, while simultaneously satisfying the policy goals of the Proposed Regulations. Finally, we propose to eliminate the requirement that the names of originator-sellers be disclosed to investors, but to retain the requirement for such disclosure, upon request, to the appropriate regulator. This modification will both (a) enable the regulators to monitor originator-seller compliance with the requirement in the "eligible ABCP conduits" provisions of the Proposed Regulations and (b) allow the ABCP market to continue to operate with the type of disclosure to ABCP investors that has been developed with investor input and with which investors are satisfied.

B. Credit Card ABS

Throughout the history of the master trust structure, credit and charge card securitizers have held meaningful economic interests in their master trusts that have been extremely effective in aligning the interests of originators and securitizers with those of investors. To preserve securitization as a viable funding option for credit and charge card securitizers, it is imperative that the proposed risk retention rules be revised to reflect the manner in which credit and charge card securitizers have historically retained exposure to the credit risk of the receivables in the master trust. The seller's interest is a fundamental structural component of every credit and charge card securitization transaction and is a quintessential and critical form of risk retention. We believe that the seller's interest option provided in the proposed risk retention rules can be adjusted in a manner that preserves it as a workable risk retention mechanism through the relatively discrete, but important, revisions we set forth in this letter. Other aspects of the proposed regulations have not been drafted to reflect the nuanced and technical features of the master trust structure and so will require more significant revisions if they are to become workable for credit and charge card securitization transactions.

IV. <u>Exemptions</u>

A. FFELP Student Loans

We believe that outstanding FFELP student loans should be exempt from the Proposed Regulations. Student loans originated under the Federal Family Education Loan Program carry a guarantee by the federal government, and continue to be held on the balance sheets of numerous state agencies, banks and finance companies. Established in 1965, FFELP provided for the origination of loans pursuant to minimum prescribed criteria to "qualified students" who are enrolled in eligible institutions, or to parents of dependent students, to finance their educational costs. FFELP loans were originated by commercial banks, thrifts, nonprofit organizations, independent finance companies, and credit unions, and are often held in an investment portfolio or securitized. We note that the Proposed Regulations do not include an exemption for FFELP loan securitizations from the risk retention requirements. Instead, the Proposed Regulations fully exempt any securitization transaction if the ABS issued in the transaction are collateralized solely by assets that are fully insured or guaranteed as to the payment of principal and interest by the United States or an agency of the United States. Under FFELP, loans provided a government guaranty of 97 to 100 percent of the defaulted principal and accrued interest in the event that the student defaulted on the loan. Our request is consistent with exemptions set forth in the Proposed Regulations for other types of partially insured or guaranteed loans, such as VA loans and Department of Agriculture Rural Development loans.

B. Qualifying Auto Loan

We believe that in preparing the qualifying auto loan definition, the Joint Regulators made a fundamental error in attempting to analogize to the residential mortgage asset class. This inappropriate paralleling is evident in the focus on debt and income verifications at origination, which have traditionally not been required for even the highest quality motor vehicle originations, a required 20% down payment (comprised of cash and/or vehicle trade-in value) in a market where advance rates above 100% are commonplace, and a requirement that the originator or its agent hold the certificate of title on the related loan when one-in-five states require that the consumer, rather than the lender, hold a motor vehicle's certificate of title. These features simply illustrate a misunderstanding of what constitutes a "standard" product in the motor vehicle marketplace. We are continuing to develop our comments on the proposal for securitizations of qualifying automobile loans. We will submit an additional comment letter setting forth suggested revisions to that proposal during the extended comment period.

C. Qualifying Equipment Loan

The Joint Regulators have proposed pursuant to Dodd-Frank a zero percent risk retention requirement for ABS issuances collateralized by qualifying "commercial loans." However, the underwriting standards initially proposed for qualifying commercial loans are not relevant to equipment commercial loans, which are a frequently securitized type of commercial loan. Notably, equipment commercial loans meet the current definition of "commercial loan" as proposed by the Joint Regulators; it is only the underwriting standards set forth in the proposed rules that do not reflect actual industry underwriting practices and standards for the origination of equipment commercial loans. Our equipment sponsor members do not believe that an equipment ABS transaction has ever been executed that would meet the criteria set forth in the Proposed Regulations.

Our equipment sponsors propose the new term "equipment commercial loan," which would have underwriting standards and other requirements targeted specifically to this important category of commercial loans, which would include loans or finance leases related to equipment used in industries such as trucking and transportation, farming, construction and mining, and forestry. In underwriting equipment commercial loans, the industry generally focuses on the type and use of the equipment, in addition to the credit quality of the applicant. This equipment is often vital to the success of the obligor's business so such obligor's motivation to keep the loan in good standing is very high. This equipment is generally income-producing or otherwise critical to the obligor's business and has a long useful life.

D. CLOs

We believe that the Joint Regulators should reconsider whether CLOs should be subject to the Proposed Regulations. CLOs involve the issuance of debt and equity securities which are backed by cash flows generated by loans to large and medium sized corporate obligors. CLOs, however, differ dramatically from traditional ABS and from ABS CDOs. We believe that if risk retention in the form currently contemplated by the Proposed Regulations is imposed on CLOs, they are likely to cease as a viable financing option. Because managed CLOs are secondary market transactions, our view is that the imposition of risk retention in the context of managed CLOs would not serve any of the concerns that are the premise of Section 941. We also believe that a note contained in the Proposing Release is inconsistent with the statutory authority of the Joint Regulators in that it imposes a risk retention obligation on CLO managers that does not fall within the scope of the plain language of Section 941. Finally, we also believe that managed CLOs currently incorporate structural fees (in particular CLO manager fee structures) that already align the interests of CLO managers with those of investors and, as such, a separate risk retention obligation is not necessary in the context of managed CLOs. In essence, the manager in a managed CLO is no different than the manager of a traditional mutual fund that invests in bonds. The incentive of the manager of a bond mutual fund is aligned with those of the investors in such fund through the bond mutual fund manager’s fee structure.

Unfortunately, as written, the qualifying commercial loan definition would have no practical significance for CLOs because the corporate loans backing CLOs are individually negotiated and none of the loans would comply with the terms as written. If the Joint Regulators conclude, however, that risk retention, as a general rule, applies to CLOs, we urge the Joint Regulators to consider defining a CLO safe harbor which would set forth the specific circumstances where risk retention would not be necessary in the context of CLOs. We believe that a safe harbor could be designed to limit its applicability to managed CLOs backed by syndicated corporate loans in contexts where (1) the interests of the CLO manager are aligned with those of investors and (2) the concerns of the “originate to distribute” model of securitization do not exist.

E. Resecuritizations

We believe the exemption proposed for resecuritization transactions is overly narrow and does not further the Congressional goal of aligning the interests of originators and investors in order to improve the credit quality of the loans underlying ABS transactions. Sponsors generally engage in resecuritization transactions in order create a class of securities that is more creditworthy, and hence will receive better ratings, than the underlying securities (which themselves may have declined in credit quality and been downgraded). This is accomplished by issuing one or more classes that are subordinate to, and hence absorb losses before, such senior class. Resecuritizations have served as an important balance sheet tool for banks as well as a means for investors in the initial securitization transaction to acquire the resecuritized and higher-rated resecuritization securities in lieu of the downgraded securities they currently own. By limiting the exemption to single class resecuritizations, the Proposed Regulations will likely render these types of transactions obsolete.

Requiring risk to be retained as part of the resecuritization transaction does not provide any additional incentives to originators to employ better underwriting practices in connection with the origination of loans and other receivables. With respect to a resecuritization transaction, the loans and other receivables have generally been originated long before such transaction is contemplated, and retention of credit risk at the resecuritization level can in no way affect the procedures employed in connection with the origination of such assets. Furthermore, the loans underlying the securities being resecuritized are seasoned, and such loans are less likely to go into default than newly originated loans. For these reasons, our issuer members believe that all resecuritization transactions should be exempt from the risk retention requirements, including those transactions that resecuritize assets that themselves do not comply with the risk retention requirements. While our investor members acknowledge that origination would not be improved by this restriction, they believe an exemption should be limited to resecuritizations of existing ABS for which risk has already been retained, to ensure that the sponsor, or other party within the securitization chain, has ongoing exposure to the transaction.

F. Municipal Bond Repackagings

We believe that securitizations involving the repackaging of municipal bonds (*i.e.*, any securitization transaction if the ABS issued in the transaction are collateralized by obligations of states, political subdivisions of states or other local governmental entities) should be fully exempted from the risk retention requirements. The most common form of such municipal bonds repackaging is often referred to in the marketplace as "tender option bonds" or "TOBs." The TOBs market, which has been in existence for nearly two decades, has come to play an important role in the larger municipal finance market by bringing together issuers of fixed rate, long-term debt and buyers of variable rate, short-term instruments. The floating rate securities created under the numerous TOBs programs have become a critical component of the investment portfolios of the short-term tax-exempt money market funds that have become such a fundamental fixture on the financial landscape of the United States. Municipal bonds repackaging securitizations are not the type of securitizations that prompted Congress to enact Section 15G, but rather are securitizations inadvertently caught up in the regulatory net cast by Congress largely because of the broad Dodd-Frank definition of ABS. Indeed, municipal bonds repackaging transactions are not perceived in the marketplace as being asset-based securitizations at all. An exemption currently exists in the Proposed Regulations for any asset-backed security that is a security issued or guaranteed by any state of the United States, by any political subdivision of a state or territory or by any public instrumentality of a state or territory that is exempt from securities registration requirements. We believe that this exemption should be expanded to provide an exemption from the risk retention requirements for any securitization that is collateralized solely by such ABS.

G. Corporate Debt Repackagings

We believe that the Joint Regulators should exercise the express exemptive authority granted to them in Section 941 of the Dodd-Frank Act to fully exempt corporate debt repackagings from the risk retention requirements, as the application of those requirements do not further the public policy behind Section 941. Corporate debt repackagings are created by the deposit of corporate debt securities purchased by the sponsoring institution in the secondary market into a trust which issues certificates backed by cash flows on the underlying corporate bonds. Corporate Debt Repackagings are generally issued in order to (i) provide access by individual investors to the corporate debt market or (ii) provide institutional investors with a preference for specific interest and currency types access to corporate debt that was issued with a differing interest or currency type.

Unlike traditional ABS, such as securities backed by mortgage or consumer loans, Corporate Debt Repackagings are not part of the process of directly or indirectly financing the origination of consumer loans or other financial assets. Instead, they represent the reoffering of existing debt securities of corporate issuers acquired in the secondary market. Those corporate debt securities are not created by the underlying corporations with the intention or expectation that they will be acquired and securitized. Accordingly, the retention of an interest in the corporate bonds underlying a Corporate Debt Repackaging would serve no public interest nor further the protection of investors, as such risk retention would have no effect, directly or indirectly, on the creation of the asset underlying the securitization, the credit quality of which is solely dependent on the credit of the issuer of the underlying corporate bond and not a third party, such as a mortgagor or automobile purchaser, that is the subject of credit underwriting.

V. Competing Regimes

A. Cross-Border Issues

It is important to highlight that securitization transactions in Europe are subject to their own risk retention requirements set forth in the European Union's CRD Article 122a.[5] The structure of the European risk retention regime is fundamentally different than the U.S. rules. While the U.S. rules apply to issuers of ABS, the European rules apply to European Economic Area credit institutions that invest in ABS. Ultimately, this could have the peculiar result of application of both risk retention regimes, which is further confused by the regulations' differing requirements. Harmonization among the two sets of rules will be critical to a functioning and efficient securitization market.

B. FDIC Securitization Safe Harbor

The FDIC's securitization safe harbor (the "FDIC Safe Harbor") currently in effect for banks also includes a risk retention requirement, but only permits a vertical slice or representative sample. While the FDIC Safe Harbor does include an "auto conform" provision that is designed to align it with the rules enacted by the Joint Regulators, the interim effects of the FDIC's inferior rules are not addressed. For example, the FDIC Safe Harbor does not take into account characteristics of different assets and it ignores securitization features such as overcollateralization and seller's interest. Furthermore, the FDIC Safe Harbor's representative sample option is formulated differently than the representative sample option included in the Joint Regulators' Proposed Regulations, and so a bank seeking to avail itself of this option would have to adopt one set of procedures to comply with the FDIC Safe Harbor in its current form and then a different set of procedures at such time as the auto-conform provision takes effect.

We also note that, by its own admission, the FDIC's May 3, 2011 CMBS transaction did not comply with the FDIC Safe Harbor. The FDIC indicated in the press release for the transaction that "[t]he pilot program is consistent with the [FDIC Safe Harbor], except for certain

[5] *See* CRD Directive 2006/48/EC, p. 78, available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2006L0048:20100330:EN:PDF.

limited differences necessitated by the origin of the collateral and the absence of information available from the failed banks." While this admission is concerning on its own, we also note that, while certain of the classes contained an FDIC guarantee, the transaction did not comply with either the vertical or representative sample retention requirements of the FDIC Safe Harbor.

VI. Need for a Re-Proposal

In preparing the Proposed Regulations, the Joint Regulators undertook the complex task of evaluating the diverse characteristics of securitized assets and the structures historically used in securitizations. We applaud the hard work of the Joint Regulators in developing the Proposed Regulations and their efforts to tailor the proposed rules to each asset class and securitization structure. However, we believe that the time-intensive task of creating risk retention rules that both protect investors and encourage a robust and efficient securitization market is far from complete.

Despite the structural integrity and strong performance record of many ABS segments, the Proposed Regulations would require many sponsors to alter the structures of their securitization programs. While the Proposed Regulations include a number of permissible methods of risk retention, the definitions of and requirements for those methods would not accommodate common methods of risk retention in many asset classes, including auto loans, student loans, credit cards and ABCP. Furthermore, even in cases where the Joint Regulators indicated that the proposals were meant to exactly conform to existing market practices, there are significant differences that would create major disruptions in the ABS market. If the risk retention rules are not appropriately designed to accommodate existing market practices, we risk an immediate and significant reduction in the availability of auto loans, student loans, credit cards and business credit throughout our country without gaining material improvements to the risk retention practices that protected investors even during the worst of the financial crisis. The risk of shutting down the securitization markets is not warranted where investors have been protected by existing risk retention methods. Therefore, it is imperative that the provisions of the Proposed Regulations accommodate existing market practices that effectively align the interests of sponsors with those of investors.

Given the diversity and complexity of the securitization market and the highly technical nature of the Proposed Regulations, we believe that revisions made by the Joint Regulators in response to the comments submitted on the proposal, which will likely number in thousands of pages, will most certainly justify an opportunity for further review by all securitization market participants prior to adoption. Therefore, we urge the Joint Regulators to revise the Proposed Regulations to address the concerns described by market participants and to re-propose a rule implementing Section 941 of Dodd-Frank for further consideration and public comment prior to adoption. We strongly believe that this course of action will better enable the Joint Regulators to ensure that the final regulations achieve the goals of Dodd-Frank while promoting a healthy and vibrant securitization market.

Finally, we are also concerned about the complexity of the process of managing the implementation and interpretation of the final risk retention rules. In the Proposed Regulations, the Joint Regulators indicated that they will jointly approve any written interpretations, written responses to requests for no-action letters and legal opinions, or other written interpretive guidance concerning the scope or terms of the final rules that is intended to be relied on by the public generally. The Joint Regulators further indicated that they will jointly approve any exemptions, exceptions or adjustments to the final rules. The process for seeking corrections to final regulations or interpretive guidance from a *single* regulator is often onerous and time-consuming. These burdens will be dramatically compounded in the case of the final risk retention rules where the corrections and guidance would need to be approved by multiple regulators. In light of this concern, it is imperative that securitization market participants be granted an opportunity to review the impact of substantive revisions to the re-proposed risk retention rules before they are adopted.

COMPREHENSIVE LETTER

I. Introduction

ASF submits this letter to express our views relating to implementation of Section 941 (Regulation of Credit Risk Retention) of the Dodd-Frank Act. We support efforts to align the incentives of issuers and originators with investors of asset-backed securities ("ABS") and believe these incentives should encourage the application of sound underwriting standards by both the originator and securitizer in connection with the assets that are securitized. We believe that risk retention can aid in achieving this goal so long as the requirements ultimately prescribed are appropriately tailored to each class of securitized assets. Section 941 of the Dodd-Frank Act requires the Joint Regulators to jointly implement rules to require any "securitizer" to retain an economic interest in a portion of the credit risk for any asset that the securitizer, through the issuance of an "asset-backed security," transfers, sells, or conveys to a third party. Section 941 amends the Securities Exchange Act of 1934 (the "Exchange Act") to establish an alternative definition of "asset-backed security" (an "Exchange Act ABS") that is broader than the existing definition set forth in Regulation AB of the Securities Act of 1933 (the "Securities Act") and 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.

The general standards for risk retention are set forth in Section 941, which requires a securitizer to retain "(i) not less than 5 percent of the credit risk for any asset" or "(ii) less than 5 percent of the credit risk for an asset" if the originator of the asset meets underwriting standards to be prescribed by the Joint Regulators. The regulations prescribed under Section 941 must also specify "the permissible forms of risk retention" and "the minimum duration of the risk retention." In addition, the regulations "shall establish asset classes with separate rules for securitizers of different classes of assets, including residential mortgages, commercial mortgages, commercial loans, auto loans, and any other class of assets that the Federal banking agencies and the SEC deem appropriate" and, for each asset class established, the regulations "shall include underwriting standards established by the Federal banking agencies that specify the terms, conditions, and characteristics of a loan within the asset class that indicate a low credit risk with respect to the loan." Additionally, Section 941 specifies that the regulations shall provide for certain exemptions as further described in this letter.

In November and December of 2010, ASF submitted a series of preliminary comment letters to each of the Joint Regulators supporting the proposal of risk retention requirements that are tailored to each major asset class, including (i) our comment letter[6] relating to residential mortgage-backed securities ("RMBS") and the qualified residential mortgage ("QRM") exemption (the "ASF RMBS Risk Retention Letter"), (ii) our comment letter[7] relating to auto

[6] *See* "ASF Comment Letter re RMBS Risk Retention & QRM," American Securitization Forum (November 12, 2010), available at http://www.americansecuritization.com/uploadedFiles/ASF_RMBS_Risk_Retention_Letter_11.12.10.pdf.

[7] *See* "ASF Comment Letter re Risk Retention for Auto ABS," American Securitization (November 22, 2010), available at http://www.americansecuritization.com/uploadedFiles/ASF_Auto_Risk_Retention_Letter_11.22.10.pdf.

ABS (the "ASF Auto Risk Retention Letter"), (iii) our comment letter[8] relating to ABCP (the "ASF ABCP Risk Retention Letter"), (iv) our comment letter[9] relating to credit card ABS (the "ASF Credit Card Risk Retention Letter"), (v) our comment letter[10] relating to student loan ABS (the "ASF Student Loan Risk Retention Letter") and (vi) our comment letter[11] relating to corporate debt repackagings (the "ASF Repack Risk Retention Letter" and collectively, the "ASF Preliminary Risk Retention Letters"). In these comment letters, our membership sought to highlight the intricacies of each of these asset classes and stress the need for risk retention requirements that permit tailoring of the retention forms to each class of securitized assets.

The views set forth in the ASF Preliminary Risk Retention Letters were consistent with the Dodd-Frank Act's directive to implement "separate rules for securitizers of different classes of assets" and reflected the primary recommendation of the Board of Governors of the Federal Reserve System in its October 2010 Report to the Congress on Risk Retention (the "Federal Reserve Study"), in which it stated:

> "Thus, this study concludes that simple credit risk retention rules, applied uniformly across 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."[12]

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[8] *See* "ASF Comment Letter re Risk Retention for ABCP," American Securitization Forum (November 22, 2010), available at http://www.americansecuritization.com/uploadedFiles/ASF_ABCP_Risk_Retention_Comment_Letter_11.22.10.pdf.

[9] *See* "ASF Comment Letter re Risk Retention for Credit and Charge Card ABS," American Securitization Forum (November 23, 2010), available at http://www.americansecuritization.com/uploadedFiles/ASF_Credit_Card_Risk_Retention_Letter.pdf.

[10] *See* "ASF Comment Letter re Risk Retention for Student Loan ABS," American Securitization Forum (November 23, 2010), available at http://www.americansecuritization.com/uploadedFiles/ASF_Student_Loan_Risk_Retention_Letter.pdf.

[11] *See* "ASF Comment Letter re Corporate Debt Repackaging," American Securitization Forum (December 14, 2010), available at http://www.americansecuritization.com/uploadedFiles/ASF_Corporate_Debt_Repackaging_Letter_FINAL_12-14-10.pdf.

[12] The Board of Governors of the Federal Reserve System, Report to Congress on Risk Retention, available at http://federalreserve.gov/boarddocs/rptcongress/securitization/riskretention.pdf, pg. 3, 83-84.

In addition, the Financial Stability Oversight Council ("FSOC"), chaired by Treasury Secretary Timothy F. Geithner, indicated in its January 2011 study (the "FSOC Study") that a risk retention framework should "[a]lign incentives without changing the basic structure and objectives of securitization transactions; [p]reserve flexibility as markets and circumstances evolve; and [a]llow a broad range of participants to continue to engage in lending activities, while doing so in a safe and sound manner."[13]

During the week of March 28, 2011, each of the Joint Regulators approved for release their notice of proposed rulemaking (the "Proposing Release") entitled "Credit Risk Retention." The Proposed Regulations provide a range of options that securitizers may choose from in meeting the risk retention requirements, including: (i) retention of a "vertical slice" of each class of interest issued in the securitization, (ii) retention of an "eligible horizontal residual interest" in the securitization, (iii) use of "L-Shaped" risk retention, which combines both vertical and horizontal forms, (iv) 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, (v) retention in its portfolio of a "representative sample" of assets equivalent to the securitized assets; and (vi) other risk retention options that purport to take into account the manner in which risk retention often has occurred in connection with the issuance of asset-backed commercial paper ("ABCP") and commercial mortgage-backed securities ("CMBS"). In addition, the Proposed Regulations set forth various exemptions, including exemptions based on certain "qualified" loans such as the QRM, qualifying automobile loans ("Qualifying Automobile Loans") and qualifying commercial loans ("Qualifying Commercial Loans"), as well as hedging restrictions and the premium capture cash reserve account, which would be funded in certain circumstances by excess spread monetized at the time of securitization.

In drafting the Proposed Regulations, the Joint Regulators have indicated that they have taken into account the diversity of assets that are securitized, the structures historically used in securitizations, and the manner in which securitizers may have retained risk. We applaud the hard work of the Joint Regulators in developing the Proposed Regulations and their efforts to tailor the proposed rules to each asset class and securitization structure. However, we believe that the time-intensive task of creating risk retention rules that both protect investors and encourage a robust and efficient securitization market is far from complete.

As such, we respectfully submit herein our comments regarding risk retention for RMBS, ABS backed by auto loans and leases, credit card receivables, student loans and equipment loans, ABCP, municipal bond and corporate debt repackagings, and CLOs. We believe these comments are of critical importance to the Joint Regulators' goal of prescribing risk retention rules that properly align incentives without inhibiting the return of the securitization market and adversely impacting the availability and cost of credit. Simply put, the absence of a properly functioning securitization market, and the funding and liquidity this market has historically provided, adversely impacts consumers, businesses, financial markets and the broader economy. The recovery and restoration of confidence in securitization is therefore a necessary ingredient

[13] Timothy F. Geithner, Chairman, Financial Stability Oversight Counsel, Report to Congress on Macroeconomic Effects of Risk Retention Requirements, available at http://www.treasury.gov/initiatives/wsr/Documents/Section%20946%20Risk%20Retention%20Study%20%20%28FINAL%29.pdf, pg. 3.

for economic growth to resume, and for that growth to continue on a sustained basis into the future.[14]

II. The State of the Securitization Market

As noted by the Board of Governors of the Federal Reserve in its recent study on risk retention, different segments of the ABS and RMBS markets have recovered at varying levels during the 18 months since the "end" of the recession.[15] Auto and auto-related ABS accounted for $53.9 billion in issuance in 2009, which represents 80.7% of the auto and auto-related ABS issuance of $66.8 billion during 2007, just before the downturn.[16] $7.2 billion in equipment ABS was issued during 2009, in contrast with the 2007 issuance of $6.1 billion.[17] Most of the reductions in the Auto and Equipment ABS markets can be explained by the overall decrease in purchases of these products, thereby reducing the financing demands in these markets. In 2009, credit card ABS accounted for $46.6 billion in issuance, down 50.7% from 2007 issuance of $94.5 billion.[18] Most credit card ABS reductions have resulted from the changed capital adequacy changes made as a result of the implementation of FAS 166 and 167, which will be discussed below. Meanwhile, the student loan sector issued $20.8 billion in ABS during 2009, down 64.2% from 2007 issuance of $58.1 billion.[19] Given the elimination of the FFELP program, student loan issuance is expected to be a fundamentally small market, which is limited to securitization of legacy FFELP loans for another couple of years as well as the relatively smaller volumes of private student loan originations. By comparison, on the RMBS side, $48.1 billion of RMBS were issued in 2009, down 92.5% from 2007 issuance of $641.8 billion.[20] In addition to the overall reduction of issuance in the RMBS market, we further note that 97% of RMBS were federally-backed in 2010, as compared with only 64% in 2007 when the private market accounted for a much larger share of RMBS issuance.[21] Simply put, the absence of a properly functioning securitization market, and the funding and liquidity this market has historically provided, adversely impacts consumers, businesses, financial markets and the broader economy. The recovery and restoration of confidence in securitization is therefore a necessary ingredient for economic growth to resume, and for that growth to continue on a sustained basis into the future.[22]

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[14] For more information on the role of securitization within the financial system and U.S. economy, *see* Appendix A.
[15] Federal Reserve Study, pg. 2.
[16] Data are from Asset Backed Alert, see the Proposing Release, pg. 12-13, available at http://www.sec.gov/rules/proposed/2011/34-64148.pdf.
[17] *Ibid*.
[18] *Ibid*.
[19] *Ibid*.
[20] *Ibid*.
[21] Analysis by 1010data, based on data from FNMA, GNMA and FHLMC.
[22] For more information on the role of securitization within the financial system and U.S. economy, *see* Appendix A.

III. Risk Retention

ASF supports efforts to align the incentives of issuers and originators with investors of ABS and we believe these incentives should encourage the application of sound underwriting standards by both the originator and securitizer in connection with the assets that are securitized. ASF began the process to better align incentives over three years ago, when we launched our Project on Residential Securitization Transparency and Reporting ("Project RESTART"),[23] which is a broad-based industry-developed initiative to help rebuild investor confidence in mortgage and asset-backed securities. As part of this effort, we have produced Model RMBS Representations and Warranties and are in the process of producing Model RMBS Repurchase Principles, which combine to create a very strong alignment of interests in RMBS transactions. As part of the Dodd-Frank Act, Congress also decided to address alignment of incentives, but opted to employ credit risk retention and tasked the Joint Regulators with implementing regulations that will effect "skin in the game," but still permit appropriate access to credit.

While ASF believes that risk retention can aid in achieving an appropriate alignment of incentives, any rules enacted must be carefully calibrated so as to not cause unintended consequences. As further described in this letter, we believe the currently proposed risk retention rules will prove to be a major impediment to securitization, which will most certainly constrain credit as well as increase its cost. ASF delivered its initial views on the Proposed Regulations before a hearing of the House Committee on Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises entitled, "Understanding the Implications and Consequences of the Proposed Rule on Risk Retention"[24] and a subsequent hearing of the Senate Banking Committee's Subcommittee on Securities, Insurance & Investment entitled, "The State of the Securitization Markets."[25]

A. Industry Efforts to Align Incentives

During the recent economic crisis, some commentators questioned whether mortgage loan originators sufficiently mitigated or retained sufficient risk in the loans they were making to borrowers, especially when those loans were sold into securitization trusts. These critics pointed to a lack of "skin in the game," which they believe misaligned incentives between originators and investors and failed to ensure the loans underlying RMBS were of adequate credit quality. The risk or "skin in the game" traditionally retained by originators of RMBS is embodied in the representations and warranties that issuers provide with respect to the mortgage loans sold into the securitization trust and the repurchase mechanics that serve to enforce those representations and warranties. Some market participants, including some investors, have indicated that they believe the traditional representations and warranties did not have "teeth" because the repurchase mechanisms included in past transactions have not effectively provided a means to return or "put back" materially defective mortgage loans to the originator.

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[23] *See* http://www.americansecuritization.com/restart.
[24] *See* "ASF Risk Retention Testimony Before HFSC," American Securitization Forum (April 14, 2011), available at http://www.americansecuritization.com/uploadedFiles/ASF_HFSC_Risk_Retention_Testimony_4-14-11.pdf.
[25] *See* "ASF Senate Banking Testimony," American Securitization Forum (May 18, 2011), available at http://www.americansecuritization.com/uploadedFiles/ASF_Senate_Banking_Securitization_Testimony_5-18-11.pdf.

Beginning in 2008 as part of ASF Project RESTART, ASF began working with its RMBS originator, issuer, financial guarantor, rating agency, trustee and investor members to identify potential areas of improvement and work toward a model set of representations and warranties (the "ASF Model Reps") and a model set of repurchase principles (the "ASF Model Repurchase Principles") for future, plain vanilla RMBS transactions. The completed ASF Model Reps are currently available on the ASF website[26] and the ASF Model Repurchase Principles are expected to be released in the next couple of months.

i. Representations and Warranties as Risk Retention

In securitizations, representations and warranties are used to allocate the origination risk of mortgage loans between the issuers of the securities and the investors who purchase them. The allocation of origination risks begins when a mortgage loan is sold by an originator for inclusion in a securitization trust. This sale is accompanied by representations and warranties regarding the mortgage loans being sold, including representations and warranties relating to the mortgaged property securing the loan, the documentation for the loan, the manner in which the loan was originated and its compliance with applicable law. These representations and warranties are important to ensure, among other things, that the securitization trust contains mortgage loans having expected characteristics and terms which can be serviced in accordance with accepted servicing standards. The representations and warranties included within the securitization contracts for an RMBS transaction may vary from transaction to transaction depending on a number of factors, including the type of collateral involved, the specific features of the transaction and the particular circumstances of the parties to the transaction.

Generally, if a loan is found to have breached the representations and warranties and such breach materially and adversely affects the interests of investors in such loan, the loan can be "put back" or returned to the seller who is obligated to repurchase it, effectively a 100% risk retention. Much like a defective product is returned to the store from which it was sold, a materially defective mortgage loan will be returned to the issuer or other representing party through its removal from a securitization trust for the applicable repurchase price or a qualified substitute loan. Like representations and warranties, the "repurchase" remedy in RMBS transactions are governed by the securitization contracts and may vary from transaction to transaction depending on a number of factors.

Without exception, our originator, issuer and investor members view representations and warranties as risk retention for RMBS transactions. ASF supports a 100% repurchase of a loan where its characteristics do not conform to the stated characteristics set forth by the originator and result in a breach of the representations and warranties that materially and adversely affects the interests of investors in such loan. ASF believes that risk retained through representations and warranties results in an even greater amount of skin in the game than the 5% risk retention requirements set forth in the Dodd-Frank Act. In addition, the principal goal of any risk retention initiative should be to establish and reinforce commercial incentives for originators and issuers to create and fund assets that conform to stated underwriting standards and other securitization eligibility criteria, thereby making those parties economically responsible for the

[26] *See* www.americansecuritization.com/uploadedFiles/ASF_Project_RESTART_Reps_and_Warranties_121509.pdf.

stated attributes and underwriting quality of securitized loans. For this reason, the ASF continues to advocate that "skin in the game" for originators and issuers of RMBS continue to be implemented through the representations and warranties that originators and issuers provide with respect to the mortgage loans sold into the securitization trust coupled with meaningful repurchase mechanisms designed to ensure their enforcement.

ii. ASF Model Reps

The Dodd-Frank Act and recent rules issued by the SEC require each nationally recognized statistical rating organization ("NRSRO") to include in any report accompanying a credit rating a description of (i) the representations, warranties, and enforcement mechanisms available to investors; and (ii) how they differ from the representations, warranties, and enforcement mechanisms in issuances of similar securities. This requirement seeks to achieve the same goal that ASF had originally sought when we began creating the ASF Model Reps over two years ago: a means to provide a transparent comparison between different transactions that would allow investors to decipher between the strength of representations, warranties and repurchase provisions in one transaction versus those in another. However, without a baseline such as the Model Reps to facilitate the comparison, the comparing party under the Dodd-Frank provisions (the NRSROs) would have to analyze all differences in language, including specific phraseology and the use of knowledge qualifiers, to evaluate whether various actions and requirements are included within a particular set of representations and warranties. This is a very difficult task.

Historically, the type and form of representations and warranties included in RMBS transactions varied greatly, and investors often expressed concerns about their inability to compare the representations and warranties provided by different issuers. The ASF Model Reps were developed primarily to express customary market representations and warranties in the same, transparent language across transactions and provide a "baseline" against which investors and rating agencies can measure the representations and warranties contained in a particular transaction. The Model Reps were designed to allow market participants to easily determine whether departures from the Model Reps have occurred and whether knowledge qualifiers were used, adding transparency to the negotiation process among the parties to a given transaction and enabling issuers and investors to more easily and better assess their willingness or unwillingness to assume origination risks. The Model Reps also provide more significant protections by changing the language of the representations and warranties contained in existing RMBS transactions and including many new provisions which did not previously exist. Among these representations are warranties are ones covering mortgage fraud, verification of income, employment and asset verification, veracity of appraisal process, conformance to underwriting guidelines, occupancy status of property, and early payment default. We also address the use of "knowledge qualifiers," which refers to language in the representations and warranties requiring that the issuer be cognizant of the fact that causes a breach. The ASF Model Reps would clearly specify knowledge qualifiers in an exhibit so that rating agencies and investors can identify knowledge qualifications at a glance for comparison across issuers.

iii. ASF Model Repurchase Principles

Throughout the development of the ASF Model Reps, our members also began to consider changes to the repurchase provisions that serve to enforce the representations and warranties in a transaction. In most existing transactions, securitization contracts call for the trustee or another specified party to demand repurchase when defects have been discovered. However, investors believe that the repurchase process set forth in most securitization contracts does not provide certain parties with an adequate means to pursue a repurchase demand. In addition, the effectiveness of the specific mechanisms to identify breaches or to resolve a question as to whether a breach occurred in the RMBS sector has also been questioned in many cases.

For future transactions, our members, including issuers, investors and financial guarantors, have agreed to work towards a model set of principles for investigating, resolving and enforcing remedies with respect to representations and warranties in RMBS transactions by, among other things, clearly delineating the roles and responsibilities of transaction parties in the repurchase process and allowing greater access into the mortgage loan files so that breaches can be discovered. The goal of the working group is to create a model framework for remediation in future RMBS securitization transactions while aiding the recovery of the RMBS market.

Although ASF has not yet established final Model Repurchase Principles, our membership has generally agreed that proper governance principles for RMBS would require a robust mechanism for the investigation and resolution of disputes regarding breaches of transaction representations and warranties. The basic elements of a mechanism currently being discussed would involve (i) review of pool assets by an independent third party that is given access to the loan files for compliance with representations and warranties following the occurrence of an agreed-upon “review event,” (ii) recommendation by the independent third party to the securitization trustee of whether or not to demand repurchase of, or substitution for, the pool asset by the representing party and (iii) if the representing party disputes the independent third-party’s findings, submission of the dispute to a binding determination by a second independent party. We believe that such a strong third-party mechanism will ensure that representations and warranties in securitizations have “teeth,” with the beneficial effect of causing asset originators to exercise caution in underwriting and deterring transfers of substandard assets to securitization vehicles.

We note that the Dodd-Frank Act and recent rules issued by the SEC also address loan repurchases in securitizations and require any securitizer to disclose fulfilled and unfulfilled repurchase requests across all trusts aggregated by the securitizer, so that investors may identify asset originators with clear underwriting deficiencies. Although the Dodd-Frank Act’s requirements for repurchase activity would ensure that some ongoing disclosure is provided in securitizations about whether a representing party will repurchase pool assets as to which claims of breach of representations or warranties are asserted, it would not ensure that the repurchase of noncompliant assets is effected, as it is a purely disclosure-based provision. Instead, we believe that securitization participants would be incentivized to adopt better practices if the framework for a third-party mechanism of the type we have described in this section were included within

RMBS transactions. We believe that a robust third-party mechanism for investigating and resolving breaches will serve the interests of investors and issuers going forward.

IV. FDIC's Securitization Safe Harbor as Compelling Evidence of the Need for a Coordinated Approach to Risk Retention

A. Summary

ASF has consistently supported risk retention as a mechanism to better align the economic interests of originators and sponsors with securitization investors, but proposals with risk retention requirements have come in several different forms, including SEC rule proposals under "Regulation AB II" and FDIC rules relating to its securitization safe harbor rule for insured depository institutions.

ASF has forcefully advocated that regulators develop risk retention requirements on a coordinated, interagency basis, in accordance with Congress' mandate under Section 941 of Dodd-Frank, and has cautioned that unilateral rule-making would introduce multiple layers of regulation addressing the same core issues, which would be extremely detrimental to the recovery of the fragile securitization markets.

While the SEC appears to have deferred action on its risk retention rule proposals until the regulatory processes relating to the Dodd-Frank risk retention requirements are completed, the FDIC has brashly moved forward to adopt a securitization safe harbor that effectively preempted Congress' mandate to develop risk retention regulations on an interagency basis.

The FDIC's securitization safe harbor contains several provisions, including rigid and narrowly-drawn risk retention provisions, that operate as levers to regulate the securitization markets rather than as conditions relevant to its powers as conservator or receiver. In particular, the FDIC established:

- a one-size-fits-all risk retention requirements that are neither calibrated to the credit and performance characteristics of a particular asset type nor mindful of the manner in which securitizers have retained exposure to credit risk historically;
- disclosure standards for securitization transactions that are different from the SEC's own disclosure rules; and
- documentation and servicing requirements that overlap with provisions of Dodd-Frank and related implementing regulations.

As a result, banks that seek to sponsor securitization transactions are subject to multiple, overlapping (and, in the case of the FDIC's safe harbor, hastily prepared) requirements, which impede the recovery of the securitization markets by needlessly deterring banks from the use of securitization.

As noted above, ASF believes the language and legislative history of Section 941 indicate that Congress expected risk retention regulations to be developed on a coordinated, interagency basis. Accordingly, ASF requests that Congress pass legislation providing that, except as set forth in Section 15G of the Exchange Act, no governmental agency shall promulgate risk retention regulations, and that any such regulations previously promulgated are repealed by the terms of such legislation and without need of further action by any such agency.

B. Discussion

ASF supports efforts to align the economic interests of originators and sponsors with securitization investors and agrees that risk retention is one mechanism that can help establish a better alignment of interests. New laws, regulations and proposals with risk retention requirements have, however, come in several different forms. At the time, Dodd-Frank was adopted by the United States Congress and signed into law by the President, rule proposals with independent risk retention provisions were put forth for public comment by (i) the FDIC relating to the treatment by the FDIC as conservator or receiver of financial assets transferred by an insured depository institution (a "Bank") in connection with a securitization or participation transaction and (ii) the SEC relating to offering, disclosure and reporting requirements for ABS.[27]

ASF submitted extensive comment letters to each of the FDIC and the SEC noting that their respective risk retention proposals overlapped significantly with the risk retention requirements in Dodd-Frank and that the regulatory processes to implement the Dodd-Frank risk retention requirements were moving forward rapidly. ASF urged the FDIC and the SEC, therefore, to impose risk retention requirements only on a coordinated basis, in accordance with the legislative mandate that such regulations be developed on an interagency basis, as informed by the findings and recommendations presented to Congress in several risk retention reports mandated under Dodd-Frank.

ASF expressed serious concerns that, in the event either the FDIC or the SEC were to impose risk retention requirements before the regulatory processes relating to risk retention were complete, and on a unilateral rather than interagency basis, issuers might ultimately be subject to multiple and possibly conflicting requirements. ASF also cautioned that if reform were to occur at several levels and over time, revitalization of the securitization markets would inevitably be slowed, with many issuers exiting the securitization market with the enactment of the first set of rules and returning, if at all, only after all of the contemplated legislative and regulatory actions had been taken. Moreover, if the aggregate burden for issuers were ultimately too great, ASF cautioned that issuers might significantly reduce or cease their securitization activities and rely on more limited and costly alternative sources of funding, resulting in a corresponding contraction of available credit for consumer finance and small business, including mortgage loans, auto loans and leases, small business loans and credit cards.

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[27] Dodd-Frank Act, H.R. 4173, 111th Cong. (2010); Treatment by the Federal Deposit Insurance Corporation as Conservator or Receiver of Financial Assets Transferred by an Insured Depository Institution in Connection with a Securitization or Participation After September 30, 2010 (75 FR 27471, May 17, 2010); Asset-Backed Securities (75 FR 23328, May 3, 2010).

Notwithstanding the concerns expressed by ASF and by other market participants, and even by other governmental agencies, on September 27, 2010, the FDIC effectively preempted Congress' mandate to develop risk retention regulations on an interagency basis by including in its final securitization safe harbor a requirement that the sponsor must retain at least five percent of the credit risk of the financial assets in one of two ways – (i) through retention of a "vertical slice" of at least five percent of each tranche transferred to investors or (ii) by retaining in its portfolio a "representative sample" in an amount equal to at least five percent of the securitized assets.[28] The FDIC's final safe harbor does contain an "auto-conform" provision that will replace the credit risk retention requirements described above with those implemented under Dodd-Frank when they become effective. As discussed below, however, the FDIC's risk retention requirements that are now in place are too rigid and narrowly drawn and the Dodd-Frank risk retention regulations have only recently been proposed, and so their effective date is still over a year from now in the case of RMBS and over two years from now in the case of all other classes of ABS. In addition, as discussed further below, Banks that sponsor revolving asset master trust securitization transactions could face more unique transition issues under the FDIC's auto-conform provision.

Last month, in accordance with Section 941 of Dodd-Frank, the Joint Regulators charged with the responsibility to prescribe risk retention regulations issued the Proposed Regulations for that purpose.[29] Both the language and legislative history of Section 941 indicate that Congress expected the Joint Regulators, in formulating these rules, to be mindful of the heterogeneity of securitization markets and to give due consideration to the findings and recommendations presented to Congress in certain risk retention studies and reports mandated by Section 941.[30] Consistent with this Congressional mandate, the Joint Regulators indicate that they have taken into account the diversity of assets that are securitized, the structures historically used in securitizations, and the manner in which securitizers may have retained exposure to the credit risk of the assets they securitize. As a result, unlike the FDIC's final securitization safe harbor, the Proposed Regulations under Dodd-Frank provide a range of options that securitizers may choose from in meeting the risk retention requirements, including: (i) retention of a "vertical slice" of each class of interest issued in the securitization, (ii) retention of an "eligible horizontal residual interest" in the securitization, (iii) use of "L-Shaped" risk retention, which combines both vertical and horizontal forms, (iv) 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, (v) retention in its portfolio of a "representative sample" of assets

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[28] In contrast, the SEC appears to have deferred action on its risk retention rule proposals until the regulatory processes relating to the Dodd-Frank risk retention requirements are completed.

[29] Section 15G to the Exchange Act, as added by Section 941 of Dodd-Frank, generally requires the Joint Regulators to prescribe risk retention regulations that (i) require a securitizer to retain not less than five percent of the credit risk of any asset that the securitizer, through the issuance of ABS, transfers, sells, or conveys to a third party, and (ii) prohibit a securitizer from directly or indirectly hedging or otherwise transferring the credit risk that the securitizer is required to retain under Section 15G.

[30] *See, e.g.*, 15 U.S.C. § 78o-11(c)(1)(E), (c)(2), (e); S. Rep. no. 111-76, at 130 (2010) ("The Committee believes that implementation of risk retention obligations should recognize the differences in securitization practices for various asset classes."). Section 941 of Dodd-Frank directed each of the Board and the Financial Services Oversight Counsel to study certain effects of the risk retention requirements and promptly report their findings to Congress. *See generally* the Federal Reserve Study and the FSOC Study.

equivalent to the securitized assets; and (vi) other risk retention options that purport to take into account the manner in which risk retention often has occurred in connection with the issuance of ABCP and in commercial mortgage-backed securitization transactions.[31]

Moreover, as directed by Congress, the Joint Regulators' Proposed Regulations purport to calibrate risk retention with asset quality by exempting ABS supported by qualified residential mortgages and ABS supported by other high quality assets from any risk retention requirement.

By contrast, the risk retention requirements in the FDIC's final securitization safe harbor embrace a blanket one-size-fits-all retention requirement that is arbitrary in its application to any particular asset type because it does not account for important differences in the expected credit and performance characteristics of one asset type as compared with another asset type. Nor does it account for the diversity of assets that are securitized, the structures historically used in securitizations, or the manner in which securitizers may have retained exposure to the credit risk of the assets they securitize. Many sponsors already have significant equity and other investments in the capital structure of their securitization transactions in the form of seller's interests, subordinated and first-loss positions, excess spread that represents an interest in excess finance charge collections, over-collateralization, reserve accounts and the like. Adding a vertical slice component as contemplated by the FDIC's safe harbor will almost certainly add too much incremental cost and render securitization transactions uneconomical relative to other funding options available to the sponsor.

As an alternative to a vertical slice, the FDIC's safe harbor does contemplate retention of a representative sample as a means of risk retention, but the FDIC's version of this option is formulated differently than the representative sample option included in the Joint Regulators' Proposed Regulations, and so a Bank seeking to avail itself of this option would have to adopt one set of procedures to comply with the FDIC safe harbor in its current form and then a different set of procedures at such time as the auto-conform provision takes effect. It also remains to be seen whether representative sampling is even a meaningful option for some asset classes, such as established revolving asset master trusts with existing securitized portfolios.

Banks that sponsor revolving asset master trust securitization transactions could face more unique transition issues under the FDIC's auto-conform provision. Master trusts allow sponsors to employ a single issuing vehicle to issue multiple issuances of ABS over time. Each issuance provides for the conveyance of additional pool assets in contemplation of future issuances of ABS backed by the same revolving asset pool. Master trusts represent a more integrated form of structuring technology, where each issuance forms a part of the more complete structure of the issuance platform. It is of paramount importance, therefore, that the sponsor of a master trust securitization platform have the option (but not the requirement) to select and maintain the same form of risk retention over the life of the master trust. If a Bank were to sponsor a revolving asset master trust securitization transaction in conformity with the

[31] Notably, as to each proposed form of eligible risk retention, the Joint Regulators have also set forth a host of questions for which public comment is sought – questions that evidence both the complexity of the rule-making initiative and the care that is required to produce regulations that appropriately balance the competing objectives of aligning economic interests while preserving securitization as a viable and economical alternative relative to other funding options.

more limited risk retention options currently available under the FDIC safe harbor, the sponsor could effectively be relegated to that form of risk retention for all of the master trust's future ABS issuances, even if a broader (and potentially more efficient) range of options becomes available at such time as the auto-conform provision of the FDIC safe harbor takes effect.[32]

We recognize that legislators and regulators have an interest in fashioning effective regulations to enhance practices of issuers and confidence of investors, but it is critical that legislators and regulators work in concert with, and not in opposition to, one another. Simply stated, by imposing rigid and narrowly-drawn risk retention requirements on Banks that sponsor securitization transactions before the regulatory processes relating to risk retention have been completed, the FDIC has impeded the recovery of the securitization markets by needlessly deterring Banks from the use of securitization.

Accordingly, ASF requests that Congress pass legislation providing that, except as set forth in Section 15G of the Exchange Act, no governmental agency shall promulgate risk retention regulations, and that any such regulations previously promulgated are repealed by the terms of such legislation and without need of further action by any such agency.

As a final observation, the FDIC's securitization safe harbor contains several other provisions that, like its risk retention provisions, operate more as levers to regulate the securitization markets than as conditions to its powers as conservator or receiver and, once again, effectively preempt the efforts of Congress and other agencies to do so. For example, the FDIC's safe harbor establishes disclosure standards for securitization transactions that are different from the SEC's disclosure rules, subjecting issuers to multiple and potentially conflicting requirements. Similarly, the safe harbor imposes specific documentation and servicing requirements on all types of transactions and imposes additional requirements in these areas for securitizations of residential mortgage loans, while some of these subjects are also covered by the Joint Regulators' risk retention rule proposals and are expected to be covered by proposals for uniform national servicing standards later this year. ASF remains deeply concerned that the fragile securitization markets are continuing to face unnecessary uncertainty and the potential for costly administrative changes as a result of multiple layers of regulation addressing the same basic issues and introduced on a staggered basis.

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[32] The FDIC's prior securitization safe harbor, adopted a rule in 2000, provided that the FDIC, as conservator or receiver of a Bank, would not use its statutory authority to disaffirm or repudiate contracts in order to reclaim financial assets transferred by a Bank in connection with a securitization or participation if the transfer met all conditions for sale accounting treatment under GAAP. On June 12, 2009, the Financial Accounting Standards Board ("FASB") modified GAAP through FAS 166 and FAS 167, which represent accounting standards that make it more difficult for a transferor of assets in a securitization to meet the conditions for sale accounting treatment. These modifications became effective for annual financial statement reporting periods that began after November 15, 2009.

The FDIC's new securitization safe harbor contains a grandfathering provision that makes the safe harbor available for securitization transactions by revolving or master trusts *at any time*, as long as the trust had issued ABS prior to September 27, 2010 and transfers of pool assets in connection with issuances of ABS backed by the same, revolving pool satisfy the GAAP conditions for sale accounting treatment as in effect prior to November 15, 2009. This grandfathering provision is *not*, however, available for revolving or master trusts that initially issue ABS only on or after September 27, 2010 or that transfer pool assets in connection with issuances of ABS backed by the same, revolving pool in a manner that does not satisfy those prior GAAP conditions for sale accounting treatment.

V. Cross-Border Issues

As the securitization industry has grown in depth and scope, the techniques used in the U.S. to more efficiently finance consumer and wholesale financial assets have been implemented on a global scale. As part of that process, the investor base for ABS outside the U.S. has also grown significantly in size and sophistication. Increasingly, both originators and investors think globally and look to diversify funding sources and investment exposures across markets, products and regions. The free and efficient flow of investment capital and opportunities into and out of the U.S. is of great importance to both U.S. lenders (and the consumers and businesses they serve) and U.S. asset managers (and their investors).

Providing U.S. lenders the ability to efficiently raise funding offshore for financial assets originated in the U.S. allows U.S. consumers and businesses to benefit from lower borrowing costs and greater access to capital. Likewise, providing U.S. investors with access to investments in ABS transactions originated abroad allows those investors to better diversify the credit, product and geographic mix of their portfolios.

Although deficiencies in securitization practices have been found outside of the U.S. as well, the performance of ABS supported by non-U.S. assets contrasted favorably with the performance of ABS supported by similar assets originated in the U.S., particularly in the residential mortgage sector. Nevertheless, in response to perceived weaknesses in European market practice, Article 122a of the European Capital Requirements Directive ("Article 122a"), containing risk retention requirements similar in many ways to those found in the Proposed Regulations, was adopted by the EU Parliament in 2009 and went into force for new transactions on January 1, 2011.

Article 122a applies generally to any "securitization" in which a European credit institution assumes exposure (and clearly applies to "securitizations" originated by sponsors located outside of the European Union). Accordingly, any U.S. sponsor of ABS wishing to sell at least part of the offering to credit institutions located in Europe would need to comply with the requirements of both Article 122a and the Proposed Regulations. Similarly, a European sponsor of ABS wishing to sell to investors located both in its home market and in the U.S. (in an amount or on terms that would not allow compliance with the safe harbor for certain foreign-related transactions found in Section __.22) (the "Cross-Border Safe Harbor") would need to comply with both sets of regulation. Given the global reach of ABS markets, other jurisdictions may likewise adopt their own risk retention requirements in the future, which would further complicate the regulatory playing field and lead to a compounding number of overlapping regulations. This type of regulatory duplication could make the costs associated with cross-border offerings of ABS prohibitively high. It would therefore be beneficial to all global market participants if the Joint Regulators were to take into further consideration the interactions between the Proposed Regulations and other risk retention regimes such as Article 122a.

Unlike purely domestic transactions where assets originated in the U.S. are packaged into ABS sold only to investors based in the U.S., unique concerns arise in cross-border transactions, where, potentially two (or possibly even more) sets of risk retention regulations may apply to the transaction. The ASF understands and appreciates the numerous areas of overlap or close similarity between the Proposed Regulations and Article 122a (currently, the only other major risk retention regulatory scheme). Nevertheless, our membership is concerned that certain differences, most of which we do not believe are essential to the spirit of, or policies lying behind, the Proposed Regulations may hinder or prevent cross-border transactions and thus adversely impact U.S. consumers, businesses and investors.

While we have highlighted some of the key differences between the Proposed Regulations and Article 122a in its current format, we recognize that laws and regulations of other jurisdictions (such as Article 122a) may be amended, reinterpreted or even repealed from time to time. Further, other jurisdictions may in the future adopt risk retention rules for securitization transactions that are similar to, or very different from, the Proposed Regulations. As a result, we have suggested revisions to the Proposed Regulations that we believe will preserve the flow of cross-border capital in a manner consistent with the underlying policies behind the Proposed Regulations as set out in the NPR and elsewhere, while at the same time not being dependant on any particular formulation of risk retention rules in other jurisdictions.

Below, we highlight a number of concerns that may hinder or prevent cross-border ABS transactions and provide some suggestions on how the Proposed Regulations might address these concerns and enhance the efficiency and security of global capital markets.

A. Reg. S Only Offerings

The Cross-Border Safe Harbor provides a limited safe harbor for non-U.S. issuers that sell no more than 10% of the dollar value by proceeds of all classes of ABS interests to U.S. persons (and satisfy certain other conditions). For ABS offerings also being sold outside of the U.S. to European credit institutions, the Cross-Border Safe Harbor would allow the sponsor to conduct the offering at least in part in the U.S. while not having to comply with two sets of risk retention guidelines. However, the Proposed Regulations do not provide a corollary exemption for offerings of ABS by U.S. issuers made exclusively outside of the U.S. To the extent that such offerings conducted only under Regulation S ("Reg. S Only Offerings") are sold at least in part to European credit institutions, the sponsor of the transaction would still have to comply with the requirements of Article 122a as well as the Proposed Regulations, unnecessarily adding significant administrative burden and cost to the transaction and generally disincentivizing U.S. sponsors from raising capital in the European markets.

We additionally note that each of the U.S. and European risk retention regimes strives to attain its own balance by combining clear risk retention rules with certain exemptions and distinct requirements for certain types of transactions. Where a securitizer is required to comply with multiple risk retention regimes, in most cases it will have to comply with both set of rules and lose the flexibility provided in each of the regimes. Thus, U.S.-based cross-border offerings run an added risk of incurring more severe risk retention requirements than other non-U.S. offerings. This creates a strong policy incentive to provide additional flexibility to U.S. securitizers who wish to issue abroad.

Since a Reg. S Only Offering would, by definition, not be sold on initial distribution to investors in the U.S., we believe that the market protection policy behind the Proposed Regulations would have less relevance and thus compliance with the Proposed Regulations should not be required. However, we also recognize that an overarching policy behind the Proposed Regulations is to align the interests of originators of financial assets with those of investors funding the assets so as to promote a sustainable financial system. To that end, our proposed exemption for Reg. S Only Offerings of ABS by U.S. sponsors would require that risk retention requirements similar to those found in the Proposed Regulations would still have to apply to the transaction.

Our proposal, therefore, is to create a limited exemption under Section __.22 from the U.S. risk retention requirements for U.S. sponsors of ABS issued in a Reg. S Only Offering so long as at least 10% of the offering is made to investors located in a jurisdiction that maintains substantially similar risk retention requirements to those of the U.S. (a "Qualified Non-U.S. Jurisdiction"). We request that the Joint Regulators provide a definition of the term "Qualified Non-U.S. Jurisdiction" in the revised rules. The definition could refer to a jurisdiction that has implemented, and which maintains, a system of risk retention broadly similar to that found in the U.S. To avoid the need for time-consuming subsequent regulatory action, the definition could also specify certain elements of a broadly similar risk retention regime, which, if present, would automatically bring a given non-U.S. jurisdiction within the scope of the new definition.

We also propose that the Joint Regulators, as part of the issuance of the final version of the Proposed Regulations (possibly in the preamble), make an affirmative determination that Article 122a, in its current form, contains elements which make it broadly similar to the U.S. retention regime, and that, therefore, member states of the European Union that have implemented Article 122a are considered "Qualified Non-U.S. Jurisdictions" for the purposes of the finalized U.S. risk retention rules[33]. Considering that Article 122a, like the Proposed Regulations, aims to align the interests between securitizers and purchasers of securities, and that some of its fundamental requirements are substantially similar to those of the Proposed Regulations (i.e. the base 5% risk retention requirement, the prohibition on certain types of hedging that would defeat the purpose of the retention requirement, etc.), such a determination would greatly assist cross-border securitization offerings, without compromising on the Joint Regulators' policy goals.

B. Reserve Accounts

As discussed above, compliance with the Proposed Regulations would be required for any offering of ABS by a non-U.S. sponsor made at least in part in the U.S. (and not eligible for the Cross-Border Safe Harbor) ("Non-U.S. ABS"). Since these transactions would be originated outside of the U.S., they would most likely be backed by an asset pool comprised of assets denominated in a currency other than the U.S. dollar ("Non-Dollar Assets").

[33] We recognize that the current position of the Joint Regulators is that the decision-making process on matters of interpretation and implementation be handled jointly by all relevant Joint Regulators. To the extent that it is agreed that one regulator would have exclusive/special decision-making powers with respect to certain aspects of the risk retention regulations, the Joint Regulators may consider authorizing such regulator to review, from time to time, changes in Article 122a or new risk retention regimes which other jurisdictions may adopt subsequent to the adoption of the finalized risk retention rules. Such reviews could be done, for example, to determine whether Article 122a continues to meet the standards set out in the definition of a Qualified Non-U.S. Jurisdiction or whether other countries' retention regimes which may be adopted following the finalized rules meet those standards.

For Non-U.S. ABS backed by Non-Dollar Assets, however, it would be more costly (or, in certain cases, completely impracticable) for sponsors of such Non-U.S. ABS to utilize the horizontal cash reserve account option, since any such reserve account would have to be invested in U.S. dollar-denominated assets (U.S. Treasury securities or bank accounts insured by the FDIC), and currency swaps would have to be introduced to address the mismatch between the currency in which the pool assets are denominated and the U.S. dollar investments in the horizontal cash reserve account. We do not believe that there is a valid policy reason for creating such a currency mismatch in a Non-U.S. ABS transaction. We further note that the reserve account requirements would similarly affect ABCP conduits, which would likewise be subject to costly cash reserve requirements.

As a general principle, we believe that any amounts invested in a reserve account for Non-U.S. ABS backed by Non-Dollar Assets under the Proposed Regulations should be held in a currency that matches the underlying assets. Accordingly, we propose that any such reserve account be held in government-issued or guaranteed securities or in the deposits of a regulated bank that also accepts consumer deposits, in either case denominated in any currency corresponding to securitized assets representing at least 10% of the asset pool. This adjustment would resolve the currency mismatch between U.S.-dollar denominated deposits and foreign currency assets for reserve accounts. The arrangement would thereby permit the use of a horizontal cash reserve account and permit compliance (if relevant) with the requirements for a premium capture cash reserve account. [34]

C. Government-Backed ABS

Prior to the enactment of the Dodd-Frank Act, ratings issued by NRSROs provided a benchmark by which to measure the quality of certain securities used to meet both transactional and regulatory requirements. With the removal of these NRSRO ratings from securities regulations pursuant to Dodd-Frank Section 939A, regulators have lost a valuable reference to measure the credit-worthiness of certain assets. This introduces the risk that subsequent regulatory provisions will restrict the scope of the market by precluding exemption for certain high-quality securities, while providing an exemption for less stable securities. We note that in Section __.22, an exemption from risk retention requirements is provided for ABS that are guaranteed by the U.S. government. This exemption applies not only to federal government-backed ABS, but also to ABS backed by U.S. state and local governments. (We note that Article 122a provides a similar exemption that applies only to countries that are members of the European Union[35].) We believe the limitation in the Proposed Regulations to U.S. government securities would unnecessarily restrict U.S. investors from having access to ABS backed by assets issued or guaranteed by foreign governments which may be issued outside of the U.S. without any required risk retention. This restriction has the potential to diminish cross-border collaboration in ABS markets.

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[34] We reiterate here our concerns raised in Section A.iv. above with respect to the premium capture cash reserve account required by Section __.12 and further note that the impracticability of this provision is underscored by the requirement that such accounts, in the case of a non-U.S. and non-dollar issuance, be maintained in U.S. Treasury securities or FDIC-backed deposits.

[35] Section 3(b) of Article 122a provides an exemption for securitized exposures guaranteed by regional governments, local authorities and public sector entities of members of the European Union.

By providing exemptions to certain U.S. government-backed ABS but not comparable non-U.S. government-backed ABS, the regulators deprive U.S. investors of valuable investment opportunities where the credit worthiness of those instruments is comparable to or greater than certain exempt U.S. government-backed securities, which appear to be exempt for no other reason than national sovereignty.

We propose, therefore, that the Joint Regulators provide exempt treatment for non-U.S. government-backed ABS backed by equivalent governmental entities in any Qualified Non-U.S. Jurisdiction (as defined above). This would have the added benefit of promoting international coordination among jurisdictions that took a similar approach to the U.S. in promoting risk retention in offerings of ABS.

D. Cross-Border Safe Harbor

The Cross-Border Safe Harbor in Section __.22 provides an exemption from the Proposed Regulations for non-U.S. issuers selling not more than 10% of the dollar value of proceeds of all ABS interests to or for the benefit of U.S. investors (and meeting certain other conditions). This threshold provides a valuable benchmark for determining when an issuance has only a slight impact on U.S. markets and does not require application of U.S. risk retention requirements. We note, however, that no distinction is made under this section between issuances of securities into the U.S. in which the securitizer has conducted no risk retention and issuances in which the securitizer is in compliance with a non-U.S. risk retention regime (such as Article 122a).

The 10% cap, therefore, has a disproportionate effect on issuers that already have expended resources on risk retention and healthy securitization practices. Where a securitizer has already conducted risk retention under regulations in force in a Qualified Non-U.S. Jurisdiction (as defined above), the ABS issued by such a securitizer would be broadly equivalent to ABS issued by a U.S. issuer in compliance with the Proposed Regulations. It would therefore be appropriate to encourage non-U.S. securitizers to engage in risk retention before issuing into the U.S. by providing them with greater access to U.S. capital markets if they do so.

We, therefore, propose the provision of a safe harbor for non-U.S. securitizers that have already conducted risk retention in accordance with the rules of a Qualified Non-U.S. Jurisdiction, irrespective of the amount of their U.S. offering. Such a safe harbor would not only ensure an alignment of interests between securitizers and purchasers of securitized assets that is satisfactory to the U.S. regulators, but it would also be a straightforward and efficient means of addressing inconsistencies among risk retention regimes and thus facilitating cross-border transactions. It would also be responsive to the G20 calls for international regulatory coordination and consistency. Specifically, we suggest that the Cross-Border Safe Harbor be expanded at the end of Section__.22(a)(2) to allow an exemption from compliance with the Proposed Regulations for securitization transactions (i) which comply with the risk retention regime of one or more Qualified Non-U.S. Jurisdictions and (ii) where the offering document used to offer the securities in the U.S. contains an affirmative undertaking by the relevant sponsor(s) or originator(s) to retain a net economic interest in accordance with the risk retention regime of the relevant Qualified Non-U.S. Jurisdiction.

While we consider the above amendment to the Cross-Border Safe Harbor to be the most effective way of balancing investor and market protection with the promotion of a level regulatory playing field between jurisdictions, we recognize that there may be certain additional policy concerns raised by such an approach, particularly when a large percentage of an offering of Non-U.S. ABS is targeted at the U.S. Accordingly, should the Joint Regulators find that such an exemption would provide a level of access to the U.S. markets that is too great, we would propose an alternative change that would still distinguish offers into the U.S. by non-U.S. issuers that already comply with a risk retention regime from those by non-U.S. issuers that do not. Specifically, we suggest that the 10% dollar value limitation on non-U.S. issuances in the current Section__.22 be raised to 33% for securitizers otherwise in compliance with the risk retention requirements of a Qualified Non-U.S. Jurisdiction. We believe that this provision would be a valuable step towards restoring the most significant cross-border securitization markets while maintaining clear jurisdictional distinctions and promoting strong risk retention standards. We believe that the above adjustment would encourage international cooperation in developing effective standards for managing the risks of securitization on a global scale.

Finally, we note that the Proposed Regulations do not specify how the percentage value of ABS sold to U.S. investors for purposes of the Cross Border Safe Harbor is calculated. In particular, no reference is made to possible secondary trading that might occur with respect to a securitization transaction. We therefore request that the Joint Regulators clarify that the Cross-Border Safe Harbor be determined at the time of issuance and not be affected by subsequent secondary market trading activity.

E. Master Trusts

Under Section __.7 of the Proposed Regulations, the sponsor of a revolving master trust may satisfy its risk retention requirements by maintaining a seller's interest in the asset pool. Under the Proposed Regulations, "revolving asset master trust" is defined as an issuing entity that is a master trust and an issuer of ABS "collateralized by a single pool of revolving securitized assets that are expected to change in composition over time." The provision therefore restricts the seller's interest retention option to master trusts that include revolving assets.

We note that the definitions of "seller's interest" and "revolving asset master trust" in Section __.7, according to the Proposed Regulations, "are intended to be consistent with market practices." Yet, the Proposed Regulations fail to account for market practices, and specifically, transaction structures, in non-U.S. jurisdictions. Notably, U.K. mortgage master trusts do not involve a revolving asset pool, and as a result, such non-U.S. master trusts would not be entitled to the seller's interest risk retention option. This places an unnecessary burden on a widely accepted model for structuring master trusts and would close U.S. capital markets in many cases to investment opportunities in assets backed by non-U.S. master trusts. We further note that the European risk retention regime accommodates both revolving and non-revolving exposures in master trusts, and we would therefore not expect any change in existing market practices in non-U.S. jurisdictions.

We, therefore, propose that the scope of Section __.7 of the Proposed Regulations be expanded to include non-revolving asset master trusts, and that the definition of "revolving asset master trust" be revised to include master trusts backed by non-revolving assets. In addition, the definition of "seller's interest" should be revised in order to accommodate non-U.S. transactional structures in which the assets are held by a trustee instead of the issuer.

VI. Concerns Relating to the Issuance of Interpretive Guidance

The Proposed Regulations contemplate that any written interpretive guidance relating to the risk retention regulations that is intended to be relied upon by the public generally will be issued jointly by the appropriate agencies. We do not believe this approach is appropriate. The process of obtaining guidance from a single regulator is often onerous and time consuming. Attempting to obtain advice from multiple regulators, each with their own perspectives on how the rules should be interpreted, will likely prove unworkable. In addition, cases are likely to arise where different agencies simply have different good faith interpretations of what the regulations mean. We propose instead that a single agency be appointed to be responsible for issuing interpretative guidance with respect to each discrete aspect of the regulations. This approach seems particularly sensible in light of the fact that the Joint Regulators generally have differing areas of expertise and focus, and therefore certain agencies are better equipped to interpret some parts of the regulations, while other agencies are better equipped to interpret other parts of the regulations.

VII. Request for Re-Proposal

In preparing the Proposed Regulations, the Joint Regulators undertook the complex task of evaluating the diverse characteristics of securitized assets and the structures historically used in securitizations. We applaud the hard work of the Joint Regulators in developing the Proposed Regulations and your efforts to tailor the proposed rules to each asset class and securitization structure. However, we believe that the time-intensive task of creating risk retention rules that both protect investors and encourage a robust and efficient securitization market is far from complete.

For the past two months, ASF has worked with its membership to develop detailed and constructive responses to the Joint Regulators' requests for comment. We believe that many other interested parties, including individual market participants, academics, members of Congress and the general public, will submit comment letters as well. Given the diversity and complexity of the securitization market and the highly technical nature of the Proposed Regulations, we believe that revisions made by the Joint Regulators in response to these comments, which will likely number in thousands of pages, will most certainly justify an opportunity for further review by all securitization market participants prior to adoption. Therefore, we urge the Joint Regulators to revise the Proposed Regulations to address the concerns described in each of our separate comment letters and to re-propose a rule implementing Section 941 of Dodd-Frank for further consideration and public comment prior to adoption. We strongly believe that this course of action will better enable the Joint Regulators to ensure that the final regulations achieve the goals of Dodd-Frank while promoting a healthy and vibrant securitization market.

The securitization market is a vitally important sector of today's financial markets. Currently, there are over $11 trillion of outstanding securitized assets, including residential mortgage-backed securities, asset-backed securities and asset-backed commercial paper. It is estimated that 64% of outstanding home mortgages are funded through securitization.[36] Historically, banks securitized 50-60% of their credit card assets.[37] Meanwhile, in the auto industry, approximately 91% of auto sales are financed through auto ABS.[38] Securitization also provides an important source of commercial mortgage loan financing throughout the United States.

Over the years, securitization has grown in large measure because of the benefits it delivers to transaction participants and to the financial system. However, the efficiency, liquidity and low cost of funding that have long been achieved in the securitization markets are threatened by the risk retention rules set forth in the Proposed Regulations. To ensure the availability of credit for mortgage loan borrowers, consumers and businesses, it is imperative that the final risk retention rules promote a robust securitization market.

While we support measures to ensure the alignment of the incentives of sponsors and investors in the ABS markets, we believe that the burdens imposed on ABS sponsors by the risk retention rules must be commensurate with the risks associated with investment in ABS. Existing securitization programs have structural features that operate to align the interests of sponsors with those of investors. In fact, in the context of most major sectors of non-mortgage ABS, misalignment of interests has not been identified, and no investor who held those ABS securities to maturity experienced losses during the recent financial crisis. The confidence of issuers and investors in the strength of these structures and the quality of the assets underlying these non-mortgage ABS is evidenced by the relative speed with which these segments of the market have recovered.[39]

Despite the structural integrity and strong performance record of these ABS segments, the Proposed Regulations would require many sponsors to alter the structures of their securitization programs. While the Proposed Regulations include a number of permissible methods of risk retention, the definitions of and requirements for those methods would not accommodate common methods of risk retention in many asset classes, including auto loans, student loans, credit cards and asset-backed commercial paper. Furthermore, even in cases

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36 *See* Fitch Ratings, "U.S. Housing Reform Proposal FAQs: Filling the Void" pg. 1-2 (Feb. 2011), available at: http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=606315 (free registration required).

37 *See* Citigroup, "Does the World Need Securitization?" pg. 10 (Dec. 2008), available at: http://americansecuritization.com/uploadedFiles/Citi121208_restart_securitization.pdf.

38 Ibid., pg 10.

39 For example, auto and auto-related ABS issuances in 2009 represented 80.7% of auto and auto-related ABS issuance in 2007, just before the downturn. In 2009, credit card ABS accounted for $46.6 billion in issuance, down 50.7% from 2007 issuance. Meanwhile, the student loan sector issued $20.8 billion in ABS during 2009, down 64.2% from 2007 issuance. By comparison, in the RMBS market, $48.1 billion of RMBS were issued in 2009, down 92.5% from 2007 issuance. *See* Proposing Release, pg. 12-13.

where the Joint Regulators indicated that the proposals were meant to exactly conform to existing market practices, there are significant differences that would create major disruptions in the ABS market.

Altering the structures of ABS programs to conform their risk retention features to the methods permitted under the Proposed Regulations would be very expensive and, in many cases, would render the economics of the programs untenable. If the risk retention rules are not appropriately designed to accommodate existing market practices, we risk an immediate and significant reduction in the availability of auto loans, student loans, credit cards and business credit throughout our country without gaining material improvements to the risk retention practices that protected investors even during the worst of the financial crisis. The risk of shutting down the securitization markets is not warranted where investors have been protected by existing risk retention methods. Therefore, it is imperative that the provisions of the Proposed Regulations accommodate existing market practices that effectively align the interests of sponsors with those of investors.

Unfortunately, structuring the Proposed Regulations to accommodate existing market practices is easier said than done. Numerous classes of assets are securitized, multiple securitization structures are utilized for each asset class, and each of those structures is extremely complex. The task of ensuring that the sponsors of each asset class and of each existing structure can comply with the Proposed Regulations without substantial additional costs requires an intimate knowledge of the characteristics of each asset class and each securitization structure. For example, the specific credit history factors proposed to be used as a proxy for credit score in the "qualified residential mortgage" definition have not been established to be predictive of the probability of default. In fact, industry statistics indicate that these proposed delinquency payment requirements could result in the inclusion of a credit score as low as 437 and the exclusion of a score as high as 850. Additionally, the proposed "qualifying auto loan" definition requires a 20% down payment, a level required in some cases in the residential mortgage market but rarely, if ever, required in the auto loan market where advance rates of 100% are commonplace. The complexity of the securitization structures and securitized assets is further demonstrated by the fact that the Joint Regulators included 174 requests for comment in the Proposed Regulations.

We are also concerned that revisions made to the Proposed Regulations to accommodate an existing market practice for one asset class or in one securitization structure may have the unintended consequence of excluding an existing market practice for another asset class or in a different securitization structure. The potential for these unintended consequences is particularly acute in the context of the portions of the Proposed Regulations that will be the subject of comment from representatives of multiple asset classes, including provisions prescribing the general methods of risk retention that are available to all asset classes. Securitization market participants cannot evaluate the consequences of substantive revisions made by the Joint Regulators in response to comments to the Proposed Regulations unless they are given an opportunity to review those revisions before the final rule is adopted.

In addition to our concerns about the complexity of the subject matter of risk retention rules, we are concerned about the complexity of the process of managing the implementation and interpretation of the final risk retention rules. In the Proposed Regulations, the Joint Regulators indicated that they will jointly approve any written interpretations, written responses to requests for no-action letters and legal opinions, or other written interpretive guidance concerning the scope or terms of the final rules that is intended to be relied on by the public generally. The Joint Regulators further indicated that they will jointly approve any exemptions, exceptions or adjustments to the final rules. The process for seeking corrections to final regulations or interpretive guidance from a single regulator is often onerous and time-consuming. These burdens will be dramatically compounded in the case of the final risk retention rules where the corrections and guidance would need to be approved by multiple regulators. In light of this concern, it is imperative that securitization market participants be granted an opportunity to review the impact of substantive revisions to the proposed risk retention rules before they are adopted.

Given the complexity of adopting risk retention rules that effectively regulate the diverse and dynamic securitization market, the highly technical nature of the Proposed Regulations and the unique difficulty of obtaining future corrections or interpretive guidance on the final risk retention rules, it is imperative that securitization market participants be given a meaningful opportunity to review and provide comment on the re-proposed risk retention rules before they are adopted. We believe that this course of action will better enable the Joint Regulators to ensure that the final regulations achieve the goals of Dodd-Frank while promoting a healthy and vibrant securitization market. Therefore, we strongly urge the Joint Regulators to release a revised version of the Proposed Regulations for additional public comment.

VIII. Impact of Proposals on Different Asset Classes

A. RMBS

i. Overall Negative Effect on RMBS

In crafting credit risk retention rules as mandated by Dodd-Frank, it is important to balance two objectives: 1) achieving an alignment of interests between sponsor and investor to restore needed credibility to the securitization market, and 2) avoiding imposition of requirements that will cause private (non-government guaranteed) securitization to be economically prohibitive as a funding alternative. Within this context, for RMBS, it is also important to be mindful of the nonpartisan policy objective of significantly reducing reliance on government-backed funding for residential mortgage loans through Fannie Mae and Freddie Mac (the "GSEs")[40], and ultimately giving the private markets the space over a reasonable time to step in as the key source of funding for mortgages in America.

If these objectives are balanced correctly, the risk retention rules will not dampen the return of the private RMBS securitization market, which will help loan originators to make mortgage credit available to low and moderate income borrowers at a reasonable cost. The

[40] *See* "Reforming America's Housing Finance Market - A Report to Congress," United States Department of the Treasury and United States Department of Housing and Urban Development (February 2010), p. 12-13.

availability of reasonably priced credit on equitable terms will enable more Americans to afford to invest in new homes, which will in turn stimulate the United States economy by preventing housing prices from continuing to decline. Unfortunately, we believe that the Proposed Regulations fail to fully balance and take into account these important national objectives. While we believe that a reasonable risk retention framework can assist in aligning incentives in securitization, the Proposed Regulations will result in many unintended consequences that will be detrimental to the credit markets and consumers. Except where specifically noted otherwise, the views expressed in this section of our comment letter represent a consensus view of our RMBS issuer and investor members.

Our high-level observations about the effect of the Proposed Regulations on RMBS are as follows, and are supported by the discussion in the sections to follow:

- these proposals will impose increased costs that will make many securitizations economically unfeasible, given a prohibitively low return on capital for securitizers;
- the proposals go far beyond the legislative intent of Dodd-Frank, by taking a mandate for 5% risk retention, and adding on to that (in most cases) the entire value of the interests issued in the securitization over par, through the premium capture cash reserve account;
- the proposals use risk retention not just to ensure quality of underwriting within the "originate to distribute" model, but also eliminate viable business models for originating or purchasing loans for resale into the capital markets;
- the proposals disadvantage higher interest rate loans (which will include all loans that do not qualify as QRMs) by making securitizations of such loans much more problematic (as compared to lower interest rate loans), and further disadvantage borrowers who do not qualify for QRMs;
- the proposals worsen the existing non-level playing field between the GSEs and private securitizers by increasing the relative execution advantages of the GSEs as to loans that do not qualify as QRMs, thus impeding the bipartisan policy goal of winding down the GSEs over an appropriate timeline; and
- the proposals would incentivize originators to impose higher points and fees on borrowers under non-QRM loans, instead of recovering costs of origination through securitization, and would disrupt the ability of originators to offer rate lock features to borrowers.

While seeking to align interests among private market participants, these proposals may result in a misalignment of the impacts of government policy on the housing finance markets.

The capital markets need a clear signal from the government as to whether public policy is, or is not, to encourage the return of a robust private RMBS market. These proposals signal to the market the unintended result of further entrenching government involvement in the housing markets. Reforms that can enhance the quality of asset underwriting and disclosure to investors are welcomed by securitization market participants. Reforms that seek to turn private securitization into a not-for-profit activity destroy the prospect for a return of the private RMBS market, and would ensure that taxpayers will continue to bear full exposure to the housing finance markets indefinitely.

In November 2010, we submitted the ASF RMBS Risk Retention Letter[41] to the Joint Regulators setting forth specifically the views of our membership relating to the implementation of the risk retention provisions of Dodd-Frank for the RMBS market. In that letter, we raised many of the same issues discussed herein.

ii. Issuer Concerns with "Eligible Horizontal Residual Interest" Definition for RMBS

The definition of an "eligible horizontal residual interest", which limits the types of first loss interests in a securitization that can be used to satisfy risk retention as a horizontal slice, is too narrow and cannot be used in securitizations of higher interest rate loans.

In a typical private RMBS offering, investment grade securities of the highest rating are used to provide term financing for a fixed pool of mortgage loans. Credit enhancement is typically provided by creating subordinated interests in the pool. The structures used to create subordination vary greatly, depending on whether the mortgage loans generate significant amounts of excess spread.

Prime borrowers are ones that meet conservative underwriting standards with respect to credit history, equity in the property, debt-to-income ratio, and the like, and typically have higher credit scores. Historically, such borrowers qualified for the lowest available interest rates, in part because they have a stable and strong financial condition. In a securitization of comparatively lower interest rate loans, the difference between the rates on the loans (net of servicing fees and other transaction level costs), and the rates on the securities issued, is very small and does not contribute meaningfully to credit enhancement. In such a securitization, the most subordinate class typically has attributes like those of an "eligible horizontal residual interest" as defined in the Proposed Regulations, in that it has a principal amount representing a portion of the principal balance of the loans in the pool, which bears interest at a rate similar to the rate on the other securities.

In the past, mortgage loans with comparatively higher interest rates have been given to non-prime borrowers. Non-prime borrowers are ones that do not meet these conservative underwriting standards for one or more reasons. Such borrowers may have had credit problems in the past due to loss of employment or health issues. They may have comparatively low incomes, or may not have funds available for a substantial down payment, resulting in higher loan-to-value ratios. Non-prime borrowers typically have lower credit scores than prime borrowers. However, these borrowers can be deserving of credit under prudent underwriting guidelines, although at a higher interest rate than would be available for the most creditworthy borrowers, given some elevation in the risk of default. In a securitization of higher interest rate loans, the difference between the weighted average of the rates on the loans (net of servicing fees and other transaction level costs) and the weighted average of the rates on the securities issued is referred to as "excess spread." That excess spread may be in the range of 0.5% to 1.0%, but since the interest attributable to this excess spread is paid on the entire balance of the pool over the life of the transaction, the present value of the excess spread could be equal to 4.0% to 8.0%

[41] *See* "ASF Letter re RMBS Risk Retention & QRM," American Securitization Forum (November 12, 2010) at: http://www.americansecuritization.com/uploadedFiles/ASF_RMBS_Risk_Retention_Letter_11.12.10.pdf.

(or higher) of the total pool balance, assuming minimal losses. In securitizations of non-prime loans, the excess spread typically will be treated as the first loss class. Thus the first loss class may have no principal amount (or par value) initially, but it represents an entitlement to excess spread across the entire pool on a subordinated basis. In such transactions, there are typically also second and subsequent loss classes, which do have principal amounts representing a portion of the principal balance of the loans in the pool, and which do bear interest on their own balances at a rate similar to the rate on the other securities.

Under the new rules, securitizations secured by QRMs will not be required to comply with the risk retention requirements, while those secured by non-QRMs generally will be required to comply with such requirements. As a result, non-QRMs will be less liquid assets, and lenders are likely to charge higher interest rates to compensate for this lack of liquidity. Therefore, securitizations of non-QRMs (which will likely make up the vast majority of mortgage loans that are made) will likely also have significant amounts of excess spread, and are therefore likely to be structured similarly to the way non-prime securitizations have been structured in the past. In such a structure, an excess spread class that is the most subordinate class, if retained by the sponsor, would represent a retention of the credit risk of the assets in the pool. In any given period, excess spread received that is not used to cover current losses may be required under the documents to be used to pay principal on the senior securities. This creates overcollateralization, represented by the excess spread class, which is an interest in the principal amount of the pool that is available to cover future credit losses. Typically, once the overcollateralization reaches a certain level, excess spread thereafter may be released to the excess spread class. This excess spread class clearly represents the credit risk of the assets being securitized, because any losses experienced by the assets will initially be borne by such class. Yet this type of class would not meet the proposed definition of "eligible horizontal residual interest," to the extent that it is not structured as also having an initial principal amount of 5%, and even in that case the present value of the excess spread would not count towards the risk retention requirement.

Our issuer members are very disappointed that the Proposed Regulations do not recognize an excess spread first loss class with no stated principal amount as a valid form of risk retention. This is 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 Dodd-Frank, which instructs the Joint Regulators to issue rules to require a sponsor to retain 5% 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. As discussed in the preceding paragraph, the retention of an excess spread first loss class with no principal amount would clearly meet the statutory mandate for retention of credit risk in the assets, because such a class would be entitled to cash flows with a present value that can be calculated and which would be exposed to loss in the event of credit losses on the pooled assets. However, under the Proposed Regulations as drafted, even if the sponsor did retain the excess spread first loss class, it would also have to have 5% credit risk retention as a vertical slice, or as a 5% horizontal slice structured as part of the excess spread first loss class (for example, by combining the excess spread with an initial overcollateralization level of 5% of the pool balance). This could result in total risk retention of

9.0% to 13.0% or more[42], which as we will discuss later has significant implications for accounting and legal sale treatment as well as risk-based capital reserves. For these reasons, we request that the Proposed Regulations be revised to permit a class to qualify as an eligible horizontal residual interest if it has either a par value, or a fair value, equal to 5% of the par value of all ABS interests in the issuing entity. We note that in the ASF RMBS Risk Retention Letter submitted to the Joint Regulators in November 2010, we specifically requested that the rules permit the requirements for horizontal risk retention to be complied with through the retention of an excess spread first loss class.

The practical effect of this aspect of the Proposed Regulations, combined with the premium capture rules discussed below, is that for securitizations where there is excess spread (which will likely include all securitizations of non-QRMs loans), the entire value of the excess spread must be fully subordinated and treated as an additional layer of required risk retention, on top of the 5% otherwise required. Yet this is not acknowledged in the Release, nor is there any justification offered as to why this is the appropriate level of risk retention for non-QRMs. Furthermore, it is not consistent with the plain language of Section 945 of Dodd-Frank. This will result in higher costs being passed through to the borrowers and/or reduced availability of credit to borrowers who do not qualify for QRMs, which we expect to include the vast majority of all borrowers under the regulations as proposed.

iii. Investor Concerns Relating to Horizontal Risk Retention and the Use of Excess Spread

Our RMBS investor members do not believe that excess spread should be considered in determining whether the eligible horizontal residual interest satisfies the required amount or value. They are concerned that aggressive assumptions used in calculating present value may overstate the amount of excess interest expected to be generated, and therefore overstate the ultimate risk retained by the sponsor. They believe that determining whether the eligible horizontal residual interest meets the 5% (or other applicable percentage) requirement should be based on the par or face amount of the ABS interests retained at issuance. For example, if an excess spread first loss class is used as the eligible horizontal residual interest, it would have to have an initial overcollateralization ("OC") of at least 5% of the par or face amount of all ABS interests issued. Alternatively, if the initial OC amount is less than 5%, then a combination of the initial OC, and the next most subordinate tranche or a reserve fund, totaling 5% of the par or face amount of all ABS interests issued should satisfy the requirement.

In addition, our investor members harbor general concerns about horizontal risk retention. Investors are concerned that if the servicer and the sponsor are affiliated, the servicer may be motivated to adopt servicing strategies that benefit the first loss tranche or equity interest over the other tranches. In particular, investors are concerned that when the collateral is impaired servicing strategies can be employed that will cause excess cashflow to be released to the eligible horizontal residual interest at the expense of the more senior classes. Investors suggest limiting payments made on the retained residual interest to an interest coupon equal to

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[42] These hypothetical numbers reflect the estimated present value of the retained positions, assuming very minimal losses. The market value of the retained positions might be considerably lower, because under conservative valuations they would be discounted more heavily to account for potential losses.

the Net WAC of the loans and thus locking it out of any other payments. Investors note that this same concern does not exist in the shifting interest structures generally used in prime deals, as there is no excess cashflow concept in those transactions.

Our investor members note that because of this tension, it is critical that the uniform servicing standards currently being developed as part of the interagency effort (outside of QRM) require that servicers act in the best interests of all investors taken as a whole, without regard to any securities that the servicer or an affiliate may own.

iv. Harsh Impact of "Premium Capture Cash Reserve" Rules on RMBS

a. General

The premium capture cash reserve proposals within the Proposed Regulations are not in any way contemplated by Dodd-Frank, and came as a surprise to observers. The intent of these proposals is to prevent the upfront monetization of excess spread by the sponsor, under the theory that allowing such monetization would effectively negate the economic exposure that a sponsor is required to retain. The premise appears to be that using profits generated by monetization of excess spread to finance or fund the required risk retention would make the sponsor indifferent to asset quality and that therefore it must be made impossible for the sponsor to generate an upfront return through issuing a securitization. This would of course result in the sponsor having to finance or fund required risk retention positions through sponsor equity or debt, with equity likely being the only option for first loss risk positions. But, if the effect of the rules is that sponsors cannot generate returns through issuing a securitization, they will simply not securitize.

It is important to note that our investor members support reforms that seek to create a stable securitization market over time and in this vein, they are generally supportive of the concept that the Joint Regulators attempted to employ through the premium capture cash reserve account. The ability of issuers to monetize excess spread at the inception of a securitization transaction can result in an issuer having less overall exposure to the transaction than it otherwise would. The requirement to fund the premium capture cash reserve account effectively negates that reduction in exposure. However, the assumption that using returns received through the monetization of excess spread would result in a sponsor not having any "skin in the game" is incorrect. While it is possible that utilizing such returns to effectively purchase the interests required to be retained could result in no net cash outlay by the sponsor, the retained interests would still need to be held on the sponsor's balance sheet. This will subject the sponsor to capital charge and other accounting implications, which would become more severe if the value of the retained interests decline, thereby giving the sponsor reason to ensure that such interests retain their value.

As currently proposed, our investor members agree that the premium capture cash reserve account would likely result in decreased incentives to securitize for any issuer other than those that securitize purely for financing. In a worst case scenario, institutions with other sources of funding will move away from securitization altogether, resulting in a constriction of credit and an increased cost of capital. Moreover, investors will lose important access to purchasing these securities. Investors are also concerned that a reduced availability of credit would put negative pressure on home values and, in turn, affect the trillions of dollars of outstanding ABS that investors currently own.

b. Detrimental Effects of the Proposal

Under these rules as proposed, a sponsor would have to create and fund a "premium capture cash reserve account" with cash in an amount equal to the excess of:

a) the gross proceeds (net of issuance costs) from the sale of all ABS interests to persons other than the sponsor, over

b) 95% (for vertical, horizontal, and other types of risk retention representing an interest in the securitization held by the sponsor) or 100% (for other types of risk retention) of the par value of all ABS interests issued.

The premium capture cash reserve account would be required to bear first losses and thus would be subordinate to any horizontal slice risk retention. Furthermore, the Proposed Regulations would deem the amount of gross proceeds in a) above to also include the par value of any ABS interest retained by the sponsor (or fair value of any such interest with no face amount) if either 1) the sponsor does not intend to hold the interest to maturity, or 2) the interest is an interest-only type class and is not the most subordinate interest in the transaction. If an excess spread first loss class with no initial principal balance was retained by the sponsor, such retention would not trigger the requirement to establish a premium capture cash reserve account, but nevertheless as discussed above such a class would not count towards meeting the risk retention requirement.

Our issuer and investor members agree that there are several problems with these proposed rules that must be addressed.

First, the proposed rules do not take into account the cost of origination, which are often recouped through a premium on the loan's interest rate. This includes out-of-pocket costs such as appraisals and title insurance, as well as the originator's overhead and profit on sale, to the extent not paid by the borrower as points or fees. These costs are reflected in the price paid by the sponsor to the originator, such that the sponsor's cost basis in the loan is typically greater than par. Therefore, to avoid the sponsor having to deposit cash equal to origination costs into a premium capture cash reserve account, originators would be compelled to impose more costs on the borrower in the form of points and fees. While higher discount points should also result in a lower interest rate for the borrower, it is not clear why this outcome is good public policy, as it restricts consumer choice. In addition, a lender's ability to charge higher points and fees is becoming more restricted. Under the Proposed Regulations, as discussed below, the QRM definition would limit points and fees to 3% of the loan amount. Similarly, under Proposed Ability to Repay Rules discussed in Section xvi below, in order for a loan to qualify as a "Qualified Mortgage" (and therefore be entitled to the presumption that the borrower has the required ability to repay), the total points and fees charged cannot exceed 3% of the loan amount (other than in the case of loans with balances less than $75,000).

Second, the proposed rules generally do not allow the sponsor to realize any upfront cash profit from issuing a securitization. Unless somehow the sponsor's cost basis in the loans can be reduced below par, any proceeds realized in excess of par would be forced into a fully subordinated cash reserve. As with any private sector activity, market participants will not engage in aggregation of loans and securitization unless it can be done profitably. This aspect of the proposed rules would adversely affect smaller originators who do not have the wherewithal to issue their own securitizations, and would cause such originators to continue to be dependent on the GSEs and FHA for funding.

Third, these rules would interfere with an originator's or sponsor's ability to use interest rate hedges during the period between origination and securitization. Even if, by imposing points and fees on the borrower, a loan can be originated for a securitization exit at par, if a sponsor or originator used a hedge to protect against rate movements prior to securitization, and if rates were to go down, the sponsor or originator would lose money on the hedge, but the offsetting gain that should have been available to cover the loss on the hedge will instead take the form of a premium value in the securitization that must be deposited in the premium capture cash reserve. This inability to hedge will have pervasive effects. Originators will be much less likely to offer borrowers loans with rate lock or "float down" features for the period between application and funding, or borrowers will be required to pay a substantial premium in order to obtain loans with such features. Without such features, in a rising interest rate environment, borrowers will be unable to benefit from the lower interest rates available at the time they make the decision to buy a home. In addition, an increase in interest rate between application and funding will cause an increase in the borrower's debt-to-income ratio. This could result in a borrower who qualified for a QRM at the time of application to no longer qualify at the time of closing, which would likely cause the interest rate and other pricing terms of the loan to substantially increase. If this means that borrowers will not know the pricing terms of their loan at the time they commit to purchase a home, a significant degree of uncertainty will be introduced into the homebuying process, which may serve as a further hindrance to the recovery of the housing market.

Fourth, the deemed additions to gross proceeds for certain retained interests are unduly harsh. The same results could be achieved by 1) requiring the sponsor to fund the premium capture cash reserve account only on the actual sale of any retained interests post-closing, and 2) as to non-first loss excess spread classes, requiring the sponsor to deposit cash received from such classes as and when distributed into the premium capture cash reserve account. There is no reason to require an upfront deposit of the full value of these retained interests at the time of issuance, in order to achieve the stated regulatory objectives.

Fifth, for the same reasons discussed above, the harsh impacts of the premium capture cash reserve rules will be most severe for loans with higher interest rates, because securitizations of such loans create significant amounts of excess spread. It is likely that loans that do not qualify as QRMs will be charged premium interest rates in order to compensate for the limitations on liquidity resulting from the risk retention requirements. These proposed rules, together with the issues noted above with the definition of "eligible horizontal residual interest", effectively cap the upfront proceeds that can be generated from a securitization. We believe that in practice this will work like price controls, such that originators and securitizers will be economically disincentivized to offer credit at prices (interest rates) higher than those that are offered to the borrowers who qualify for QRMs. As with any system of price controls, this will effectively result in restricting supply, or rationing, of credit to the benefit of stronger credits and detriment of weaker credits. This will result in credit being less available to, and more expensive for, borrowers who do not qualify for QRMs, which includes the vast majority of all borrowers, especially those with low to moderate incomes, as well as first time homebuyers.

v. Effects of "Premium Capture" and "Eligible Horizontal Residual Interest" Provisions on Non-QRM Borrowers

Under the QRM definition as proposed, the vast majority of borrowers will not qualify for QRMs. Even if the Joint Regulators adopt the changes to the definition that we propose below, a substantial percentage of borrowers will still be excluded. In order to compensate for the risk retention requirements applied to non-QRM loans and the corresponding reduction in the liquidity of such loans, non-QRM borrowers will be required to pay higher interest rates. As discussed above, the securitization of loans with higher interest rates results in greater amounts of excess spread.

The effects of the premium capture cash reserve rules and the restrictive definition of eligible horizontal residual interest could effectively eliminate the ability of the private markets to fund non-QRM mortgage originations through securitization. Since the GSEs will continue to be able to securitize without regard to risk retention requirements, and since they will purchase loans for securitization with borrower credit scores as low as 620, that means that 1) during the GSE wind down period, the GSEs will be the primary source of capital markets liquidity for non-QRM loans, exposing taxpayers to a reverse cherry-picked portfolio, and 2) once the GSEs have been wound down to the point that they no longer are excluded from risk retention, there will not have emerged a private capital markets alternative providing comparable liquidity for non-QRM loans. Thus, at the end of the GSE wind down period, the then legacy GSEs will be saddled with a higher concentration of non-QRM loans that would have otherwise been the case, and at the same time non-QRM borrowers will suddenly have greatly restricted sources of credit.

vi. Further Effects of "Premium Capture" and "Eligible Horizontal Residual Interest" Provisions on Feasibility of Securitization

a. Accounting Consolidation and True Sale Issues

One further consequence of the proposals discussed above is that for pools with significant excess spread, it will likely be impossible to achieve sale treatment under GAAP in cases in which the sponsor is affiliated with the servicer. By effectively adding the value of the excess spread to the required 5% risk retention, the total required risk retention will likely to be viewed as a significant interest triggering financing treatment. This in turn will require higher capital requirements, especially as to insured depository institutions. We note that the likelihood of these proposals resulting in loss of sale treatment may be mitigated if a viable alternative to the representative sampling approach is provided, as suggested below. However, the application of the premium capture rules alone could cause the loss of sale treatment in transactions where the sponsor is affiliated with the servicer, even if (such as in the case of representative sample retention) no securities are retained. This result will be dependent on whether the amount retained in the premium capture cash reserve account is deemed to be a significant interest, but because the interest will be in a first loss position, even a small percentage will likely be considered significant.

The ASF RMBS Risk Retention Letter submitted to the Joint Regulators in November 2010 provided some significant detail about our accounting committee's views on the impact of various forms of risk retention on sale treatment under GAAP. The letter indicated that vertical slice retention in and of itself would likely not cause the sponsor to consolidate the assets of the securitization issuer (even if the sponsor or an affiliate is acting as servicer). However, this conclusion "is dependent on the sponsor owning no more than 5% of each tranche... A higher percentage of retention could change the analysis and require consolidation."[43] Thus our ASF RMBS Risk Retention Letter clearly warned that retention in excess of a 5% vertical slice could result in consolidation.[44] Our accounting committee has confirmed that the premium capture reserve account rules, if applied to situations in which risk is retained through a vertical slice, would therefore likely always result in consolidation (assuming servicing is retained by an affiliate of the sponsor), since those rules would require additional retention in excess of 5% of each tranche.

Furthermore, the larger levels of recourse that result by requiring total risk retention of 5% plus the value of excess spread may make it less likely that a sponsor will be able to obtain a "true sale" opinion from outside legal counsel, as required by rating agencies and by investors. "True sale" opinions are considered crucial in securitizations, to demonstrate legal isolation from the sponsor. For many firms, the amount of subordinated exposure to losses (or "recourse") is a key factor in the analysis. Moreover, the inability to transfer the recourse, and the apparent inability to finance it through a special purpose vehicle, are additional factors that may cause a true sale opinion to be difficult to obtain.

As discussed above, we believe that the premium capture cash reserve account requirements and the restrictions on what can constitute an eligible horizontal residual interest effectively require a greater percentage of the credit risk of the issued securities to be retained by the sponsor than was intended by Dodd-Frank. Every dollar of retained credit risk must effectively be paid for, directly or indirectly, by the sponsor who is retaining it. The funds utilized for such purpose will not be available to the sponsor for other purposes, including making additional credit available to consumers or otherwise contributing to the recovery of the United States economy.

b. Economic Impact on Borrowers

One way to measure the economic impact of the premium capture rule is to consider its effect on a securitization execution, with the view that, like any other private sector activity, any increase in cost mandated by government regulation will be passed along to the consumer.

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[43] ASF RMBS Risk Retention Letter, pg. 12.

[44] *See* also the remarks of James Kroeker, Chief Accountant of the SEC, at an Open Meeting on April 7, 2010 where he stated, "if you're in the order of magnitude of a small interest, 0 up to 5%, barring unusual retention of risk... that wouldn't, in and of itself, necessarily require you to consolidate." http://www.connectlive.com/events/secopenmeetings/

There are a variety of funding alternatives for a lender making a residential mortgage loan. For a lender that is an insured depository institution (or IDI), loans can be funded with insured deposits, but an IDI is limited in its ability to fund loans this way by capital constraints. For lenders generally, outside funding can also be obtained through 1) sale to a GSE, 2) private securitization, or 3) a whole loan sale to any of a variety of types of purchasers including an IDI, a conduit, an investment bank, a fund, a REIT, or other investor. Generally, before committing to make a loan, the lender will compare the available funding alternatives, and will determine the best execution for that loan taking into account a variety of factors. Once the best execution is selected, the loan's interest rate and other pricing related terms are set at a level that will allow the lender to recover its cost basis in the loan plus a reasonable profit. This process is referred to as "margin management". It is important to keep in mind that margin management does not take place in a vacuum, but rather in a highly competitive marketplace. Other potential lenders will have access to the same or similar funding alternatives, so lenders must price loans competitively in order to maintain market share. This means that the lender must manage its costs of origination, and must set its profit margins competitively, if it wants to stay in business.

Generally, a lender's cost basis in a loan includes not just the net amount advanced to the borrower, but also direct origination costs not charged to the borrower, hedging costs, and an overhead allocation. The cost basis at origination will always be greater than par, unless the borrower pays discount points that exceed the above factors that add to the cost basis. And, no matter what the form of execution is, "margin management" results in the interest rate being set at a level that will recover the cost basis, plus a reasonable yet competitive profit. In other words, loans originated for sale through a GSE securitization, or via a whole loan sale will be priced and sold for cash at a premium to par to the extent needed to recover the lender's cost basis (plus profit). Pricing loans at a premium to par is a normal and, absent payment by the borrower of substantial discount points at closing, necessary part of the mortgage finance business.

In order for private securitization to be a viable funding alternative for an originator, it must be the best execution for a given loan and it must be possible for the lender to generate cash or other proceeds through the securitization execution that enable it to recover its cost basis in the loan (plus profit). The following discussion explains how, to date, private securitization has been able to generate proceeds that can compete with other funding alternatives and be the best execution, and also explains how the proposed premium capture rules would interfere with securitization.

One of the many benefits of private label securitization as a funding source is that it permits the creation of a senior asset that is of higher credit quality than the underlying asset, meaning that the senior portion of the securitization can be sold with a significantly lower yield than that of the underlying asset, even with prime quality assets. This creates the potential for a senior IO interest, representing the difference between the loan rate (net of servicing) and the security rate on the senior balance, and which has a significant present value. The creation of a senior IO interest is ordinarily a natural byproduct of an economically efficient capital structure, that can provide for the aggregate value of the interests issued by a securitization trust to be greater than the value that the underlying assets would have to a portfolio investor.

See the example shown below, in which the senior Class A-1 has its interest rate reduced from 5.00% to 4.125%. This is done so that the Class A-1 can be sold at par, instead of selling at a premium which would otherwise result. This would typically be done to accommodate the investors in the Class A-1, who are looking for top credit quality but who do not want to bear the risk that would result if they paid a premium and the bond then paid faster than expected. Note that the interest cash flow allocated to the senior IO in this example is part of the specific interest entitlements on all classes, which in the aggregate and together with the servicing fee total 5.25% on the balance of this loan. This is different from "excess spread", which results where the interest rate on the loan is greater than the total of the interest allocated to the various classes (i.e., which would result in this example if the loan interest rate were greater than 5.25%) and can be used for credit enhancement.

Importantly, a senior IO interest does not represent a windfall for the originator. Rather, as the example below shows, the value of the senior IO can be applied towards recovery of the originator's cost basis in the loan, as well as the discount from face amount represented by the value of the subordinate classes in the transaction. The ability to create and sell a senior IO in a private securitization contributes directly to the viability of securitization as a funding alternative, and may be necessary in order for securitization to be the best execution when compared to all-cash alternatives.

Consider the example of a borrower looking for a $100,000 prime quality 30 year fixed rate loan. Let us assume an interest rate of 5.25%. If the proposed rules were in effect, a threshold question for any lender would be whether the borrower is eligible for a QRM. Although prime quality, let us assume that the borrower would not qualify as a QRM borrower because of failure to meet the credit history requirement due to non-payment of an obligation other than a prior mortgage loan.

Assume that, in this case, if this loan were included in a private securitization, the effect of this loan's inclusion would result in adding the following amounts to the different classes in the structure (with a servicing fee of .25%):

	Face	Rate	Price	Value	Rating
Class A-1	$92,500	4.125%	par	$92,500	"AAA"
Class A-2	$2,500	5.00%	92.5%	$2,312.50	"AA"
Senior IO	notional	0.809%	3.24%	$3,237.50	"AAA"
Class B	$5,000	5.00%	60%	$3,000	no rating
Total Value	$100,000			$101,050	

In this example, the senior IO represents .875% on the balance of the Class A-1, which is expressed above as .809% on a notional balance equal to the loan's balance. This bond's cash flows have a present value of $3,237.50 using a 4:1 multiple.

Let us further assume that the originator will be the sponsor of the securitization, that the Class A-1 and Class A-2 are sold, and that the sponsor will use horizontal risk retention by retaining the Class B. Also assume that the direct origination costs not charged to the borrower, hedging costs, and overhead allocation total $1,000, that the borrower is not charged points, and further that $500 would represent a reasonable profit from the origination activity. Therefore, the originator would need to realize cash proceeds of $101,500, in order to recover its cost basis and generate a reasonable profit without needing to partially fund the loan from capital or other sources.

Absent the proposed premium capture rules, if the senior IO interest were sold for cash, the total cash proceeds of the securitization execution would be $98,050. This amount, when added to the $3,000 value of the retained Class B would almost (but not quite) cover origination costs and a reasonable profit for the originator. Because the originator will be retaining the Class B in order to comply with the risk retention rules, the originator will need to use other sources of funds to carry that retained interest, and because the Class B is likely not eligible collateral for lending (even on a full recourse basis), the originator will most likely need to use capital to carry the Class B. Securitizers have of course anticipated the need for capital to cover risk retention positions since Dodd-Frank was enacted.

But, with the premium capture rule added to the mix, the situation changes dramatically. Because of the premium capture rules, in this example (and disregarding issuance costs), the creation of a senior IO class, whether or not sold, requires that the sponsor deposit cash equal to $3,050 in the premium capture cash reserve account. This represents an outlay of funds which will be illiquid for an extended and uncertain period, generate only the most minimal yield, and will be subject to a high degree of credit risk. Moreover, the sponsor's total cash proceeds from the offering will be limited to $94,813, not the $98,050 that would have resulted from retaining the Class B but selling the senior IO absent the premium capture rules.

We believe that the risk retention requirements (without regard to premium capture) will have only a marginal impact on pricing. Securitizers have long been accustomed to retaining various types of interests issued in their transactions, and carrying them at fair value. In contrast, we believe that originators will view the requirement to fund a premium capture cash reserve account as a cost of doing business, which must be taken into account in determining the best execution at the time of commitment to lend. This means that, in order for securitization to be selected as the funding alternative, the cost of the premium capture would have to be imposed on the borrower, in the form of higher points or a higher interest rate. In this example, if using the points approach, the originator would need to impose points in excess of 3% on the borrower to cover the cost of the premium capture. But market considerations make it difficult to charge points to the borrower, especially at such high levels. It would be a financial hardship for the borrower to further come out of pocket to cover this fee, at a time when the borrower is incurring other transaction costs and must also provide a down payment on the property as needed under the originator's underwriting criteria. Borrowers also disfavor points because they create a financial disincentive to refinancing the loan or selling the property sooner than anticipated (as points represent an upfront cost to be amortized over time), and also because they may not be deductible in some circumstances. Moreover, charging points in excess of 3% would cause the loan to not be a Qualified Mortgage under the Proposed Ability to Repay Rules discussed in Section xvi below, which would be a strong disincentive from the lender's perspective.

Let us assume instead that the originator determines to make itself whole for the outlay required to fund the premium capture in the form of a higher interest rate on the loan. (This additional interest would need to be addressed in some manner, perhaps by carving it out as an interest strip prior to selling the loan to the issuing entity, in order to avoid it simply resulting in a larger senior IO and a larger premium capture account.) To recover the outlay of $3,050 over an assumed 18 month period (which is reasonable given the borrower's incentives to refinance if he or she becomes QRM eligible), this would require an interest rate approximately .2.00% higher, and with a monthly payment approximately 24% higher, than would otherwise be the case for this loan.

The impact on the housing markets, and on the competitiveness of non-GSE securitization for loans that do not meet QRM criteria, is obvious. The market interest rate for this loan, if sold to one of the GSEs, would be 5.25% or even less. But, if this loan were originated with the intent to securitize in a private securitization, the interest rate would have to be at least 7.25% to offset the premium capture requirements. Thus, unless the loan did qualify for the QRM exemption, the originator would be economically precluded from a private securitization alternative, and would likely be forced to fund the loan either through sale to a GSE or with deposits (if an IDI). To the extent that securitization is not viable as a funding alternative for the foregoing reasons, these same reasons would also render securitization non-viable as an exit strategy for the purchaser in a whole loan sale, and therefore the whole loan sale funding alternatives available to the lender at the time of origination would be correspondingly limited.

vii. Alternative Interpretation of "Premium Capture" and "Eligible Horizontal Residual Interest" Provisions

We have been informed by representatives of one of the Joint Regulators that the intent of the premium capture reserve account provisions was only to ensure that the value of the 5% risk retention, particularly if held as a horizontal slice, is in fact worth at least 5% of the fair value of all securities backed by the pool (the "Alternative Meaning"). If this is indeed the case, our issuer and investor members suggest that all relevant portions of the Proposed Regulations be re-proposed to fully reflect this Alternative Meaning, so that commentators may have actual proposed language to comment on. The intent of the premium capture reserve account rules should be limited to confirming that the value of the risk retention position is at least equal to 5% (or other applicable percentage), and these rules must not act to further limit the total proceeds that can be realized from a securitization as would be the case under the plain meaning of the Proposed Regulations.

Assuming the Alternative Meaning is in fact intended by the Joint Regulators, our members firmly believe that it will not be possible for market participants to properly comment on the proposed premium capture reserve account provisions or the eligible horizontal residual interest provisions unless the relevant portions of the Proposed Regulations are re-proposed. We urge the joint regulators to issue such a re-proposal, as opposed to issuing final rules that attempt to institute the Alternative Meaning without giving all market participants an opportunity to comment on it.

However, we do have several initial comments on the Alternative Meaning. First, since the premium capture reserve account provisions under the Alternative Meaning would only appear to be relevant to retention in the form of either an eligible horizontal residual interest or L-shaped risk retention, the provisions should be revised to only apply in situations where one of those forms of risk retention is utilized and an express exemption should be granted for cases where vertical or representative sample risk retention is utilized. Under the Alternative Meaning, the premium capture rules are entirely unnecessary in cases where vertical risk retention is used, since vertical risk retention will always result in a sponsor holding securities worth 5% of the fair value of all the securities backed by the pool. This is because vertical risk retention requires the sponsor to retain 5% of each class of securities, which by definition will always be worth 5% of the fair value of all the securities backed by the pool. Representative sample retention relies on the sponsor retaining an interest in the assets themselves, and therefore the issue of ensuring that the sponsor holds securities that are worth 5% of the fair value of all the securities is moot.

The regulations should also provide guidance on how the fair value of the securities is to be determined, since a variety of mechanisms exist in the market to make such determinations. The regulations should not impose any specific methodology, but should set forth a standard. We propose that the regulations state that fair value of each ABS interest be determined using reasonable assumptions and methodology, that are applied consistently within the specific securitization. It is also important that the rules permit fair value to be assessed at or prior to "pricing" of the transaction (i.e., the point at which investors commit to buy the securities), so that sponsors know what percentage of the securities can be sold to investors and what percentage must be retained. In addition to the existing disclosure requirements which would likely require that the methodology used to determine fair value be disclosed, the rules should clearly establish what the consequences will be of a failure to determine fair value in accordance with the standards specified in the rules.

Finally, even with the changes suggested above, we question whether the market value approach imbedded in the Alternative Meaning is appropriate. Prior to the emergence of the Alternative Meaning, the discussion around risk retention has been that a horizontal slice should represent 5% of the credit risk of the assets. This correlates to the first $5 of loss of principal amount, on a $100 pool. The Dodd-Frank mandate is to develop regulations under which 5% of the credit risk is retained, in a variety of forms which may include horizontal first loss, and with the 5% reduced for more conservatively underwritten assets. Implicit in the Dodd-Frank mandate, by referencing 5% of the credit risk, is the concept that when a horizontal slice is used, the risk retained will represent less than 5% of the value of the pool. Unless the assets have zero risk, the value of the first 5% of the credit risk by definition will represent less than 5% of the value of the assets, because the first 5% of credit risk is disproportionately risky and therefore has a disproportionately lower value. The more risky the assets are, the higher will be the discount to face amount in the value of any first loss interest. Thus, if a first loss class were required to represent 5% of value, that would in effect be a self-executing provision in which the percentage of the total credit risk required to be retained would be automatically increased above 5% in direct relationship to how risky the assets are. We believe that this is fundamentally inconsistent with the framework envisioned by the Dodd-Frank mandate.

viii. Impracticality of "Representative Sample" Retention for RMBS; Suggested Alternatives

a. Issuer View

The proposal for a representative sample outlined in the Proposed Regulations is not practical for use with RMBS offerings. First and foremost, the representative sample methodology proposed requires that there be a minimum pool of 1,000 assets, from which the securitized pool as well as the representative sample must be drawn, and that all 1,000 of the assets be in the pool or the sample. This is not practical for jumbo prime residential loans (loans meeting all GSE underwriting criteria except for being larger than the permitted maximum balance), which are the most likely type of residential mortgage loan to initially find acceptance as the capital markets recover. We note that the recent landmark $289,529,000 registered RMBS offering by Sequoia Mortgage Trust 2011-1, was backed by a pool of only 302 loans, with an average balance of approximately $978,000. Even if the 1,000 asset minimum requirement did not apply, we believe that it would be very difficult, and potentially impossible, by any selection method to break out a sample of 15 or so loans such that all material characteristics of the sample were representative of the securitized pool to the degree required under the proposed rules. The other requirements proposed to ensure that the sample selected be truly representative are unduly burdensome and make this form of risk retention likely to be of very limited practical use to RMBS sponsors. This includes the requirements relating to (i) the characteristics of the retained assets being within a two-tailed confidence interval of the same characteristics of all assets in the pool, (ii) maintaining certain specified policies and procedures and obtaining an agreed upon procedures letter relating to such policies and procedures, (iii) servicing of the retained assets being conducted by the same entity and under the same standards as the securitized assets, (iv) complying with the hedging, transfer and sale restrictions with respect to the retained assets and (v) providing disclosure to investors concerning the retained assets. We believe it essential that a practical alternative for a representative or random sample be provided that is workable for RMBS, in order for there to be fairness and a level playing field as among the various asset classes.

The requirements described above are primarily designed to ensure that the sample retained will be representative of the assets that are securitized. However, we believe it is not necessary to meet the goals of the risk retention rules that such requirements be imposed. Furthermore, in certain respects, such as the requirement that retained assets be within a two-tailed confidence interval of the assets being securitized, these "representative" requirements are at odds with the requirement that the selection be random. Instead, we propose that sponsors be permitted to meet the risk retention requirements simply by retaining a randomly selected sample of loans equal to 5% (by principal balance) of the loans identified for a particular securitization pool. The assets to be retained would be chosen using an established random selection procedure which would not take into account any characteristics of the assets other than principal balance. Since the retained sample would be picked at random, it might not be closely representative of a given securitization pool. However, when viewed in the aggregate over a number of different securitizations that are part of a program, the larger the number of securitizations, the more likely it would be that all of the loans retained by a sponsor over all of such sponsor's securitization transactions would be representative of all of the loans securitized by such sponsor. Furthermore, by the very nature of the randomness of the process, a sponsor that retains a randomly selected sample of assets from a pool to be securitized will be subject to the risk that such assets will perform in a manner similar to the assets that are securitized. Therefore, such sponsor will be motivated to employ sound credit and underwriting processes in the origination of loans for securitization. In other words, it is not necessary that such loans truly be representative of a given securitization pool, so long as a sponsor, in the exercise of its sound business judgment, must act on the assumption that such assets may be representative of the assets that are securitized.

As another alternative to the representative sample methodology included in the Proposed Regulations, we propose permitting the sponsor to retain a 5% pro rata participation in each asset included in the pool of assets that is securitized. Such a participation would have to be a pari passu pro rata interest in each asset, and as such could meet the definition of "participating interest" under FAS 166 such that the selling sponsor would not have to treat the retained participation as having been sold for purposes of GAAP. The 95% participation sold to the issuing entity, and the 5% retained interest, would share equally, on a pro rata basis, in all principal and interest payments on the loan as well as any servicing expenses and losses realized. Servicing of the entire loan (thus both participations) would be conducted by a servicer under a servicing agreement, so there would be no differences in how the participation interests are serviced. We would further propose that the rules permit a variation on this structure, under which the entire loan is sold to the issuing entity, and the issuing entity creates and transfers back to the sponsor a 5% participation interest in each loan, having the features described above, which would then be the risk retention interest. Some of our accounting members have suggested that this approach may have the same result, in terms of the 5% participation not constituting an interest in the issuing entity.

This alternative would be particularly useful in the case of the securitization of a relatively small number of jumbo prime residential loans, such as in the Sequoia Mortgage Trust transaction described above. Since a randomly selected sample of loans from such a pool would consist of a very small number of loans, the sample would likely not be considered to be credible risk retention by investors, because it likely would not perform in a manner representative of the pool. For a sample of such a small number, the delinquency rate of the sample would be driven purely by the number of loans that happened to be in default and their relative sizes, and it would only be a coincidence if that rate approximated the delinquency rate of the securitized pool.

We believe that this approach can be easily executed and for "chunkier" pools consisting of a relatively smaller number of assets with relatively larger balances, will be superior to the representative sample in terms of credibility. There will be no question that the retained participations are exactly representative of the securitized pool, and that the retained participation will perform exactly like the securitized assets. Without this alternative, the Proposed Regulations would discriminate against sponsors of "chunkier" pools by not offering a risk retention alternative that, like representative sampling, is most favorable in terms of making sale treatment under GAAP a possibility for the securitized assets.

We note that, in order for the 5% participation approach to be workable where it is created by the sponsor, it will be necessary for the 95% participation sold to the issuing entity not to be treated as a separate "security" under federal securities laws. Under Regulation AB and related rules, if a pooled asset is itself a security then additional registration requirements apply that would be unduly burdensome. While we believe that with appropriate contractual provisions such a participation should not be treated as a separate "security" under applicable case law, in order to use this suggested form of risk retention there would need to be clarification in the rules that the 95% participation would not be treated as a separate security under Federal securities laws, in light of general statements that have been made by the SEC regarding its view that participations that are securitized should generally be viewed as separate securities.[5] This clarification would apparently not be needed, where the 5% participation is created by the issuing entity.

b. Investor View

Our investor members oppose the representative sample form of risk retention set forth in the Proposed Regulations because they believe it will be impossible to ensure that the sample of loans selected is in fact random or that it adequately represents the overall credit risk of the loans that are securitized. Furthermore, the requirement that the sample pool be representative based on material characteristics creates a natural tension with the requirement that the selection process for the pool be random. They believe the proposed concept is flawed and is likely to be ineffective in practice while creating incentives for adverse selection.

While investors believe that the issuers' proposed participation interest sample approach solves the problem of ensuring representativeness, they question its utility in light of the fact that it is economically equivalent to vertical risk retention (setting aside accounting considerations). They are also concerned that the creation of the participation interest and the segregation of individual loans may cause unnecessary bankruptcy or receivership issues down the road.

ix. Limitations on L-Shaped Risk Retention

The Proposed Regulations permit sponsors to meet the risk retention requirements by retaining a combination of a vertical interest and a horizontal interest (i.e., "L-shaped" risk retention). The Proposed Regulations specify that when utilizing L-shaped risk retention, the Sponsor must retain not less that 2.5% of each class of issued securities (the vertical component) and an eligible horizontal residual interest in an amount equal to at least 2.564% of the par value of all issued securities, other than those interests required to be retained as part of the vertical component (the horizontal component). We urge the Joint Regulators to consider revising the regulations to permit greater flexibility with respect to L-shaped risk retention by permitting the percentages of retention at the vertical and horizontal levels to vary (though each must be greater than a de minimis amount), for example by permitting a sponsor to retain not less than 3% of each class of issued securities and an eligible horizontal residual interest in an amount equal to at least 2% of the par value of all issued securities. We believe these changes, along with clear disclosure of the retained interests, will provide needed flexibility to securitization sponsors while still meeting all the goals of the risk retention requirements.

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

x. Limitations on the Resecuritization Exemption

a. Issuer View

We appreciate the Joint Regulators' efforts to provide for an exemption from the risk retention requirements for certain types of resecuritization transactions. However, we believe the exemption is overly narrow and does not further the Congressional goal of aligning the interests of originators and investors in order to improve the credit quality of the loans and other receivables underlying ABS transactions. That goal is only furthered by requiring a portion of the credit risk of the underlying assets to be retained in connection with the initial securitization transaction. Requiring risk to be retained as part of the resecuritization transaction does not provide any additional incentives to originators to employ better underwriting practices in connection with the origination of loans and other receivables. With respect to a resecuritization transaction, the loans and other receivables have generally been originated long before such transaction is contemplated, and retention of credit risk at the resecuritization level can in no way affect the procedures employed in connection with the origination of such assets. This is true irrespective of whether credit risk was actually retained in connection with the initial securitization. Furthermore, the loans underlying the securities being resecuritized are seasoned. As further discussed under Section xiii below, seasoned loans are less likely to go into default than newly originated loans. For these reasons, all resecuritization transactions should be exempt from the risk retention requirements, including those transactions that resecuritize assets that themselves do not comply with the risk retention requirements (which will be the case with respect to the resecuritization of assets initially securitized prior to the implementation of the risk retention rules).

We note that the Joint Regulators propose to adopt the resecuritization exemption pursuant to Section 15G(e)(1) of the Exchange Act, as amended, which permits exemptions that would help ensure high quality underwriting standards, encourage appropriate risk management practices, improve the access of consumers and businesses to credit on reasonable terms or otherwise be in the public interest and further the protection of investors. As noted in the Release, resecuritization transactions have the potential to improve the access of consumers and businesses to credit on reasonable terms by providing a vehicle for investors to purchase interests in multiple smaller pools of ABS. The volume of resecuritization transactions will likely decrease substantially if credit risk is required to be retained at the resecuritization level. As discussed above, this proposed requirement will in no way help ensure that high quality underwriting standards and appropriate risk management practices are adhered to.

In addition, we note that restricting the exemption to resecuritizations that issue a single class of securities will result in the exemption having very limited practical effect, because private market resecuritization transactions generally involve the issuance of multiple classes of securities. In the current market environment, sponsors generally engage in resecuritization transactions in order create a class of securities that is more creditworthy, and hence will receive better ratings, than the underlying securities (which themselves have often declined in credit quality and been downgraded). This is accomplished by issuing one or more classes that are subordinate to, and hence absorb losses before, such senior class. This enables investors in the initial securitization transaction to acquire the resecuritized and higher-rated resecuritization securities in lieu of the downgraded securities they currently own. By limiting the exemption to single class resecuritizations, these types of transactions will likely become obsolete, which will eliminate the benefit these investors receive by holding the newly issued, higher-rated securities.

The Release appears to express concern that by permitting multiple class resecuritizations to be exempt from the risk retention requirements, the credit risk retained at the level of the initial securitization would effectively be re-allocated among the multiple classes of securities that are issued, thereby diluting the effect of the risk retention requirements. We do not believe this would be the case. The portion of the underlying collateral that is retained by the underlying sponsors would not be transferred to the resecuritization trust and therefore would not serve as collateral for the newly issued securities, irrespective of whether one, or more resecuritization securities is issued. Furthermore, the types of resecuritization transactions discussed here are easily distinguishable from collateral debt obligations ("CDOs"). Unlike typical CDOs, the pool of collateral is established at the closing of the transaction and the sponsor generally does not have the ability to sell assets or purchase additional assets (i.e., they are not "managed pool" transactions). If the Joint Regulators wish to exclude CDOs from the resecuritization exemption to the risk retention requirements, our issuer members suggest that this could be accomplished by not permitting the exemption to apply to transactions with managed pools of collateral. Such an exception to the exemption would appear to exclude the types of transactions with which the Joint Regulators are most concerned, without excluding the large majority of private market resecuritization transactions.

b. Investor View

Our investor members acknowledge that issuers must be able to credit and time tranche securities in a resecuritization in order to make such transactions economically viable. For this reason, they agree that the proposed rule regarding resecuritizations is too restrictive and will not be used in its current form. While our investor members do not believe that all resecuritizations should be exempt from the risk retention requirements, they believe that resecuritizations of existing ABS for which risk has already been retained should be, because the credit risk of the underlying ABS is the same credit risk that exists at the resecuritization level. However, to address the Joint Regulators' concerns about CDOs, our investors suggest limiting the number of ABS transactions that underlie each class of securities in an exempt resecuritization to not more than 10.

xi. The QRM Criteria

ABS backed exclusively by QRMs are exempt from the risk retention requirements of the Proposed Regulations. Section 15G(e)(4)(b) of the Exchange Act (as added by Section 941 of Dodd-Frank) requires the Joint Regulators to promulgate the definition of QRM, taking into account "underwriting and product features that historical loan performance data indicate result in a lower risk of default." In Subsections a. through e. below, we discuss certain of the specific criteria proposed for QRMs that our issuer members believe are overly restrictive and do not significantly further the statutory intent. In Subsection f., we discuss our investor members' general support for the proposed definition while also providing select criteria that they believe should be expanded.

a. Credit History

The proposed QRM definition requires that, at the time of origination of the loan, the related borrower is not currently 30 days or more past due on the payment of any debt obligation, has not been 60 days or more past due on the payment of any debt obligation in the past two years and has not been a debtor in a bankruptcy case or had any property repossessed or foreclosed upon in the past three years. The Release explains that the Joint Regulators determined, based on a review of historical data, that a borrower's credit score was a significant indicator of such borrower's ability to repay his mortgage loan. However, due to understandable concerns relating to utilizing credit scores provided by privately owned entities as a factor in meeting a regulatory requirement, the Joint Regulators decided to require compliance with the credit history criteria described above, which they believe serve as a reasonable proxy for credit score.

We generally agree that credit scores serve as a useful indicator of a borrower's ability to repay its loan. Our members believe that there is a known and understood correlation between credit score and probability of default. However, credit scores are complicated models that take into account many factors in addition to those included in the proposed credit history criteria. It is not possible to mimic a credit score through the application of specific and finite tests. For example, during the course of conversations with certain of the companies that provide credit scores, we were advised that a borrower failing to meet the delinquent payment requirements set forth in the QRM definition could still have a credit score as high as 850, while a borrower meeting those requirements could have a score as low as 437. Our members are not comfortable that the specific credit history factors listed above, as proposed to be used in the rule as a proxy for credit score, are predictive of probability of default in any established way. In other words, correlation of default risk to credit score is considered known and proven, but correlation of default risk to those specific credit history factors is considered to be not known or proven.

To underscore that point, we note that Appendix A in the Release, which seeks to establish an empirical basis between selected QRM criteria and historical default risk, uses data that are not based on those specific credit history factors, presumably because little such data was available. Instead, "to proxy the credit history restrictions in the proposed QRM definition, borrowers with FICO scores below 690 were deemed not to satisfy the proposed QRM credit history standards."[45] But ironically, the credit history standards themselves are intended as proxies for credit scores. We note that the large majority of the evidence cited in the Release points to a correlation between credit score and ability to repay, but does not cite evidence of a connection between the limited credit history criteria proposed and loan repayment.

We propose that the credit history criteria be eliminated from the definition of QRM because we do not believe they further the statutory goal of establishing QRM criteria that historically have resulted in a lower risk of default. In lieu of such criteria, we believe the Joint Regulators should consider substituting a minimum credit score requirement. We suggest that the minimum credit score be reconciled with the minimum credit score required by the GSEs to purchase a loan or guarantee ABS backed by a loan, which we understand to be 620. Utilizing

[45] *See* Proposing Release, pg. 199.

the same credit score standard as is utilized by the GSEs will also have the benefit of limiting the competitive advantages enjoyed by the GSEs, which are discussed in further detail below. Alternatively, a higher credit score number could be used, such as 660, based on a further historical analysis of data that correlates the likelihood of default to specific credit score levels. Especially when combined with the other conservative underwriting criteria included in the QRM definition, we believe that there is room to set the bar at a level such as 660 and thereby serve many more borrowers, with only a marginal increase in risk.

While we understand the policy concerns surrounding the use of credit scores calculated by private companies as a regulatory criterion, we note that credit scores are universally used in underwriting policies and procedures, including by the GSEs. We note that although Dodd-Frank requires regulators to remove reliance on rating agencies from their regulations, it does not similarly prohibit reliance on credit scoring companies. We do not believe that there are serious concerns about the credibility or reliability of credit scores, and there is no perceived need to improve any aspect of the credit scoring process. In other words, the credit scoring system is not broken or deficient in any way, so there is no need to move to a replacement.

b. Payment Terms

The proposed definition of QRM requires adjustable rate mortgage loans to meet certain criteria in order to be considered QRMs. In particular, the proposal requires that the interest rate on the mortgage loan not increase by more than 2% in any 12-month period or by more than 6% over the life of the loan. We believe that these requirements are overly restrictive because they would exclude from the definition of QRM certain popular "hybrid" loan products that feature a fixed rate of interest for an initial period that begins to adjust after the expiration of such period. These loans are preferred by borrowers who want predictable payments during an extended initial period, and are not quote "affordability products." These loan products generally provide for a fixed rate period of five to ten years and permit the interest rate to increase by up to 5% on the "first reset date" (i.e., the first payment date after the expiration of the fixed rate period). Importantly, these mortgage loans would otherwise be subject to the limitations on interest rate increases contained in the Proposed Regulations (i.e., no more than 2% in any 12 month period and no more than 6% over the life of the loan).

If these hybrid mortgage products do not qualify as QRMs, they will become more expensive for borrowers to obtain, forcing borrowers to choose between accepting increased costs on the mortgage transaction or acquiring a mortgage product less suitable to their needs. Accordingly, we encourage the Joint Regulators to revise the Proposed Regulations in order to allow for interest rate increases of up to 5% on the adjustable-rate mortgage loan's first reset date. The risk of default on any such mortgage loan will be substantially mitigated by the requirement that the borrower's debt-to-income ratio be determined based on the maximum interest rate that could be charged during the first five years of the loan term, as with all other adjustable rate loans.

c. Ability to Repay

The proposed QRM definition requires that in order for a loan to qualify as QRMs, the related borrower have a "front-end" debt-to-income ratio (i.e., the ratio of the borrower's monthly housing debt to the borrower's monthly gross income) that does not exceed 28% and a "back-end" debt-to-income ratio (i.e., the ratio of the borrower's total monthly debt to the borrower's monthly gross income) that does not exceed 36%. Our issuer members believe that these percentages are overly conservative and do not reflect the general standards applied by mortgage originators to the underwriting of prime residential mortgage loans. We believe that requiring a "front-end" debt-to-income ratio of 33% and a "back-end" ratio of 38% would include a significantly larger number of borrowers with only marginally increased risk of default, especially when combined with the other conservative QRM criteria. Ratios lower than these numbers would exclude from the definition of QRM a significant percentage of high quality mortgage loans, unfairly making these loans substantially more difficult and expensive for low risk borrowers to obtain.

We urge the Joint Regulators to re-evaluate the available data relating to the effect of debt-to-income ratios on borrowers' ability to repay their loans in order to determine to what extent increasing the maximum debt-to-income ratios in the manner proposed would be likely to increase the risk of loan defaults. We note that the data reviewed by the Joint Regulators appears to compare loans originated with "front-end" debt-to-income ratios of 28% or lower and "back-end" debt-to-income ratios of 36% or lower to all loans originated by the GSEs between 1997 and 2009. We believe it would be more appropriate to compare loans with such debt-to-income ratios to loans with only slightly higher debt-to-income ratios consistent with those we suggest, in order to determine if the proposed changes would significantly increase the risk of default. We believe that a marginal increase in risk of default would be a small price to pay in exchange for making credit more available to deserving consumers at a reasonable cost.

We note that the proposed QRM criteria are generally very conservative and leave little room for the exercise of lender discretion (for example, the requirements relating to maximum loan-to-value ratios, maximum debt-to-income ratios and maximum points and fees that can be charged). We further note that, as discussed in more detail above, the requirements relating to the establishment of a premium capture cash reserve account make it less likely that originators will desire to originate loans that trade at a premium above their principal balance, since any such premium will effectively need to be deposited into the securitization's premium capture cash reserve account. Therefore, it will be in the interest of loan originators to avoid creating loans that are worth more than par. Since the originator's ability to affect the value of the loan through flexible debt-to-income and loan-to-value requirements or by charging points and fees is limited by the QRM definition, they may choose to affect values by lowering the loan amounts they make available to borrowers. This could decrease the amount of credit available in the housing market to fund purchases, thereby further depressing home values. Permitting higher maximum debt-to-income ratios is one step the Joint Regulators could take to help prevent this outcome.

d. Loan-to-Value Ratio

The Proposed Regulations require that loans meet strict maximum loan-to-value ratio requirements in order to qualify as QRMs. Under the proposal, a loan made for the purpose of purchasing a property must have a loan-to-value ratio that does not exceed 80%. However, a rate and term refinancing (i.e., a loan made to refinance an existing loan in which the borrower does not receive any cash) cannot have a loan-to-value ratio in excess of 75%. We believe that both purchase loans and rate and term refinancings should be permitted to have loan-to-value ratios up to 80%. Since residential real estate values throughout the country are generally not rising, requiring refinance loans to have lower loan-to-value ratios will in many cases, require borrowers to contribute cash in order to take advantage of lower interest rates, or lock in fixed rates, by refinancing their mortgage loans. Such cash might otherwise be used by the borrowers to make purchases or otherwise be contributed to the economy in a beneficial manner. The fact that a borrower would have to pay cash in order to refinance may also discourage borrowers from refinancing into loans with safer and more economically desirable terms.

e. Points and Fees

The proposed QRM criteria limit the points and fees that can be charged on a QRM to 3% of the total loan amount. In determining what types of charges constitute points and fees, the QRM criteria generally track the points and fees criteria set forth in the definition of "qualified mortgage" under the amendments to the Truth in Lending Act ("TILA") enacted by Dodd-Frank. This is consistent with Dodd-Frank's mandate that the definition of QRM be no broader than the definition of "qualified mortgage" under TILA. However, the QRM criteria diverge from this approach when addressing the treatment of bona fide discount points and certain bona fide third-party charges. The definition of "qualified mortgage" under TILA excludes certain bona fide discount points and bona fide third-party charges when calculating total points and fees, but the QRM criteria includes all such points and charges. The TILA criteria for determining if bona fide discount points and bona-fide third party charges can be excluded from total points and fees is reasonable and well established. Therefore, we believe that the QRM criteria should provide for the exclusion of bona fide discount points and bona-fide third party charges from the calculation of total points and fees if such points or charges would be excluded under the TILA "qualified mortgage" definition.

Furthermore, we believe that an exception to the 3% limit on total points and fees should be made for loans with small balances. Since lenders earn less interest on loans with smaller balances, charging points and fees is necessary in order for lenders to have an economic incentive to make such loans. These loans are generally made to lower income borrowers in areas of the country where property values are lower than average (such as in certain southern states and in rural areas). If such loans cannot qualify as QRMs, they will become more difficult and expensive for these borrowers to obtain. In this regard, we note that the Proposed Ability to Pay Rules discussed in Section xvi below include two alternatives allowing higher points and fees: A) a set of five categories of loan amounts with corresponding limits on points and fees as follows: less than $20,000, up to 5%; $20,000 or more but less than $40,000, up to 4.5%; $40,000 or more but less than $60,000, up to 4%; $60,000 or more but less than $75,000, up to 3.5%; and $75,000 or more, up to 3%; and B) a sliding scale under which points and fees may be up to 5% where the total loan amount is less than $20,000, up to 3% where the total loan amount is $75,000 or more, and with the points and fees cap phased from 5% down to 3% for loan amounts increasing from $20,000 to $75,000. We propose that one of these alternatives be added to this QRM criterion.

f. Views of Our Investor Members on the QRM Criteria

Our investor members generally support the definition of QRM proposed by the Joint Regulators. While the proposed definition is restrictive, the investor members believe that a clear, bright line rule is preferred to a definition that is overly complex, especially if the Joint Regulators are seeking to make the QRM the exception and not the rule. For example, our investor members believe that the prohibition on interest-only loans and the 2% interest rate cap on the first reset date appropriately limit payment shock on borrowers. In addition, our investor members share the concerns described by the Joint Regulators concerning the use of FICO scores, as such scores differ among consumer reporting agencies, may change over time and were somewhat ineffective during the recent crisis.

However, there are a few criteria in the definition that should be expanded. First, our investors believe that the proposed credit history criteria are likely too strict and will leave out creditworthy borrowers who may have accidentally missed a payment on a debt. To alleviate this concern, our investor members suggest striking the 30 day past due requirement. Second, our investor members agree that a rate/term refinance should be subject to an 80% LTV requirement. Borrowers who qualified for QRMs should not be prohibited from taking advantage of lower interest rates and refinancing on a subsequent date at the same LTV. The investor members do not agree that these types of refinancings result in an increased credit risk requiring 5% more home equity. However, to afford a bit of protection, in calculating the LTV in these situations, investors suggest using the lower of the present property value and the property value at origination. Third, the investor members believe that the DTI and LTV requirements are overly restrictive when taken together. Instead, the investor members believe that a matrix approach should be used whereby the DTI or LTV requirement could be increased if a certain DTI or LTV threshold, as applicable, was met. Finally, our investor members believe that the inclusion of servicing standards in the QRM definition is inappropriate and support instead the development of national servicing standards that would apply to all residential mortgage loans, as further discussed in Section xv below.

Finally, while investors acknowledge that the QRM definition will provide incentives for better mortgage underwriting, they point out that the definition does not prevent subsequent events from increasing the risk of the loan. In particular, the QRM definition fails to address the second lien issue that contributed substantial harm to RMBS investors leading up to and during the financial crisis. While the QRM definition does not permit second liens at the time of origination, there is nothing that will prevent the borrower from taking out a second lien loan immediately thereafter. So, the "low risk" QRM loan can become quite risky after the addition of a second lien post origination. Unfortunately, resolving this issue is quite complicated. Ultimately, a mechanism should be employed that prevents QRM borrowers from either taking out a second lien or taking out a second lien that would raise the CLTV above a certain threshold. Investors, in principle, are not in favor of restricting credit, especially for high quality borrowers. However, the fact that a QRM pool results in zero risk retention with no future second lien restrictions is concerning and is potentially the best example of why the QRM concept is difficult to employ in a securitization framework.

xii. The Effect of the QRM Criteria on Availability of Credit

Within the category of prime borrowers in terms of credit score, clearly many such borrowers and their proposed loan terms will not meet the QRM criteria. The highly conservative nature of the QRM definition will likely limit the availability, and increase the cost, of mortgage credit to consumers, particularly to those with low to moderate incomes. In light of the risk retention requirements that will exist upon the securitization of non-QRM loans, these loans will certainly feature higher interest rates, more points and fees and more onerous terms than QRM loans.

As currently contemplated, only the highest quality mortgage loans will qualify as QRMs and therefore QRMs will comprise only a small percentage of the mortgage market. The Release indicates that approximately 19.79% of all loans purchased or securitized by the GSEs during the period 1997 - 2009, and approximately 30.52% of loans in 2009 alone, would have met the QRM criteria. We believe that this percentage is far too small in light of the constrained nature of the current mortgage credit market. Even highly creditworthy borrowers are continuing to experience difficulties in obtaining mortgage financing, as uncertainty in the world financial markets in general and the mortgage market in particular make obtaining credit difficult. This problem will be substantially exacerbated, and the availability of mortgage credit to consumers will suffer, if the QRM definition is not expanded to include a greater percentage of the mortgage market.

In particular, we believe there is significant scope for easing the DTI restrictions. As indicated by the data in Appendix A to the Release, approximately 17.36% of all loans purchased or securitized by the GSEs during the period 1997 - 2009, and approximately 24.47% of loans in 2009 alone, would not have met the DTI criteria. Yet the increase in default rates for loans not meeting this criteria is only 1.38%, and is far lower than that for years other than 2004-2008.

xiii. Proposed Additional Exceptions to the Risk Retention Requirements

a. "QRM Blend" Exception

Under the Proposed Regulations, the QRM exemption to the risk retention requirements is only available if all the loans underlying the securitization are QRMs. This requirement effectively splits the securitization market into transactions backed by QRMs and transactions backed by non-QRMs. We are concerned that it may not be possible for sponsors to originate QRMs in numbers sufficient to generate the critical mass of loans necessary for economically efficient securitizations. This is particularly true in light of the very stringent definition of QRM proposed by the Joint Regulators. This problem also exists with respect to other potential sub-classes of loans that may have the benefit of exceptions from the risk retention requirements (for example, seasoned loans and modified QRMs (as described below)) and could even potentially exist with respect to loans that do not have the benefit of exceptions from the risk retention requirements, to the extent that such non-excepted loans form a small sub-class of the residential loan market. Anytime a class of assets is split into artificial sub-classes for purposes of securitization, any one of those sub-classes may lack the volume of origination necessary to make securitization feasible. If the loans in a sub-class are not able to be securitized efficiently, the costs of such loans will increase substantially.

In order to alleviate this risk, our issuer and investor members urge the Joint Regulators to establish a "QRM blend" exception from the standard 5% risk retention requirement. A QRM blend exception would allow QRMs to be included in a pool that also contains non-QRMs, in a way that effectively preserves the 0% risk retention requirement on the QRM portion of the pool.

But first, we address the statutory basis for a QRM blend exception. Under Section 15G of the Exchange Act (as added by Section 941 (b) of the Dodd-Frank Act), the Joint Regulators are mandated under subsection (e)(4) to issue regulations that define "qualified residential mortgage" and provide for a complete exemption from the risk retention requirements for pools backed entirely by QRMs. But subsection (c)(2)(B) contains a separate mandate, that the regulations specify for each asset class, including residential mortgages, underwriting standards that indicate a low credit risk. And subsection (c)(1)(B)(ii) mandates that assets meeting these underwriting standards be given a risk retention requirement of less than 5%. The Proposing Release indicates that the Joint Regulators determined not to specify such underwriting standards under subsection (c)(2)(B) for residential mortgages at this time, but for purposes of this discussion, we refer hypothetically to such loans meeting standards set under this subsection as "low risk residential mortgages" or LRRMs. We maintain that the mandate under the Dodd-Frank Act relating to LRRMs also creates authority under which a QRM blend exemption could be established.

Subsection (c)(1)(B)(i)(I) would on its face appear to require that a LRRM loan that is not a QRM be given a retention requirement of 5%. But that cannot be correct, because otherwise this would not give effect to subsection (c)(1)(B)(ii), which would require that LRRMs be given a risk retention requirement of less than 5%. Therefore, there must be read into subsection (c)(1)(B)(i)(I) an exception for non QRM loans that meet the LRRM criteria.

Similarly, subsection (c)(1)(B)(i)(II) would on its face appear to require that if a QRM is included in a pool that contains any non-QRMs, then the QRM would have to have a risk retention of 5%. But that cannot be correct, where the other loans in the pool meet the LRRM criteria, as this would have the perverse effect of requiring 5% on the QRMs in the pool while the LRRM loans that are non-QRMs have a lower retention requirement. And, since the QRMs in the pool would also meet the criteria for LRRM loans (which would presumably be less restrictive than the QRM criteria), such QRMs should at least benefit from the lower retention requirement for LRRM loans, and therefore the literal reading in this context cannot be correct because it would not give effect to subsection (c)(1)(B)(ii) which requires that LRRMs have a reduced risk retention requirement. Thus the language should not be read literally in the context of a blended pool of QRMs and LRRM loans. Therefore, there must be read into subsection (c)(1)(B)(i)(II) an exception for QRM loans that are included in a pool of loans that meet the LRRM criteria. We would propose that this exception be that such QRMs have a risk retention requirement of 0%.

While a review of these provisions makes it clear that there is authority for a QRM blend exemption in the context of a pool of QRMs combined with LRRMs, we believe that the same reasoning supports a QRM blend exemption in the absence of a regulatory proposal for LRRMs. Or put another way, we do not believe that the implicit authority for a QRM blend exemption is not available simply because the Joint Regulators have elected at this time not to propose LRRM criteria.

Issuers believe that a QRM blend exception could only be effective if they were permitted to construct a securitization in which some portion but not all of the loans in a pool meet the QRM criteria and the 5% risk retention requirement would be ratably reduced by the proportion of the total pool that meets the QRM standards. Such a partial exemption would be in keeping with the risk retention mandate of Dodd-Frank, because sponsors would still have the incentive to originate loans in accordance with safe underwriting standards. In a blended pool, loans originated so as to comply with the strict underwriting standards of the QRM definition would effectively have no risk retention requirement. Loans originated in accordance with underwriting standards that did not meet the QRM criteria would effectively be subject to a 5% risk retention requirement. The percentage of risk retention for the pool as a whole would be equal to the weighted average of each loan’s effective risk retention requirement. This would meet all the goals of the risk retention rules, while at the same time maintaining the feasibility of securitizing QRMs and avoiding the increased costs to borrowers that would follow if such securitizations were not economically efficient. The percentage of QRM loans and non-QRM loans in a blended pool should be disclosed in the prospectus.

Under a simplistic approach to a QRM blend, the risk retention requirement would be set at initial issuance as the simple average of the applicable risk retention requirements for the QRM loans on the one hand, and the non-QRM loans on the other hand. But, under this approach, the relative proportions of QRM and non-QRM loans in the pool could change over time, and this could result in the risk retention held on the non-QRMs in the pool being less than what would be required if the pool consisted solely of non-QRMs. Our investor and issuer members have both indicated concerns with this result and believe that it is not in the spirit of the Proposed Regulations.

Accordingly, we propose a refinement to the QRM blend concept that would ensure the proper amount of risk retention, regardless of the payment speeds on the QRM and non-QRMs. When using either a vertical slice or an eligible horizontal residual interest, the classes that are retained by the sponsor would have payment and loss allocation rules that would cause these classes to perform in the same way as if they represented an interest totaling the required percentage solely in the non-QRM loans. For example, for a pool consisting of $100 million of QRMs and $100 million of non-QRMs (and assuming no LRRM exemption), the required risk retention classes (whether vertical or horizontal) would total $5 million, and cash flows distributed to such classes, as well as losses allocated to such classes, would be based solely on payments on and losses realized on the non-QRM loans. We believe that the regulations could require that such a QRM blend concept would only be permitted if the appropriate amount of risk is retained irrespective of differing payment speeds on the QRM and non-QRM loans.

We note that our QRM blend proposal is consistent with common practice in GSE securitizations, where the assets backing the securities consist of a combination of loans that meet the standard conforming loan requirements as well as “jumbo conforming” loans that do not meet the lower balance requirements.

b. "Modified QRM" Exception

Our issuer members also urge the Joint Regulators to establish a "modified QRM" definition the criteria for which would be similar to, but less stringent than, the QRM definition and provide a lower percentage risk retention requirement for transactions consisting entirely of loans that meet this definition. This proposal should only be adopted if the QRM blend proposal is also adopted. We suggest that modified QRMs generally be required to meet the same criteria as QRMs, except with respect to loan-to-value ratio, debt-to-income ratio and credit history. We propose that a modified QRM generally be required to have a front-end debt-to-income ratio that does not exceed 33% and a back-end debt-to-income ratio that does not exceed 38%. Similar to our proposals discussed above with respect to the QRM definition, we believe that a credit score requirement should be substituted for the credit history requirements contained in the Proposed Regulations. Of course, the minimum credit score required for a modified QRM should be less than that required for a QRM. However, in order to promote flexibility, we believe such criteria should not be absolute, but rather should be based on a sliding scale, such that a borrower who exceeds a particular criteria by a certain amount would be permitted to fail to meet other criteria by a specified amount and still qualify for a modified QRM. In addition, in circumstances where certain specific, objective and quantifiable compensating factors exist, we believe loan originators should be permitted to make exceptions to certain of the modified QRM criteria. We note that the Joint Regulators have authority to establish the modified QRM exception pursuant to section 15G(c)(2)(B) of the Exchange Act, which contemplates that the risk retention rules include underwriting standards for the various types of assets (including residential mortgage loans), which, if met, would allow such assets to qualify for a less than 5% risk retention requirement.

Our investor members believe that only the highest quality loans should be exempted from the risk retention requirements. For this reason, while they agree that a blended pool exception needs to be created to increase liquidity of QRMs, they are not in favor of creating a lower standard QRM to increase the amount of loans that can be included in securitization pools with less than 5% risk retention. Instead, they suggest that regulators consider the revisions proposed by investors to widen the QRM included in Section xi above, such as a matrix approach for DTI and LTV.

c. Seasoned Loan Exemption

We further propose that the Joint Regulators establish an exemption from the risk retention requirements for loans that were originated a significant period of time prior to securitization. Our issuer members suggest that this time period be no longer than two years. These "seasoned" loans have established payment histories with borrowers who have demonstrated their ability to repay. Therefore, many of the QRM characteristics, such as credit history and debt-to-income ratio, have very little (if any) relevance to these loans. Historically, loans are far more likely to default early in their terms, and become less likely to default as they become more seasoned. Lenders who are securitizing seasoned loans have already retained 100% of the risk of such loans during the period in which the loans were most likely to experience performance problems. Therefore, such lenders had every interest in originating these loans in accordance with sound underwriting criteria and imposing risk retention requirements on securities backed by such loans would in no way serve to further promote this goal. We note that the Joint Regulators have the authority to adopt a seasoned loan exemption pursuant to Section 15G(e)(1) of the Exchange Act, as amended, which permits exemptions that would help ensure high quality underwriting standards, encourage appropriate risk management practices, improve the access of consumers and businesses to credit on reasonable terms or otherwise be in the public interest and further the protection of investors.

While our investor members agree that a seasoning exemption is appropriate for the reasons articulated in the preceding paragraph, they would propose a different approach. For fully amortizing fixed rate loans, investors suggest that loans that have been outstanding and performing for three years should be exempt. For ARM loans, investors believe the time period should be dependent upon the initial reset, which, depending on the terms of the loan, may cause payment shock. They believe a prudent approach would be to exempt ARM loans that have fully performed and have been outstanding at least one year after the initial reset. Our investor members believe these approaches would ensure that the loan is high quality and not in need of any risk retention if included in a securitization.

xiv.Issues Relating to the GSEs; Need for Further Exemptions

We note that the Proposed Regulations provide a complete exemption from the risk retention requirements (including an exemption from the requirement to establish a premium capture cash reserve account) for RMBS guaranteed by the GSEs for so long as the GSEs operate under the conservatorship or receivership of the Federal Housing Finance Agency. We are concerned that the very conservative terms of the proposed QRM definition, taken together with the risk retention requirements, will provide a significant and undue competitive advantage to the GSEs over private market participants. Securities guaranteed by the GSEs will be able to be securitized free from the risk retention requirements irrespective of whether such securities are QRMs, which will result in the non-QRMs loans backing such securities having lower costs to borrowers and more attractive terms than similar loans offered by private market participants. This will have the effect of increasing the portion of the residential mortgage market dominated by the GSEs, further entrenching the importance of their role in such market. This will make it substantially more difficult for Congress to carry out its efforts to restructure or wind down the GSEs, since a substantial percentage of consumers will be wholly dependent on the GSEs to provide them with affordable mortgage financing.

In our view, the best way to level the playing field and avoid increasing the role of the GSEs in the residential mortgage market is to reduce the impact of the risk retention requirements on private market participants. This could be accomplished in a variety of ways. We urge the Joint Regulators to consider adjusting the criteria for QRMs, such that the vast majority of loans to prime borrowers that meet the product type and LTV criteria in the QRM definition (with the minor adjustments to those criteria that we propose), will qualify as QRMs. Reconciling the QRM criteria with the GSE requirements would enable private market participants to compete on equal terms with the GSEs for most of the mortgage market comprised of loans to prime borrowers. In the alternative, we urge the Joint Regulators to clarify the premium capture cash reserve account requirements and the terms of horizontal risk retention, and to revise the representative sample risk retention and the definition of QRM in the manner described above. Such modifications would have the effect of reducing the adverse impact of the risk retention requirements on private market participants, and thereby enable them to better compete with the GSEs and to serve the borrowing needs of the American homeowner.

Another way in which the Joint Regulators could partially level the playing field as between the GSEs and private market participants would be to establish the exceptions from the risk retention requirements for "QRM blend" pools, "modified QRM" loans and seasoned loans as discussed in Section xiii above.

xv. QRM Criteria – Inclusion of Servicing Standards

Finally, there is another element of the QRM definition that goes well beyond the mandate and legislative intent of Dodd-Frank for criteria that relate to underwriting and product features. This is the requirement that the mortgage loan documents contain an undertaking by the lender to maintain certain servicing policies and procedures. There is no evidence, either in the legislative history or the language of Dodd-Frank, that Congress intended to include servicing standards as part of the risk retention mandate. In fact, incorporating servicing standards into the QRM definition would have the peculiar result of regulating the servicing of the highest quality borrowers, those with the least risk of encountering servicing issues or needing loss mitigation, while the bulk of the market, consisting of borrowers with a greater need for loss mitigation, would be left unregulated. Our issuer and investor members agree that the inclusion of servicing standards in the QRM definition is inappropriate and should instead be considered as part of a federal regulatory effort to develop uniform servicing regulations applicable to all residential mortgage borrowers.

The proposed QRM definition requires the loan documents to include policies and procedures that 1) require commencement of loss mitigation efforts after 90 days delinquency, 2) allow for loan modifications if the resulting net present value would be greater than foreclosure proceeds, 3) address how the lender will service any second lien loan on the same property (when the lender services both the first and the second lien loan) and 4) include servicing compensation arrangements that are consistent with the creditor's commitment to engage in loss mitigation activities. There must also be an undertaking not to transfer servicing to any servicer who does not maintain such policies and procedures. We understand and appreciate the regulatory imperative for national servicing standards that address the above issues and our members are generally supportive of this effort. But, as noted in the Release, there is a separate interagency effort among certain Federal regulators to develop national servicing standards that will apply to all servicers of residential mortgage loans. We believe that this effort should not be rolled out on a piecemeal basis, and that the QRM definition is not the right time and place for even a limited preview of these criteria. The key to success for such criteria is that they should be universal. As proposed in the Release in the form of an additional QRM criterion, these standards would not apply to loans that are sold to, or securitized by, the GSEs. Due to the restrictive nature of the QRM criteria, these standards would apply to only a small portion of the non-GSE market, with that segment being the most creditworthy borrowers, who of course are the least likely to need loss mitigation. We frankly believe that it is just not good public policy to apply these nascent and still developing standards to this subset of new originations.

Another major concern about this criterion is that the requirement to maintain such servicing standards would be embedded within the loan documentation. We do not understand why the proposal is to include the requirement in the loan documents, as opposed to simply having regulations that apply to servicers stating that they must maintain such policies and procedures. The inclusion of such standards will further complicate the closing process, creating yet more pages of documents for already overwhelmed borrowers to read and try to understand. In addition, if the regulators determine in the future that it is appropriate to change the mandated servicing standards, such standards will either not be able to be applied to existing loans or the borrowers will need to consent to modifications of their loan documents to reflect the new servicing standards. It would likely be exceedingly difficult to obtain the consent of borrowers to such modifications after the closing of their loans.

We believe that compliance with the national servicing standards under development should be a matter of regulatory compliance only. We note that this is consistent with the recent efforts undertaken by Congress to regulate the activities of servicers, such as through the establishment of safe harbors for certain loss mitigation practices in the Helping Families Save Their Homes Act of 2009. By placing the requirement to maintain such policies and procedures in the loan documents, this approach invites the borrower to raise as a defense to foreclosure claims that 1) the servicer's policies and procedures did not meet the regulatory requirements as per the covenants in the loan documents, and 2) the servicer failed to comply with its policies and procedures in servicing the mortgage loan. In America's litigious environment, such claims, whether valid or specious, can easily be foreseen. We believe that it would not be good public policy to effectively grant to borrowers a private right of action to enforce these regulatory requirements. The Home Affordable Modification Program as well as other loan modifications were not structured to give the borrower a private right of action. Furthermore, by attaching these potential defenses in foreclosure to QRMs, but not simultaneously to non-QRMs, this aspect of the criteria would actually make QRMs <u>more</u> risky than non-QRMs from the investor's perspective, which is contrary to the Dodd-Frank mandate. If just one judge in one foreclosure action ruled that the servicer's policies and procedures did not comply with the QRM criteria, the QRM status of <u>all</u> loans serviced by that servicer would be questionable and potentially cause significant losses to institutional investors. The inclusion of servicing standards in the loan documentation also raises the moral hazard of enabling unscrupulous borrowers to better understand the length of time for which they may avoid paying their mortgages without fear of significant consequences.

As to the specific elements of the required servicing standards, we note that in some cases it will be burdensome on the borrower to commence loss mitigation at 90 days. The requirements regarding second liens are very unclear, and do not at all address the key problem with loss mitigation on a first lien where the second lien is serviced by a different servicer, or on behalf of different investors. In addition, we do not believe it is appropriate to introduce requirements relating to servicing compensation in regulations that relate solely to QRMs. If such requirements are to be developed at all, they should be developed as part of national standards that apply to all loans. Finally, any requirements for national servicing standards must contain flexibility for those standards to develop and evolve over time. Given that under Dodd-Frank, all six regulators would have to affirmatively agree on the need to evolve these servicing standards AND to agree on the appropriate evolution of these standards, our members do not believe that there will be appropriate flexibility in the evolution of these standards.

xvi. The QRM Criteria and the "Qualified Mortgage" Definition

The amendments to TILA enacted by Dodd-Frank provide that a lender may not make a mortgage loan without first determining that the borrower has the ability to repay that loan, and provide that such ability to repay shall be deemed to exist if the loan is a "qualified mortgage."

The Board has published a notice of proposed rulemaking to amend Regulation Z to implement these amendments to TILA (the "Proposed Ability to Repay Rules"), including a proposed definition of "qualified mortgage" ("Qualified Mortgage" or "QM").[46] The interplay between the proposed criteria for QRM, as compared to QM, is quite instructive, particularly as it relates to the issue of whether there is to be a level playing field between the GSEs and private label securitization. We note that while the GSEs are effectively exempt from risk retention and therefore from the restrictions in the QRM criteria, securitizations issued through the GSEs are not exempt from the restrictions in the QM definition because creditors will be subject to the Proposed Ability to Repay Rules regardless of whether the loans are securitized.

Under the Proposed Ability to Repay Rules, a creditor is exposed to significant potential liability if the ability to repay standard is not met. There are two means of complying with this requirement that are available in most circumstances. First, the requirement can be met under a general rule that requires consideration and verification of eight different underwriting factors. Second, the originator can rely on the provisions relating to QM. Since the general rule contemplates a subjective analysis with no bright line standards for verification, creditors will be strongly incentivized to rely on the QM provisions in most cases. Under the rules as proposed, there are 2 alternative QM provisions. One would operate as a safe harbor, while the other would merely create a rebuttable presumption that the ability to repay standard had been met.

Importantly, under the safe harbor version, the criteria for Qualified Mortgage are limited to criteria relating to: amortization terms; a cap on total points and fees; verification and documentation of income and assets; and underwriting at the fully indexed rate (and related provisions). The Qualified Mortgage definition does not include any criteria relating to the following, which do figure prominently in the definition of Qualified Residential Mortgage:

- Debt to income ratio
- Loan to value ratio
- Credit history or credit score

While it might be argued that this is not an apples to apples comparison, and that the risk retention rules are designed to achieve a different objective than the ability to repay rules, we believe that argument has no merit whatsoever to the extent of those aspects of the QRM definition which address the borrower's ability to repay as a factor relevant the risk of default.

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[46] Board of Governors of the Federal Reserve System, Regulation Z; Truth in Lending, Docket No. R-1417; RIN No. 7100-AD 75 (April 19, 2011).

We are not suggesting that the QM and the QRM definitions should be identical. However, we believe that the absence of reference to debt to income ratio and credit history (or credit score) in the QM definition supports our arguments set forth in Section xi. a. and c. above that the debt to income ratio and the credit history criteria in the QRM definition as proposed are too restrictive. Those elements of the QRM criteria should be made less restrictive, in order to close the gap between the QRM and the QM definitions in this regard. Otherwise, the effect of the interplay between these definitions will be to encourage continued reliance on the GSEs while discouraging private securitization.

xvii. Technical Corrections

A number of provisions in the Proposed Regulations mandate that certain disclosures be made to potential investors "within a reasonable period of time prior to the sale" of the securities. We request that, for securities offerings that are registered under the Securities Act, all of these requirements be harmonized with applicable Securities Act disclosure requirements in terms of timing. For example, there should be a general provision that states that any such disclosure requirements to investors may be satisfied by including the required disclosure in the prospectus. Moreover, there should be an express provision stating that, to the extent any such required disclosure is not known at the time of pricing because it is dependent on the offering price or the delivery date, then such information may be omitted from any preliminary prospectus.

We also recommend that the definition of "ABS interest" be revised to add an exclusion for any REMIC residual interests that are entitled to receive no cash flows, or only nominal cash flows. In every transaction that uses a REMIC election for federal income tax purposes, there must be a separate designated class of residual interests. Frequently such class will be "non-economic", meaning that it has no entitlement to cash flows, or alternatively that it has only an entitlement to a nominal payment such as a single $100 payment of principal. The reason such classes are non-economic is that the residual bears certain federal income tax detriments, in that it bears certain "excess inclusions" which are treated as taxable income to the holder even though no cash is distributed. Normally it is desirable to segregate these tax detriments from any class that is sold to investors. Typically the sponsor will pay a third party to take ownership of such a residual class, in accordance with IRS restrictions on eligible transferees of such classes. There is no reason why a sponsor should be required to retain 5% of any such non-economic residual, however this type of class does not fit clearly into clause (2) of the definition of "ABS interest" which excludes certain classes which are used for structuring purposes but have no or only nominal value.

xviii. Hedging, Transfer and Financing Restrictions

Our membership is generally supportive of the hedging, transfer and financing restrictions set forth in the Proposed Regulations. However, we believe that it is appropriate for a sponsor to be permitted to hedge, transfer or finance its retained interest free of these restrictions after a specified period of time has elapsed from the issuance of the ABS. For RMBS, our issuer members propose that time period be no longer than two years. Issuers believe that by requiring a sponsor to retain a portion of the credit risk in the underlying assets for two years, the Congressional goal of promoting sound underwriting practices will clearly be met without permanently limiting the liquidity of the retained interest. Sponsors will be motivated to originate assets with good credit characteristics knowing that they will retain a portion of the risk of default on those assets for a substantial period of time. This is especially true since historically the assets underlying ABS transactions are more likely to default early in their terms, and become less likely to default as they become more seasoned. Our investor members agree that after a certain time period, permitting issuers to hedge, transfer or finance its retained interest is appropriate. However, they suggest that this time period be the later of 5 years or when the pool is reduced to 25% of its original principal balance. They believe this longer time period will ensure that the goals of risk retention are met.

In addition, we are concerned that it may be difficult for large institutions to effectively monitor compliance with the hedging restrictions across all divisions, departments and affiliates. The division, department or entity responsible for the securitization transaction may have entirely different personnel and be far removed, both in terms of internal corporate structure and geography, from the divisions, departments or affiliated entities that engage in hedging transactions. Therefore, the possibility exists for the sponsor or an affiliate to inadvertently violate the hedging restrictions. In order to prevent such unintentional violations from triggering a breach of the risk retention rules, we propose that the Joint Regulators establish a safe harbor pursuant to which a sponsor that establishes reasonable procedures to protect against inadvertent hedging of retained interests would not be deemed to have violated the hedging restrictions in the event such inadvertent hedging occurs. The establishment of such safe harbor would be entirely consistent with the goals of the risk retention rules, since sponsors would need to make decisions regarding the credit quality of the assets being securitized with the assumption that the sponsor would be retaining a portion of the risk associated with such assets. The potential for inadvertent hedging would in no way alter that analysis.

We note that the Proposed Regulations would clearly permit hedging of interest rate risk for retained interests, which we believe to be essential. However, within the section that describes permitted hedging of interest rate risk, the exclusion of "spread risk, associated with the ABS interest that is otherwise considered part of the credit risk" is confusing and unnecessary. Changes in the spread against an interest rate benchmark, as used in valuing any given asset-backed security, may occur due to a number of factors other than ones that relate to the perceived credit risk of the security, most notably overall market conditions as they affect liquidity. In a liquidity crunch, spreads may widen due simply to the lack of bidders, as opposed to any change in the credit risk of a security. A spread hedge that is not linked to the spread on the specific security would not necessarily hedge credit risk. For example, if the sponsor is required to retain as part of a vertical slice 5% of the "AAA" rated class in a given securitization backed by 30-year prime, fixed rate loans, a hedge against changes in market spreads over a benchmark for generic 30-year fixed rate loan "AAA" rated RMBS (or an index thereof) would not act as a hedge against credit risk on the class required to be retained.

We also note the language in the Proposing Release stating that where a sponsor retains a vertical slice, that any external credit protection, such as an "insurance wrap", may not benefit the 5% portion of any tranche retained by the sponsor. We recommend that the rules be revised to permit external, transaction level credit enhancement as an exception to the prohibition on hedging. There is no reason to differentiate between internal and external enhancements in this regard, and where credit enhancement is provided in a manner internal to the structure (such as by subordination) there is no requirement (nor should there be) that any 5% portion of a senior tranche retained by the sponsor should not benefit from the subordination. Moreover, treating the 5% portion of the tranche retained by the sponsor differently from the portion sold to investors would undercut efforts to achieve an alignment of interests.

Finally, while we appreciate that the Proposed Regulations would permit financing of retained interests on a full recourse basis, we are concerned about the commentary in the Proposing Release to the effect that the sponsor "will have violated the prohibition on transfer" if the retained interest is taken by the counterparty to the financing transaction, including pursuant to the exercise of contractual remedies. The lender in any secured financing transaction must be free to exercise any and all remedies against the collateral in the event of a default by the borrower. We recommend that these provisions be revised to make clear that where a retained interest is pledged by a sponsor or consolidated affiliate in a financing transaction on a full recourse basis, and where the counterparty takes or transfers the retained interest pursuant to the exercise of remedies following a default by the sponsor or consolidated affiliate, that this will not be deemed to be a violation of the prohibition on transfer.

B. Auto ABS[47]

i. Auto Sponsor Views on Proposed Forms of Risk Retention for Auto ABS

Our motor vehicle sponsor members (the "Auto Sponsors") strongly believe that a range of risk retention options should be available for motor vehicle securitizations and are pleased that the proposed rules would allow them to satisfy the risk retention requirement by (i) holding vertical exposures; (ii) either holding or cash-funding horizontal exposures; (iii) holding "L-shaped" exposures; (iv) holding a representative sample of unsecuritized assets; or (v) for revolving master trust securitizations of automobile floorplan loans, holding a *pari passu* seller's interest. By suggesting a framework where a variety of risk retention options is available to Auto Sponsors, the proposed rules follow, in part, the recommendations that we made in the ASF Auto Risk Retention Letter, dated November 22, 2010, in which we outlined both this preference and proposed structures for certain of these forms of risk retention.

However, the Auto Sponsors have identified major problems with many of the proposed rules. First and foremost, they are very concerned that the form of risk retention that is almost universally used today in the motor vehicle securitization market—horizontal exposure—was proposed in a way that is inconsistent with our suggestions in that prior letter. The horizontal exposure option will need to be revised and clarified significantly to be a workable option for motor vehicle securitizations. Cash-funded reserve accounts are also used in most motor vehicle securitizations and the rules governing that option also need to be modified so that reserve accounts can continue to be used as a valuable form of risk retention in these transactions. Representative sampling is a potentially useful form of risk retention for motor vehicle securitizations, but those proposed rules were also drafted in a way that renders it unattractive to

[47] The transactions discussed throughout this section do not include securitizations where the receivables principally relate to motor vehicles that are medium or heavy duty trucks, truck chassis, buses or trailers, which are generally classed as equipment securitizations and are discussed in Section F.

the Auto Sponsors and it is unlikely to be used by the Auto Sponsors or in the motor vehicle ABS marketplace generally unless they are modified. The Auto Sponsors have also identified problems with the proposed rules for retaining a seller's interest that need to be corrected to make that option usable by those automobile floorplan securitizations that utilize a seller's interest. Finally, the Auto Sponsors believe that the proposed rules should be revised to allow greater flexibility to combine different forms of risk retention, which would achieve the stated goals of risk retention while reflecting the current structures of their transactions. With these changes, the Auto Sponsors believe that they would have access to a menu of options that would achieve the goals of risk retention while also providing the necessary flexibility to ensure that they are able to fund their loan origination businesses efficiently through the issuance of ABS, even if the securitization market changes over time.

Before setting forth the Auto Sponsors' specific proposals, we note that virtually all motor vehicle securitizers already have substantial involvement with the ABS they issue, by originating and servicing the collateral that comprises their asset pools and retaining risk exposure through a subordinated residual interest.[48] These retained exposures align the Auto Sponsor's interests in their securitizations with those of their investors while also providing substantial credit support for those transactions. The efficacy of the present model cannot be denied: the Auto Sponsors are unaware of <u>any</u> principal losses or missed interest payments on their ABS during the past twenty years, including during the recent financial crisis, and no payment defaults have occurred on <u>any</u> prime automobile retail loan ABS rated by Standard & Poor's since they began rating automobile ABS in 1985.

The strength of these alignments and protections is a key reason that the motor vehicle ABS market is today the most vibrant portion of the United States ABS market.[49] Because retaining subordinated residual interests already provides a very strong alignment of interests between the Auto Sponsors and their ABS investors, the Auto Sponsors are first and foremost eager to see risk retention rules enacted that permit the continued use of this risk alignment that is currently employed in nearly every motor vehicle securitization.

If the proposed rules are not revised to recognize the risk alignment that the Auto Sponsors presently maintain and instead demand additional, expensive risk retention, then the Auto Sponsors foresee a number of significant, negative impacts. First, the Auto Sponsors believe that they would become less competitive with banks and both individual consumers and businesses would face a more constricted credit market, resulting in fewer motor vehicle financing options and higher costs for purchasing or leasing vehicles. Second, motor vehicle dealers, which constitute a large number of the nation's small businesses, would also likely face constrained and more expensive credit in financing their inventory and assisting their customers with financing choices. Third, the manufacturers whose sales the Auto Sponsors support may

[48] As described in greater detail in Section B.i.a., below, the subordinated residual interests that the Auto Sponsors presently retain in their securitizations do not fit squarely within the proposed definition of "eligible horizontal residual interest."

[49] For the period from January 1, 2009 through May 26, 2011, ABS backed by prime automobile loans, subprime automobile loans, motorcycle loans, automobile leases and automobile floorplan loans together accounted for 49.4% of the domestic ABS market, and 55.7% of all consumer ABS issuances. (Source: Asset Backed Alert ABS Database)

sell fewer vehicles due to these less favorable conditions for consumers and dealers, which would harm job growth, investment and the broader economy. Finally, investors will have fewer investment opportunities in asset classes that have consistently demonstrated their soundness, even in times of economic distress and market disruption. For all of these reasons we believe that it is imperative that the risk retention rules be revised to reflect the current state of the motor vehicle securitization market and to allow the Auto Sponsors to continue to retain risk exposure to their securitizations in the ways that have been so effective for at least the past two decades.

a. Horizontal Risk Retention: Definition of "Eligible Horizontal Residual Interest"

In motor vehicle securitizations, the sponsor or an affiliate[50] generally retains ownership of the bottom of the waterfall, or first-loss position, in the transaction by holding an interest that we refer to in this section as a "subordinated residual interest." A subordinated residual interest is an equity ownership or debt interest in an issuing entity that is subordinated to all other tranches of issued ABS of the related series and that represents the right to receive cashflow at the most subordinated level of the waterfall. To the extent that on any payment date all other issued ABS have received all principal and interest payments due to them, all of the issuing entity's fees and expenses (e.g., servicer fees) have been paid in full and all of the securitization's credit enhancement[51] is at the levels that were agreed to at closing, the subordinated residual interest typically receives any excess payments generated by the asset pool.

The Auto Sponsors strongly believe that retention of this subordinated residual interest is highly effective in aligning incentives between securitizers and investors and that allowing retention of such interests should be a permissible form of horizontal risk retention for motor vehicle ABS.[52] However, the subordinated residual interests that Auto Sponsors typically retain do not satisfy the definition of "eligible horizontal residual interest" that is set forth in the proposed rules. The Auto Sponsors believe that the final rules should allow risk retention by this time-tested means and therefore request that the definition be modified so that it could be satisfied by retention of a subordinated residual interest in a motor vehicle securitization.

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[50] In almost all motor vehicle securitizations the residual interests are held throughout the life of the transaction by a consolidated affiliate of the sponsor, typically the securitization's "depositor." In many cases this arrangement is necessary for the bankruptcy treatment of the securitization that investors and rating agencies demand. Because transfers to such consolidated affiliates would be permitted at any time pursuant to the Proposed Regulations, we believe that it would also be appropriate to ***modify the Proposed Regulations so that any risk retention can <u>initially</u> be held by those consolidated affiliates as well***.

[51] In the motor vehicle ABS market many transactions feature reserve accounts that are available to fund payments of certain principal and interest on the ABS and certain senior fees and expenses of the issuing entity and that are maintained at a specified balance with the securitization's cashflow. Furthermore, transactions often feature overcollateralization that is maintained or increased over time by using excess interest collections on the securitized assets to pay down the principal on the ABS more quickly than principal is collected on the securitized assets.

[52] As described in greater detail in Section __.2, below, certain Auto Sponsors additionally retain the most subordinated class or classes of notes issued in a securitization. This provides further exposure to the securitization and the Auto Sponsors believe that any such retained junior notes should be a permissible component of horizontal risk retention.

The historical performance of motor vehicle securitizations illustrates that retention of a subordinated residual interest in its present form provides an appropriate alignment of interests between securitizers and investors. If the proposed revisions are not made, virtually all motor vehicle securitization programs would need to be significantly restructured in order to take advantage of horizontal risk retention. Requiring restructuring of motor vehicle securitizations as a cost of horizontal risk retention would only hinder the issuance of motor vehicle ABS and negatively impact the availability of credit to consumers and businesses. Furthermore, the restructured securitizations would have far more complex collection and reporting procedures and cashflow allocation mechanics than today's securitizations. This added complexity would make these traditionally sound securitization structures more difficult to establish and maintain for the Auto Sponsors and more difficult to model and understand.

There are three principal revisions that will need to be made to the proposed rules on horizontal risk retention to render them usable in motor vehicle securitizations:

1. <u>Loss Allocation</u>: As proposed, clause (1) of the "eligible horizontal residual interest" definition envisions securitizations where principal losses on the asset pool are explicitly allocated each period to the most subordinated ABS interest(s) to reduce the par value of those ABS interest(s). While this feature is commonplace in RMBS transactions and in many securitizations of automobile floorplan loans (where the subordinated residual interest is the first ABS interest of a particular series to bear pool-wide losses that are allocated to that series), motor vehicle loan and lease ABS deals do not have "loss allocation" mechanisms. The vast majority of these motor vehicle loan and lease ABS instead treat all collections each period as a single pool of distributable cash, subject to a single waterfall from which note interest, note principal, swap payments, service-provider fees, credit enhancement funding and other securitization expenses are paid. To the extent that there are losses those losses only reduce collections to be distributed, which may result in non-payment of certain waterfall priorities but do not result in a "write-down" of any ABS interests.

While a subordinated residual interest is not explicitly allocated losses, by virtue of its placement at the last position in the waterfall, it is implicitly the first ABS interest in a motor vehicle securitization to have its distributions reduced or eliminated in a particular period if there are losses on the asset pool or other cashflow disruptions. For example, if on a particular payment date $80 was required to pay securitization fees, interest and principal on the more senior ABS interests and $100 was collected on the pool during the related collection period, then $20 would be distributed on the subordinated residual interest that month.[53] If only $80 was collected due to higher losses, delinquencies or any other reason, then the subordinated residual interest would receive no payments that month but the fees and the more senior ABS would still be paid in full. To the extent that

[53] These examples are also illustrative for revolving master trust securitizations of automobile floorplan loans where the sponsor or its affiliate maintains a residual interest that is subordinated to the ABS interests of a particular series issued by the master trust. In that case, the $100 in the example represents the portion of collections on the entire pool that is allocated to that series and the $80 represents the amounts due to the senior ABS holders or service providers of that particular series. The subordinated residual interest is, therefore, the ABS interest that is entitled to any remaining amounts allocated to that series.

the $20 shortfall is a loss and is never collected, the subordinated residual interest will never be paid that amount and so would have served its function; if all or a portion of it is collected on a future date, the subordinated residual interest will again only receive a distribution if sufficient amounts are then available through the waterfall to fund all more senior payments in the month the amounts are collected. Finally, if only $75 was collected, then not only would the subordinated residual interest receive no payments that month but, assuming there was no other source to fund payments (such as a reserve account), ABS investors or securitization service providers who were entitled to payment at the most subordinate level(s) would also be underpaid that month (by $5). In this final case, however, motor vehicle ABS structures provide that the investors or service providers who were underpaid $5 in the shortfall period would receive those amounts in full in the next period that excess amounts are available, which would once again reduce payments to the subordinated residual interest.

So, while the subordinated residual interests in motor vehicle loan and lease ABS transactions do not have a "par value" that is expressly reduced or "written down" and there are no separate waterfalls for tracking or allocating principal losses, the transactions nonetheless ensure that the subordinated residual interests are in the first-loss position. ***Clause (1) of the definition of "eligible horizontal residual interest" should therefore be modified so that it applies only to securitizations that have a loss allocation feature. Clause (1) should also be modified to state that for revolving master trust securitizations, the eligible horizontal residual interest must be the first ABS interest to be allocated losses from that series' allocated portion of collections on the pool of securitized assets, rather than on the entire pool of securitized assets***.[54] If a securitization lacks an explicit loss allocation feature, then, as discussed in the following section, clause (2) of the "eligible horizontal residual interest" definition adequately ensures that the horizontal risk retention is being achieved by the sponsor holding the first-loss, most subordinated ABS interests.

2. Subordinated Payments: As described above, the subordinated residual interests presently retained by Auto Sponsors in the vast majority of motor vehicle ABS transactions do not receive any payments on a payment date unless all more senior ABS interests, all transaction fees, all swap payments and all credit enhancement have been paid in full. However, there are also motor vehicle ABS transactions where the sponsor retains the next-most junior ABS interests. For example, rather than creating three tranches of ABS interests, two senior classes of notes that are sold to investors plus a relatively "thick" subordinated residual interest that the sponsor retains, the sponsor might split the residual interest and issue four ABS interests: the same two classes of senior notes (which are again sold to investors) a new, subordinated class of notes that is retained by the sponsor and the remaining, now smaller, subordinated residual interest that is also retained by the sponsor.[55]

[54] All of our suggested modifications to the text of the proposed rules are consolidated in Exhibit A.
[55] A sponsor may elect to use this formulation so that it has a readily marketable ABS interest to sell should a market later develop for it.

For so long as a sponsor retains each of these subordinated ABS interests, the "eligible horizontal residual interest" should be comprised of both the subordinated residual interest (which is entitled to no payments until all transaction fees and expenses and ABS interests are paid on a given payment date) and the retained junior ABS (which may be entitled to interest and/or principal on a payment date, but only after every more senior ABS interest has been fully paid interest and principal, respectively, that it is entitled to on that date). The Auto Sponsors believe counting retained junior ABS interests is appropriate since the ratings on the senior ABS interests will ensure that they are protected notwithstanding the interest rate on the retained junior ABS interests, even if such rates are above-market, since the rating methodology will require that additional assets be available to support the timely payment of interest and ultimate payment of principal on the senior ABS interests. Furthermore, it is unlikely that an Auto Sponsor would be willing to commit additional assets to a transaction to support above-market interest rates on a retained junior ABS since this will result in the transaction being less efficient. ***The introductory clause of the definition "eligible horizontal residual interest" should therefore be modified to refer to "an ABS interest or ABS interests" and clause (2) should be modified to read "(2) either (a) has the most subordinated claim to payments of principal of all ABS interests of the same series that are entitled to receive principal payments on each payment date and has the most subordinated claim to payments of interest of all ABS interests of the same series that are entitled to receive interest payments on each payment date or (b) is entitled to payments on each payment date only after all other ABS interests of the same series have been paid all principal and interest due on that payment date."***

3. <u>Principal Payments</u>: The third criteria in the definition of "eligible horizontal residual interest" provides that the ABS interest is not permitted to receive any principal payments other than a proportionate share of scheduled principal payments collected on the pool. As described above, this feature is inconsistent with the way both subordinated residual interests and retained junior bonds currently receive distributions in motor vehicle ABS and is an unnecessary, inappropriate and uneconomical restriction on those securitizations.

In motor vehicle ABS the subordinated residual interest may receive distributions on the securitized assets in any period, so long as the senior ABS interests have all received their required periodic principal and interest payments, all issuing entity fees and expenses have been paid and all credit enhancement that is funded or maintained with cashflow from the securitized assets is at its then-required level. If other junior ABS interests are held as a portion of the "eligible horizontal residual interest," they will receive interest only if all senior ABS interests have been paid 100% of the interest they are then due and will receive principal only if all senior ABS interests have received 100% of the principal they are then due. Preventing these ordinary course payments on the "eligible horizontal residual interest" components when a securitization is fully performing would not serve any purpose other than to cause the sponsor to retain more credit enhancement within the securitization than the sponsor, investors, underwriters and rating agencies had previously determined was needed to protect investors against a multiple of expected losses, and all at a time when, rather than experiencing losses or a diminution in credit enhancement, the securitization was making all required payments and generating excess collections.

Furthermore, other than in securitizations of automobile floorplan loans, motor vehicle ABS collections are rarely segregated into principal[56] and interest collections and applied in separate waterfalls, as is often the case in RMBS and certain other asset classes, and in no motor vehicle ABS transactions are principal collections ever segregated into "scheduled" and "unscheduled" collection pools and waterfalls. Therefore, preventing excess payments on the subordinated residual interest other than from "scheduled payments of principal" on the securitized assets would require that motor vehicle ABS that presently allocate all collections from a single collections pool (or, in the case of many automobile floorplan loan securitizations, a pool of interest collections and a single pool of principal collections) instead begin separately tracking and accounting for (1) interest collections and distributions, (2) "scheduled" principal collections and distributions and (3) "unscheduled" principal collections and distributions. This would be wholly inconsistent with reporting and cash application for any motor vehicle ABS that is in the market today. This would also introduce unnecessary complexity into an asset class that has always performed and where sponsors and investors have traditionally relied on remarkably straightforward collection and allocation procedures.

For securitizations where the transaction documents do not have separate allocation methods for interest, "scheduled" principal and "unscheduled" principal collections, the rule should instead provide that distributions on the eligible horizontal residual interests are permitted on any payment date so long as an "allocable share" of the amount by which the securitization's asset balance has declined since the closing date has been used to pay down the more senior ABS interests. While these securitizations may not expressly provide that principal collections must be allocated in a particular manner that gives preference to the senior ABS interests, if those investor-held securities have been paid down by at least their allocable percentage of the decrease in the asset balance then the rule will achieve the same result. [57]

We understand the intent of the proposed rule is to restrict the ability to artificially reduce the amount of risk retained over time. Therefore, after the amount of retained risk is initially calculated at the start of a deal, we propose a monthly test that ensures the risk retention is not depleted due to distributions on the residual interest. The test is based on the decline in trust liabilities as compared to the decline in trust assets. This test does not alter any of the ABS transaction mechanics, including sequential payment of ABS interests, the build of credit enhancement over time through targeted overcollateralization requirements, waterfall priorities of payment, and priority principal payments. It is

[56] In automobile lease securitizations the securitized assets do not even have amortizing principal balances that could be tracked in this manner.

[57] For transactions featuring revolving periods, such as automobile floorplan loan securitizations, even this restriction on distributions should only be applicable after the related revolving period is over, since prior to that time neither the pool balance nor the senior ABS interest principal balance will decrease, as principal collections are instead distributed to the holder of the subordinated residual interest as consideration for its transfer of additional assets to collateralize the revolving pool.

simply meant to determine whether any residual cash flows can be released back to the holder of the residual interest. It also doesn't guarantee the holder of residual interest will receive a pro rata share of distributions since the residual interest will bear losses first. More specifically, we propose that as of each payment date, the servicer would calculate the cumulative decrease in the sum of the pool balance plus any reserve account balance that has occurred since closing (i.e., the decrease in the securitization's asset balance) and determine whether the aggregate principal balance of the senior ABS interests (i.e., the issuing entity's liabilities, other than those constituting the eligible horizontal residual interest) had been reduced by at least its allocable share of that decrease since closing. If the test is satisfied then there would be no limitation on payments on the eligible horizontal residual interest on that payment date; if the test is not satisfied, then the eligible horizontal residual interest would not get paid until a future payment date when the senior ABS interests have received their full allocable share of the cumulative decrease in the securitization's asset balance as of that future date.

For example, assume that the ABS interests other than the eligible horizontal residual interest have an initial valuation equal to 93% of the initial pool balance plus the initial reserve account balance. If the pool balance was initially $98,000,000 but decreased to $88,000,000 as of the tenth payment date[58] and if a reserve account had a balance of $2,000,000 both at closing and on that payment date, then the relevant test would be whether at least $9,300,000 had been used to pay down the senior ABS interests as of that payment date ($9,300,000 = 93% allocable to senior ABS interests * $10,000,000, which represents the decrease from the initial securitization asset balance of $98,000,000 + $2,000,000 = $100,000,000 to the subsequent securitization asset balance of $88,000,000 + $2,000,000 = $90,000,000). If that test is passed then the eligible horizontal residual interest would be allowed to receive any distributions that otherwise would be paid to it through the waterfall.

It should be noted that this test is performed using cumulative numbers, so the actual percentage of the decrease in the securitization's asset balance that is allocated to principal payments on the senior ABS interests on any particular payment date does not matter. This cumulative calculation is crucial because the rate at which senior ABS interests are paid principal often varies during different phases of a securitization. For instance, all excess cashflow may be allocated to paying down the most senior outstanding notes at the outset of the transaction to increase the amount of overcollateralization, but then once a predetermined level of overcollateralization is achieved excess cashflow may not otherwise be needed and would be available to pay the eligible horizontal residual interest. This is appropriate because the residual interest has received less than its proportionate share in prior periods. Using the figures from the

[58] Note that the pool balance may decrease because principal is collected on the securitized assets or because losses are realized on the securitized assets. Securitizations typically allocate cash to investor-held ABS interests in order to maintain a predetermined ratio between the pool balance and the outstanding principal balance of one or more ABS interests. Therefore, we recognize that it is necessary to confirm that the senior ABS interests have been paid principal in an amount corresponding to the cumulative decrease in the securitization's asset balance and are not suggesting a calculation that merely tracks the decrease in the senior ABS interests against some portion of actual collections on the securitized assets.

previous example, if an incremental $1,000,000 pool balance decrease occurred in month 11, the relevant test would not be whether the aggregate principal balance of the senior ABS interests decreased by at least $930,000 that month ($930,000 = 93% * $1,000,000 incremental decrease in the securitization's asset balance from month 10 to month 11). Instead, the test would be whether their aggregate principal balance had decreased since closing by at least $10,230,000 ($10,230,000 = 93% * $11,000,000 cumulative decrease in the securitization's asset balance from closing through month 11).

To give effect to these provisions, ***clause (3) of the "eligible horizontal residual interest" definition should be modified to read "(3) Until all other ABS interests in the issuing entity are paid in full, either (a) is not entitled to receive any payments of principal made on a securitized asset, provided, however, an eligible horizontal residual interest may receive its current proportionate share of scheduled payments of principal received on the securitized assets in accordance with the transaction documents or (b) if the transaction documents do not provide for the separate collection and distribution of interest, scheduled payments of principal and unscheduled payments of principal on the securitized assets, is not entitled to receive payments unless the aggregate percentage decrease in the outstanding principal balance or securitization value, as applicable, of all related ABS interests that do not comprise the eligible horizontal residual interest since the closing date is at least equal to the percentage equivalent of the aggregate decrease in the principal balance or securitization value, as applicable, of the securitized assets plus the aggregate decrease (if any) in the amount on deposit in any reserve accounts since the closing date divided by the sum of the principal balance or securitization value, as applicable, of the securitized assets as of the cutoff date plus the amount on deposit in any reserve accounts on the closing date); provided, however, that securitizations that are subject to clause (b) and feature a revolving period will be subject to this limitation only after the end of the revolving period for the related ABS interests and then only by reference to the related series' designated portion of the aggregate principal balance or securitization value, as applicable, of the securitized assets."***

b. Horizontal Risk Retention: Valuing the Retained Interest's "Par Value"

The subordinated residual interests that are typically structured in motor vehicle securitization transactions (and that the Auto Sponsors believe should qualify for horizontal risk retention purposes) have neither stated principal amounts nor calculated par values.[59] The Auto Sponsors interpret the proposed rules to allow calculation of the "par value" of these residual ABS interests according to any reasonable methodology, so long as the material features of the methodology and the results of the calculation are disclosed to investors in accordance with subsection (c)(3) of the Horizontal Risk Retention section. ***We request that this interpretation be confirmed in the final release.***

[59] To the extent that one or more components of the eligible horizontal residual interest did have a stated principal amount (e.g., if the most subordinated tranche of ABS interests other than the residual interest were retained by the sponsor in addition to the residual interest) then presumably the then-outstanding principal amount of that component would be included as a component of the eligible horizontal residual interest's value on any date of determination.

There are two calculation methodologies that the Auto Sponsors expect will often be used to value eligible horizontal residual interests in their securitizations. We further request that these two methodologies be acknowledged as permissible, but non-exclusive, valuation methods for eligible horizontal residual interests in motor vehicle ABS.

1. Discounted Cashflows Approach: The Auto Sponsors interpret the references in part (c)(3) of the Horizontal Risk Retention section to "estimated cash flows and the discount rate used" to calculate the values of ABS interests to imply that an eligible horizontal residual interest could be valued by determining the discounted present value of future cashflows on the related ABS interests.[60] In this case, components such as the current amount of overcollateralization and the discounted present value of any expected excess interest to be received on the residual interest would be included in the calculated value. So long as an Auto Sponsor discloses the components that it used to calculate the residual interest's value, the rate at which it discounted amounts expected to be received on the residual interest on future dates, the pool prepayment and loss assumptions that were utilized and similar characteristics and other material assumptions that were used to calculate the value, determining an eligible horizontal residual interest's value in this manner should be permissible. We point out that in virtually every auto retail loan ABS transaction, excess spread has been more than sufficient to absorb all losses on the securitized assets[61] and, therefore, excess spread should be fully considered in the discounted cash flow calculation. This is especially true when compared to a vertical slice retained by a sponsor which would share losses with investors and only absorb 5% of losses. ***We request that the final release state that calculating the value of a horizontal residual interest using a "discounted cashflows" approach is permissible.***

2. Balance Sheet Approach: Because the proposed rules do not indicate whether an eligible horizontal residual interest must be valued using the discounted cashflows methodology, it appears that it would also be permissible for an Auto Sponsor to value a residual interest as the difference between an issuing entity's assets (i.e., the value of the securitized assets) and its liabilities (i.e., the par value of all other ABS interests). If this is permitted, it would be appropriate in certain cases for Auto Sponsors to value certain securitized assets other than at their stated value. For example, in automobile lease securitizations a "securitization value" (or similarly defined term) is calculated for each lease that represents the discounted values of both the anticipated payments under the lease agreement and the residual value of the leased vehicle that is assumed to be realized at the end of the lease term. As with a discounted cashflow approach, so long as a sponsor fully discloses the manner in which it valued the issuing entity's assets and liabilities for purposes of determining the residual interest's value, including any prepayment and loss assumptions, asset valuation methodologies, and similar characteristics, this should be a permissible manner of calculation. ***We request that the***

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[60] The Auto Sponsors also note that this methodology is consistent with the presentation entitled "Federal Reserve Bank of New York: Understanding Premium Capture" (Adam B. Ashcraft, 7 April 2011), which references the use of a discounted cashflows approach to value an eligible horizontal residual interest.

[61] *See* Chart 1 of "Not All Risk Retention Options are Created Equal for US Nonrevolving Consumer ABS", May 3, 2011. Available at: http://www.americansecuritization.com/uploadedFiles/SP_Risk_Retention_5-3-2011.pdf .

final release state that calculating the value of an eligible horizontal residual interest using a "balance sheet" approach is permissible.

c. Reserve Accounts

As described below under "'Blended' Risk Retention," the Auto Sponsors are in favor of allowing sponsors to hold a combination of exposures to satisfy the risk retention obligations. To facilitate this, they request that cash that is in a securitization's reserve account and that is available to fund shortfalls in payments on the ABS interests should be a permissible form of risk retention, distinct from Horizontal Risk Retention. ***We request, therefore, that Section ___.5(b) be set forth as a separate Section ___.5A that permits a reserve account to be established to satisfy the risk retention requirements.***

In order to ensure that the reserve accounts that are currently maintained in motor vehicle securitizations are permissible forms of risk retention, there are three additional revisions that should be made.

1. Master Trusts: The language in Section ___.5(b) does not contemplate a reserve account that is established to support a single series issued by a master trust. The Auto Sponsors' automobile floorplan loan securitizations commonly feature reserve accounts that are available only to fund shortfalls in a particular series of ABS interests issued by the master trust. ***The language we have set forth in Annex __ for a stand-alone Section ___.5A regarding reserve accounts permits sponsors to count reserve accounts that are established in connection with the issuance of a particular series from a master trust as risk retention for that series.***

2. Investments: Section ___.5(b)(2) provides a very limited number of permitted investments for funds in reserve accounts. Additionally, Section ___.5(b)(2) would allow the investment of reserve account funds in longer-term investments, which is currently not permitted in motor vehicle securitizations where monthly payment dates are the norm and a longer-term investment would expose the securitization to the risk of loss on the investment if an earlier liquidation was needed so that the funds could be used to make required payments. In all motor vehicle securitizations that the Auto Sponsors are aware of, amounts in a reserve account may be invested in similar short-term, highly rated investments to amounts on deposit in the collection account and other trust accounts. ***The Auto Sponsors request that amounts in a reserve account should be allowed to be invested according to investment criteria that are at least as stringent as those for all other accounts in the securitization.***

3. Releases to the Sponsor: The Auto Sponsors appreciate that the proposed rules acknowledge that in many securitizations investment returns on reserve account deposits are released to a sponsor. However, we do not believe that the additional provisions regarding releases from a reserve account are necessary. As described further below, we believe that Section __.14, relating to hedging and transfer limitations, already prevents releases from a reserve account maintained to satisfy risk retention requirements (other than to fund required shortfalls on the ABS) that would cause its value to decrease below

the mandated levels. ***The Auto Sponsors therefore request that the provisions set forth in Section ___.5(b)(3)(ii)(A) be deleted.***

d. Representative Sample

An Auto Sponsor selects the pools to collateralize its motor vehicle ABS from the portion of its portfolio that meets the prescribed securitization pool criteria, with no adverse selection permitted. The other receivables that remain unsecuritized after a pool is selected typically were originated using substantially the same underwriting criteria as the securitized receivables and then remain unsecuritized, at least temporarily, and are financed wholly by the Auto Sponsor. Furthermore, many Auto Sponsors maintain a significant portfolio of unsecuritized receivables at all times. For these reasons, the Auto Sponsors appreciate the option to meet their risk retention requirements by holding a representative sample of receivables (an "Unsecuritized Pool"). However, the proposed Unsecuritized Pool rules are unnecessarily complex and burdensome and, in their present form, would not be utilized in the motor vehicle ABS markets.

Achieving the goal of aligning an Auto Sponsor's exposure with its investors' could be achieved through much less burdensome methods than those included in the proposed rules. Rather than mandating the manner in which the Unsecuritized Pool is constructed, the rules instead should only require that the Unsecuritized Pool be selected at the same time that the securitization's asset pool is selected from the same pool of assets, utilize the same selection criteria and allow no adverse selection. The proposed rules are inconsistent with random selection techniques. The proposed rules as drafted are too difficult to administer and could require multiple samplings to test whether the representative sample is equivalent in all material respects to the ABS pool. An assessment at the time that the respective pools are selected that they represent "equivalent risks" is also appropriate, but there must be a specified list of criteria for which this test should be performed, rather than demanding equivalence for "each material characteristic" whether "quantitative" or "categorical." The Auto Sponsors propose that the material characteristics to be compared are FICO score, outstanding principal balance and remaining term.

Requiring that an Auto Sponsor identify an Unsecuritized Pool based on these revised criteria, perform the testing described above, maintain the assets unsecuritized for the life of the related ABS transaction and service them in the same manner as the securitized assets are serviced are all appropriate conditions that ensure that the selection process was proper, will be respected on an ongoing basis and will expose the Auto Sponsor to a risk that is analogous to exposure to the related ABS.

However, the further requirements set forth in the Unsecuritized Pool proposal—demanding an agreed upon procedures report on the selection process, policies and procedures, testing and maintaining procedures at the time of the ABS sale and requiring monthly testing and reporting of the performance of the Unsecuritized Pool for comparison against the ABS pool—are unnecessarily costly and time consuming. These additional requirements would drive Auto Sponsors away from ever using this method because it would essentially require that they hold Unsecuritized Pools, unhedged and wholly at their own expense, while simultaneously assuming the most onerous ongoing costs of a securitization with respect to those assets. These requirements should be deleted from the proposed rules.

In addition, the requirement that the "individuals responsible for servicing the assets" in the Unsecuritized Pool and the ABS pool be unable to "determine whether an asset is owned or held by the sponsor or owned or held by the issuing entity" is unworkable. As noted above, the Auto Sponsors agree with the requirement that the assets in the Unsecuritized Pool and the Unsecuritized Pool should be serviced "under the same contractual standards" and thus with the same level of care and attention. However, as currently drafted this provision would not allow for cash flows from the receivables to be directed to the proper recipients. Cash flows for the receivables must be sent to either the sponsor or the securitization accounts for further distribution to the ABS deal parties. At the very least, this provision must be clarified to limit its applicability to servicing personnel involved in the collection process with obligors.

e. Seller's Interest

The Auto Sponsors are generally in favor of the proposed provisions regarding the use of the seller's interest as an appropriate form of risk retention for revolving asset master trusts. However, to accommodate the structure of the seller's interest in a typical automobile floorplan loan securitization, the Auto Sponsors request that the provisions of Section __.7 regarding revolving asset master trusts and the related definitions be revised as follows.

1. <u>General Requirement Section __.7(a)</u>: Section __.7(a) of the proposed rules requires that "the sponsor retains a seller's interest of not less than five percent of the unpaid principal balance of all the assets owned or held by the issuing entity." In a typical automobile floorplan loan securitization, it is the depositor and not the sponsor that holds the seller's interest. In most automobile floorplan master trusts it would be very difficult to restructure the seller's interest so that it could be transferred to and held by the sponsor. In addition, revolving asset master trusts often hold assets far in excess of the amount required to collateralize the outstanding investor interests and the master trust may hold assets other than its interests in the automobile floorplan loans. In particular, the master trust may hold cash collateral, reserve, collection and other accounts. Funds in these accounts are generally invested in short-term, highly rated investments. The Auto Sponsors do not believe that it is necessary or appropriate to include these assets when calculating the required amount of risk retention. ***Therefore, the Auto Sponsors believe that in Section __.7(a) the phrase "the sponsor" should be replaced with "the depositor" and the phrase "the unpaid principal balance of all assets" should be replaced with the phrase "the outstanding principal balance of the investor interests."***

2. <u>General Requirement Section __.7(a)(2)</u>: Section __.7(a)(2) as proposed requires that all of the securitized assets of the revolving asset master trust be "loans or other extensions of credit that arise under revolving accounts." In a typical automobile floorplan loan securitization, the assets held by the issuing master trust may be interests in such loans or extensions of credit, such as participation interests, or a certificate or other interest in a trust holding such loans or extensions of credit. In addition, some of these loans may not be "accounts" as that term is commonly used. Therefore, in order to

encompass the types of assets and structures commonly in place in existing automobile floorplan loan securitization transactions, ***the Auto Sponsors request that Section __.7(a)(2)be revised to read as follows: "(2) All of the securitized assets are loans or other extensions of credit that arise under revolving accounts or financing arrangements, or participation or other interests therein, including collateral certificates or similar interests in a trust or other entity that holds such assets."***

3. <u>Section __.2 Definition of Securitized Asset</u>: Clause (2) of the definition of securitized asset includes all assets that "[collateralize] the ABS interests issued by the issuing entity." It is typical in an automobile floorplan loan securitization that receivables that are not eligible to collateralize the investor interests are transferred to the master trust because they arise under the applicable accounts. Because these receivables do not serve as collateral for the investor interests and these receivables are not allocated to the investor interests, these assets should not be included in calculating the amount of required risk retention and should be excluded from the definition of securitized assets. ***Therefore, the Auto Sponsors believe that clause (2) of the definition of securitized assets should be revised to read as follows: "(2) Collateralizes the investor interests issued by the issuing entity."***

4. <u>Section __.2 Definition of Seller's Interest</u>: The Auto Sponsors have several comments to the definition of seller's interest. First, the definition requires that the seller's interest be "an ABS interest." However, in many automobile floorplan loan securitizations the seller's interest is not a single interest, but rather a group of different rights to which the holder is entitled under the transaction documents. Although there may be interests retained by the depositor that meet the proposed requirements, the definition suggests that those rights need to be part of a single interest. Creating such an interest would in many instances require restructuring and amendment of the existing transactions, which may be difficult or even impossible. ***Therefore, the Auto Sponsors request that the phrase "an ABS interest" in the beginning of the definition of seller's interest be replaced with "an ABS interest, ABS interests or portions thereof."***

Second, clause (1) of the definition requires that such interest be "(1) In all of the assets that: (i) Are owned or held by the issuing entity; and (ii) Do not collateralize any other ABS interests issued by the issuing entity." As previously stated, the issuing entity may own an indirect interest in the securitized assets, such as a collateral certificate, rather than the receivables, and the issuing entity may own assets in addition to the securitized assets, such as reserve, collection, distribution or other accounts, interest rate swaps, and other forms of credit enhancement. The seller's interest may not benefit from these assets, as some of them may be only for the benefit of the investors or other parties. The seller's interest should only be required to relate to the securitized assets and should exclude assets that collateralize only a specified class or series of ABS interests, such as interest rate swaps or other enhancements. ***Therefore, the Auto Sponsors request that Clause (1) be revised to read as follows: "(1) In the securitized assets owned or held by the issuing entity other than those that collateralize other specified ABS interests issued by the issuing entity."***

Third, Clause (2) requires that the seller's interest be pari passu with "all other ABS interests" issued by the issuing entity with respect to the allocation of "all payments and losses." Because the definition of ABS interest is quite expansive, it includes any type of interest, more than just the investor interests, which should be the focus of this requirement. It is typical in an automobile floorplan loan securitization that a series of ABS interests contain multiple classes which may not be pari passu with each other, much less pari passu with the seller's interest. The appropriate comparison should be between the allocations made to the seller's interest and the allocations made to each series of ABS interests as a group, allowing the allocation to be split among the ABS interests in the series as is provided in the transaction documents. In addition, there are times other than an early amortization period where the seller's interest may be subordinate to the investor interests, such as during a normal amortization period or an accumulation period. ***Therefore, the Auto Sponsors believe that the Clause (2) should be revised such that the seller interest is "pari passu or subordinate to each series of investor interests."***

Finally, existing Clause (2) requires that it is "all payments and losses" that must be allocated on a pari passu basis. ***The Auto Sponsors would like to clarify that it is collections and losses on the securitized assets that must be so allocated on a pari passu basis, not payments on the ABS interests, and suggest that the phase "all payments and losses" be replaced with "all collections and losses with respect to the securitized assets."***

f. "Blended" Risk Retention

The Auto Sponsors note that the proposed rule allowing "L-shaped" risk retention (i.e., a combination of a vertical slice and a horizontal slice in a prescribed, 50%/50% ratio) acknowledges that it is possible to "mix and match" different forms of risk retention while still ensuring that, in the aggregate, exposures are held by the sponsor that equal at least 5% of the ABS interests issued in the securitization. There is no reason that the final rules should not allow risk retention to be held in any combination of a retained "vertical slice," a retained "horizontal slice," one or more reserve accounts, an unsecuritized pool and, for revolving master trust securitizations of automobile floorplan loans, a seller's interest, so long as, in the aggregate, the exposures that are held reflect an aggregate retained risk exposure of at least 5%.[62]

Allowing this type of flexibility would ensure that sponsors are not required to retain more exposure to their securitizations than the rule intended. For instance, because the Auto

[62] The proposal suggests that an L-shaped interest is an especially useful form of blended risk retention for two reasons. First, the even split is said to ensure that each form of risk retention is "large enough to affect the sponsor's incentives." However, the Auto Sponsors do not believe, and are unaware of any studies or evidence that suggest, that their incentives would be diluted in any way if their retained exposures took on other forms or if certain of the exposures were relatively small. Second, the proposal predicts that this particular allocation "should assist investors and the [Joint Regulators] with monitoring compliance." However, the Auto Sponsors do not believe that properly disclosed blended risk retentions with different components would be confusing to the Joint Regulators or investors. Furthermore, the 50-50 split represented by L-shaped retention only exists at one point in time; after closing, when the transaction begins to pay down, the two pieces will be reduced at different rates and any perceived benefit from the even allocation will disappear.

Sponsors have, for decades, traditionally retained 100% of the subordinated residual interests in their securitizations, they anticipate that investors will continue to expect them to hold those interests. Additionally, many of the Auto Sponsors have noted that they prefer to retain the subordinated residual interests so that they can maintain ongoing exposure to their originated assets. Regardless, even if they wished to sell, resecuritize or otherwise "cash out" these subordinated residual interests, there is not a significant market for them to do so efficiently.

If an Auto Sponsor that is going to retain a subordinated residual interest finds that the interest is only "valued" at 4.5% of the par value of all ABS interests, then according to the proposed rules the Auto Sponsor would have to choose among a menu of inefficient options to achieve its required level of risk retention. Such a sponsor could transfer additional eligible assets to the asset pool without issuing any additional ABS interests to investors. This would enhance the value of the subordinated residual interest, but only by adding assets that provide credit enhancement that is otherwise unnecessary to support the securitization's expected losses and cashflow demands. Alternatively, if the Auto Sponsor does not have additional eligible assets to contribute, the least inefficient way for it to meet its risk retention requirements under the proposed rules would be to also hold a 2.5% vertical slice of the securitization, which is the minimum amount it would have to hold to satisfy the "L-shaped" risk retention requirement but results in approximately 7.0% risk retention.

A more logical solution would be to allow a sponsor to fund a reserve account to make up the 0.5% shortfall, or to allow it to construct a similarly sized unsecuritized pool under the representative sampling section. We propose that the rules be revised to allow this by modifying the section regarding "L-shaped" risk retention to cover "Combined Risk Retention." ***General requirement*: At the closing of the securitization transaction, the sum of (i) if the sponsor retains an interest in each class of ABS interests in the issuing entity, the percentage interest in any class so retained multiplied by the face value or, if applicable, the calculated value of each such ABS interest; provided, that the percentage interest for any class may be no greater than the lowest percentage interest retained in any other ABS interest that is subordinate in its right to receive payments of principal to such class's right to receive payments of principal and in its right to receive payments of interest to such class's right to receive payments of interest[63], (ii) if the sponsor retains an eligible horizontal residual interest, the calculated value of that interest minus the calculated value of that portion of the eligible horizontal residual interest retained pursuant to clause (i)[64], (iii) if the sponsor establishes a reserve account, the amount on deposit in the reserve account (without duplication of any amount included in the calculated value of an eligible horizontal residual interest pursuant to clause***

[63] The proviso ensures that if the sponsor retains varying percentages of ABS interests rather than, say, a fixed five percent of each tranche, then it would receive credit for its "vertical slice" of a more senor tranche only to the extent that it holds at least the same percentage interest of each tranche that is subordinate to it. This avoids the situation where a sponsor might attempt to hold a "vertical exposure" that was disproportionately comprised of more senior tranches but would allow full credit for a "bottom-heavy" retention where a sponsor retained a greater percentage of the more subordinated tranches. For example, a sponsor holding 5% of senior notes and 4% of junior notes (top-heavy) would not be allowed to count the incremental 1% holding of the senior notes as retained exposure but a sponsor holding 4% of senior notes and 5% of junior notes (bottom-heavy) could count the full amount of each towards its retention requirement.

[64] This formulation ensures that a sponsor may not "double-count" a retained eligible horizontal residual interest.

(ii)), (iv) if the sponsor retains a seller's interest, the percentage of the collections on the assets that is allocated at closing to the related series multiplied by the principal balance of the seller's interest, and (v) if the sponsor establishes a representative sample pool, the aggregate unpaid principal balance or securitization value, as applicable, of the assets in such pool, equals not less than 5% of the aggregate ABS interests in the issuing entity."

g. Maintaining the Retained Exposures

As described above, the Auto Sponsors interpret the risk retention rules as intending to require a sponsor to maintain a <u>fixed percentage</u> of exposure to a securitization over time rather than a <u>fixed amount</u> of exposure. By way of example, if a sponsor initially retained $5 of risk against $100 of ABS interests issued at closing, and if those ABS interests had amortized to $50 without any losses being incurred, the sponsor would be able to hedge, sell or otherwise dispose of half of its retained risk to maintain its 5% level of exposure and would not be required to maintain the full original exposure that now represents 10% of the ABS interests. The vertical exposure rules already implicitly allow and provide for this "pay down" of exposures to maintain a fixed percentage but the other permissible forms of exposure do not necessarily decrease at the same rate as the securitization's aggregate ABS interests.

We therefore request that a subsection be added to "Hedging, transfer and financing prohibitions" to clarify that it is permissible to transfer, hedge or otherwise eliminate a sponsor's exposure over time so long as exposures representing at least 5% of the par value of all outstanding ABS interests are still retained. ***The following clause should be added to Section ___ .14: "(f) Permissible Transactions. Nothing in this section ___.14 prohibits a retaining sponsor from taking any actions with respect to any ABS interests or other assets, including ABS interests or other assets that it previously retained to comply with subpart B of this part with respect to a securitization transaction, if following such actions the sponsor will continue to retain ABS interests and/or assets pursuant to subpart B of this part in respect of the related securitization that are not subject to hedging arrangements prohibited by clause (b) or clause (c) or non-recourse financing prohibited by clause (e) and are in an aggregate amount that is at least equal to 5% of the par value of all outstanding ABS interests issued by the related issuing entity."***

ii. Auto Sponsor Views on Qualifying Automobile Adjustment

The Auto Sponsors are continuing to develop their comments on the proposal for securitizations of Qualifying Automobile Loans. We will submit a second comment letter setting forth suggested revisions to that proposal during the extended comment period.

iii. Auto Investor Views on Proposed Forms of Risk Retention for Auto ABS

Our auto investors generally agree with the Auto Sponsors' description of auto ABS and their discussion of the asset class' solid historical performance. Auto investors believe that the sequential pay structure currently employed in auto ABS transactions has generally aligned incentives in an effective manner and the deals have performed as expected for many years.

Auto investors agree with Auto Sponsors that they are not aware of any Auto Sponsored deal that resulted in losses on the issued ABS.[65]

Despite this strong performance, our auto investors are supportive of the Joint Regulators' proposals to require risk retention in auto ABS transactions. They acknowledge that, as drafted, the Proposed Regulations would force the Auto Sponsors to change their securitization structures to comply. However, auto investors have concerns with certain of the views and proposals set forth by the Auto Sponsors in the above section. Ultimately, the auto investors believe that the final risk retention rule should attempt to provide an appropriate alignment of incentives between issuers and investors, while still permitting a healthy securitization market. Auto investors stress that regardless of the form of the final risk retention rules, they will continue to evaluate each transaction on its own merits.

a. Definition of the Eligible Horizontal Residual Interest

In "Horizontal Risk Retention: Definition of 'Eligible Horizontal Residual Interest'" above, the Auto Sponsors list three principal revisions that they would like to see made to the Proposed Regulations. First, Auto Sponsors would like the Proposed Regulations to account for transactions that do not have a loss allocation feature. For the reasons set forth in that section, investors agree that this is an appropriate revision.

Second, Auto Sponsors would like the ability to retain a subordinate note that is senior to the residual interest should the residual interest itself not equal the 5% retention. Investors agree that this proposal may make sense for certain transactions, but they believe that limitations would have to be placed on the subordinate note so that the purposes of the Proposed Regulations are met. Investors believe that retained risk should be structured more closely to resemble an equity interest in the transaction such that payments are only made after all required payments are made on the more senior obligations. This treatment may not be achieved under the Auto Sponsors' proposal, as an issuer who retained a subordinate tranche would receive interest payments prior to principal being paid on the more senior notes. This interest coupon would have the effect of reducing a sponsor's net economic exposure to the transaction, as it would receive cash on every distribution date regardless of whether there was enough cash to pay principal on the other outstanding notes.

If an Auto Sponsor wants to retain a subordinate note as part of its risk retention, investors suggest that such retained note be purchased at a fair market price and be locked out from receiving any principal until all senior notes have been paid in full. If the retained subordinate note was structured to receive interest prior to principal being paid on the more senior notes, investors would want to be sure that the subordinate note only received a market-level coupon. In addition, investors believe that reserve accounts should be replenished and any target overcollateralization ("OC") contained in the transaction should be met before payments are made on the subordinate note. Effectively, the risk retained in the form of a subordinate note and residual interest should be viewed as one lump sum, to be paid after all liabilities, reserve

[65] However, investors would like to note that there were a few instances in the past where a transaction's performance began to deteriorate and the issuer had to provide support to the transaction to stave off any potential downgrades.

accounts and OC targets are met. The subordinate note retained by the Auto Sponsor should only be senior in payment priority to the horizontal residual interest.

Third, Auto Sponsors have proposed an alternative to the Proposed Regulation's requirement that the eligible horizontal residual interest be locked out of any unscheduled payments, presumably to prevent the residual interest from being amortized below its threshold. Investors agree that auto securitizations do not currently split principal payments into scheduled and unscheduled payments, and acknowledge that to do so would require changes to the Auto Sponsor's securitization structures. The Auto Sponsors' alternative proposal would permit distributions on the eligible horizontal residual interest on any payment date so long as an "allocable share" of the amount by which the asset and reserve account balance has declined since the closing date has been used to pay down the more senior ABS interests.[66] The auto investors understand that the Auto Sponsors believe that this proposal would enable them to comply with the regulation while continuing to use their current auto ABS structures, which require replenishing reserve accounts and meeting OC targets prior to paying any cash to the residual. This has the effect of growing the credit enhancement over time, a feature that has been common in auto securitizations for many years.

Auto investors acknowledge that the Auto Sponsors have indicated that they do not intend to change their current auto ABS structures. They further acknowledge that the "allocable share" test has been proposed by the sponsors as an alternative to the lockout of unscheduled payments contained in the Proposed Regulations. However, the proposed test would also accommodate structures that auto investors find less desirable, ones that would effectively permit pro rata cash payments to the residual interest and result in less growth to credit enhancement. That being said, auto investors acknowledge that a certain amount of flexibility in the regulation will be necessary for innovation and to respond to changing market conditions. Incorporating a very restrictive transaction feature in a regulation that will be very difficult to amend could be detrimental over the long term. On the other hand, there is always concern that the market could conform to the regulation over time, because the regulation may, unfortunately, give some market participants a sense of security.[67] Auto investors do not believe that relying on the rating agencies (especially new rating agencies with less experience) to "police" the use of certain structures is appropriate. For this reason, our investor members believe a market-based concept, such as a credit enhancement or overcollateralization target, should be incorporated into the regulation to help alleviate this concern. As such, to preserve flexibility while also generally meeting the goals of the risk retention requirement, the auto investors are supportive of the pro rata test proposed by the Auto Sponsors, but would suggest including the additional requirement

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[66] However, investors would modify the balance used to calculate the allocable share, which the Auto Sponsors' propose to be the sum of the pool balance and any reserve account. Investors do not believe that reserve accounts should be included in this calculation because it may result in the pool balance reducing to zero while the ABS interests are still outstanding. This would effectively turn a reserve account, which has traditionally been used as enhancement in auto securitizations, into required collateral needed to fully amortize the ABS interests. While auto investors would be able to model this type of scenario, and ultimately price such a transaction, they do not believe this is an optimal result for securitization, as payments on the notes (absent losses) should be dependent upon the collateral, not a reserve account funded by the sponsor.

[67] In fact, investors would be very interested to see how past transactions, especially ones during the financial crisis, would have held up if deals were structured to mirror the Auto Sponsor's proposed change to the regulation.

that no payments can be made on the residual interest unless any waterfall-funded credit enhancement target set forth in the transaction documents has been met.

Combined, this proposal would generally meet the goals of the Proposed Regulations and permit Auto Sponsors to continue the current model of auto securitizations without locking in an overly restrictive structure that potentially might, or should, evolve over time.

b. Horizontal Risk Retention: Valuing the Retained Interest's "Par Value"

Under their "Discounted Cashflows Approach," the Auto Sponsors have proposed that the par value of the eligible horizontal residual interest be able to be calculated using an expected amount of excess spread. Our auto investor members have general concerns about incorporating the value of excess spread into the 5% required to be retained for the residual interest. These concerns stem from the fact that aggressive or simply faulty assumptions may be used in calculating the discounted cashflows necessary to value the excess spread. This could lead to an overstatement of the amount of excess interest expected to be generated, and therefore overstate the ultimate risk retained by the sponsor.[68] Additionally, given the large amount of excess spread generated in a nonprime auto deal, a nonprime issuer would be able to fund even more of the risk retention requirement than a prime issuer through excess spread. Auto investors believe it would be far more simple and straightforward to calculate the eligible horizontal residual interest based on the par or face amount of the collateral at issuance.[69] Investors believe that current subprime Auto Sponsors would not have a problem meeting such a requirement.

However, the auto investors acknowledge that this requirement would be burdensome for prime Auto Sponsors, most of whom hold considerably less than a 5% face amount in the current market and may not find securitization to be economical if such retention were required. In fact, an unattractive consequence of requiring a 5% face amount may be an auto securitization market consisting of only nonprime issuers. For this reason, investors believe it would be appropriate for prime auto securitizations to allow excess spread to account for certain of the 5%, as long as a face amount accounted for at least half of the retention.[70] Investors suggest that transactions meeting specified criteria on a pool or loan-level basis could qualify as "prime." A key consideration for a pool-based approach would be to prevent the inclusion of riskier, higher yielding assets in the pool while still maintaining aggregate criteria that indicate a higher quality pool (a concept known as "barbelling"). Some investors are so concerned with "barbelling," that they would prefer the prime designation to be made on an asset-by-asset basis. Finally, investors note that if the Joint Regulators have further concerns about funding a portion of risk retention with future excess spread, the final regulation could lockout the eligible horizontal residual interest from receiving any cashflow until its par value or face amount had increased to 5%.

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[68] While investors acknowledge that market forces should, in principle, penalize issuers who fail to accurately value their expected excess spread, they wonder whether the regulation should include "teeth" to reinforce incentives for accurate valuations by issuers.

[69] Residual interests in auto ABS transactions generally do not have a true par value or face amount. In referencing those terms, auto investors are referring to 5% of the face amount of the hard collateral at issuance.

[70] Another option may be to permit the sponsor to sell or hedge a portion of its retained residual interest position after a period of time (possibly 24 or 36 months).

Some auto investors also have concerns with valuing the eligible horizontal residual interest using the "Balance Sheet Approach" proposed by Auto Sponsors. Under the balance sheet approach, the value of the residual interest would be calculated as the value of the assets over the par value of all other ABS interests. Investors are concerned that such a calculation would include the entire yield supplement overcollateralization amount, which is used in transactions with negative excess spread. Negative excess spread occurs when loans have an "APR" that is less than the weighted average coupon (plus expenses) paid on the notes. Investors view the vast majority of the yield supplement overcollateralization amount as necessary to service the notes and not true OC, as it is sized to cover known expenses and liabilities of the trust rather than unexpected losses.

c. Reserve Accounts

The Auto Sponsors propose that the 5% risk retention requirement also be permitted to be met by retaining a combination of a residual interest and a reserve account, if the residual interest does not amount to 5% on its own. Auto investors believe that this would be appropriate for non-declining reserve accounts and support this proposal (subject to the concerns outlined in footnote 65 above).

d. Vertical Slice and L-Shaped Retention

Some of our investor members also see vertical risk retention as a workable option for auto ABS and favor the simplicity of the approach. A vertical slice would eliminate the complexity of trying to predict excess spread for purposes of valuing the retention. It also eliminates concerns about when certain payments are made to a retained residual and at what times. Still, other investors continue to favor the horizontal risk retention that has traditionally been held in auto securitizations, mainly because of the high concentration of losses to which it is exposed. Finally, other investors may desire that the sponsor be exposed to both vertical and horizontal retention in the form of an "L-Shaped" retention.

e. Representative Sample

Our auto investor members oppose any representative or random sample form of risk retention because they believe it will be impossible to ensure that the sample of loans selected is in fact random or that it adequately represents the overall credit risk of the loans that are securitized. Furthermore, the requirement in the Proposed Regulations that the sample pool be representative based on material characteristics creates a natural tension with the requirement that the selection process for the pool be random. Investors believe the proposed concept is flawed and is likely to be ineffective in practice while creating incentives for adverse selection. However, investors would be supportive of a true participation interest where 5% of each individual loan is retained by the sponsor, which would ensure that the retention is representative of the securitized pool.

iv. Auto Investor Views on Qualifying Automobile Adjustment

As is the case with our Auto Sponsor members, our auto investor members have not developed final views on a particular approach for Qualifying Automobile Loans and intend to provide detailed comments in a forthcoming response letter dedicated specifically to that proposal.

C. Asset-Backed Commercial Paper Conduits

i. Introduction

ABCP has for nearly 30 years been a vital source of low-cost working capital for businesses of all kinds both in the United States and globally, from industrial companies to finance and service companies to governmental entities. Assets funded through these vehicles include auto loans, commercial loans, trade receivables, credit card receivables, student loans and many other types of financial assets. ABCP financing of corporate America and the global economy remains substantial. For example, approximately $68 billion of automobile loans and leases, $26 billion of student loans, $34 billion of credit card charges, $41 billion of loans to commercial borrowers and $64 billion of trade receivables were financed by the U.S. ABCP market as of December 31, 2010. The total outstanding amount of ABCP sold in the U.S. market stood at $378 billion as of December 31, 2010. Asset-backed commercial paper conduits with full liquidity support from financial institutions of the type described in the Proposed Regulations[71] have functioned well, even through the depths of the financial crisis. For purposes of this letter, we refer to only such asset-backed commercial paper conduits as "ABCP conduits" and "ABCP" is intended to include only commercial paper notes issued by such ABCP conduits.

While we support appropriate risk retention in the context of the ABCP market, the Proposed Regulations would impose unnecessary restrictions that will impede this well-functioning and valuable market. As described below, the sponsors of ABCP conduits already assume well in excess of 5% of the risks of the assets financed in ABCP conduits through credit support facilities. Investors in ABCP conduits, therefore, rely on and benefit from the credit quality of those sponsors, their substantial exposure to the transactions funded by the ABCP conduits and, in this regard, investors are not primarily dependent on the assets purchased by ABCP conduits. Imposing additional risk retention requirements at the asset level would not advance the purposes of Dodd-Frank. Indeed, because ABCP investors expect to be paid either from proceeds generated through the issuance of additional ABCP or, if ABCP cannot be successfully offered on such day, through draws on the liquidity and credit support facilities

[71] We note that certain segments of the asset-backed commercial paper markets performed poorly after the onset of the global credit and liquidity crisis. In particular, asset-backed commercial paper issued by "structured investment vehicles" ("SIVs") and other non-bank supported market value financing platforms, including market value CDOs, were unable to satisfy their liquidity needs or issue additional short-term securities from the onset of the credit crunch, and were thereafter effectively shut out of the short-term capital markets. These types of vehicles would not qualify for the treatment that we are proposing today and we agree with the joint regulators that these types of vehicles should not be eligible for the risk retention options available to eligible asset-backed commercial paper conduits.

provided by regulated financial institutions, we do not believe that Congress intended ABCP to be an asset-backed security under Dodd-Frank.[72]

As we understand from our discussions with some of you, the joint regulators nonetheless intend to subject ABCP conduit sponsors to the risk retention requirements of Dodd-Frank, but desire to do so in a manner that does not materially alter or impede the functioning of the ABCP market or ABCP conduits. It appears to us that the Proposed Regulations provide a helpful general framework for imposing such risk retention requirements on ABCP conduit sponsors. There are, though, a number of provisions in the rule that are technically unworkable and inconsistent with market practice, without furthering the purposes of the Proposed Regulations. In addition, as described below, investors in ABCP seek and receive detailed disclosure about the conduit, its sponsor and the assets in the conduit. Any additional requirement to disclose the names of originator-sellers would not be required by investors in ABCP and would not serve the purposes of the rule. As we will propose, we believe that disclosure of such information on a confidential basis solely to the applicable bank regulator (or if the ABCP conduit sponsor is not a bank or an affiliate of a bank, to the SEC) would allow the joint regulators to accomplish their goal of monitoring originator-seller compliance with risk retention requirements without such investor disclosure to ABCP investors.

As more fully described below, we respectfully request that the Proposed Regulations, as they relate to ABCP and ABCP conduits, be modified as follows:

I. Limited Expansion of Horizontal Risk Retention: We are proposing a limited expansion of the permitted forms of horizontal risk retention under the Proposed Regulations to include for ABCP conduits unfunded credit enhancement in the form of unconditional and irrevocable letters of credit and other similar credit facilities. These credit facilities would be provided by sponsors of such ABCP conduits or affiliated entities that in each case would meet the Proposed

[72] “Asset-backed security” is defined in the Dodd-Frank Act as a security that entitles its holder to receive payments that depend primarily on cash flow from self-liquidating financial assets. Moreover, we believe that most ABCP conduit sponsors were not intended to be covered by the risk retention requirement for “securitizers” under Dodd-Frank because they don't transfer assets to an issuer of asset-backed securities. “Securitizer” is defined in the Dodd-Frank Act as, generally, the issuer of an asset-backed security or a person who organizes an asset-backed security by transferring assets to an issuer. Similarly, the term “sponsor” is defined in the Proposed Regulations as “a person who organizes and initiates a securitization transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuing entity.” Most ABCP conduit sponsors, particularly sponsors of multi-seller conduits, do not transfer assets to the ABCP conduits they sponsor and thus are neither securitizers nor sponsors.

In addition, we note that the term “asset-backed security” as defined in the Dodd-Frank Act includes within it the term “security” as that term is separately defined in Section 3(a)(10) of the Exchange Act. By operation of those definitions, if a note is not a security under Section 3(a)(10), then it is not an asset-backed security under Section 3(a)(77). The definition of security in Section 3(a)(10) of the Exchange Act excludes “any note, draft, bill of exchange, or banker’s acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited” (emphasis supplied). Therefore, there is support for the proposition that ABCP issued with initial maturities of 270 or fewer days is not a "security" for this purpose and therefore is not an “asset-backed security.”

Regulations' definition of regulated liquidity provider or that are provided by central governments or agencies of central governments. Such unfunded credit enhancement has earned investor confidence over the market's 30-year history, including during the most recent financial crisis, and would permit most ABCP programs to continue to operate as they currently do.

II. Technical Corrections to the "Eligible ABCP Conduit" Alternative: We suggest making technical corrections to the provisions of the Proposed Regulations relating to "eligible ABCP conduits." Our proposed corrections are designed to better align the provisions in the Proposed Regulations with existing ABCP program structures and practices, while simultaneously satisfying the policy goals of the Proposed Regulations.

III. Disclosure: We propose to eliminate the requirement for disclosure to investors of the names of originator-sellers, but to retain the requirement for such disclosure, upon request, to the appropriate regulator of the ABCP conduit sponsor. This modification will both (a) enable the regulators to monitor originator-seller compliance with the requirement in the "eligible ABCP conduits" provisions of the Proposed Regulations and (b) allow the ABCP market to continue to operate with the type of disclosure to ABCP investors that has been developed with investor input and with which the investors have expressed their agreement as described further below.

In order to address these issues directly, we have prepared a revised draft of the text of the ABCP-related provisions of the Proposed Regulations, and have attached a marked (to show all our proposed technical revisions) version of such revised draft as Exhibit B hereto. We believe the revisions would address the concerns noted above, but still promote the policy goal of encouraging sound underwriting for the assets financed through ABCP conduits.

Unique Features of ABCP Conduits; Investors Rely on Credit of Support Providers and Quality of Program

ABCP is unique and functions differently from other securitization products. In most securitization transactions, the quality and performance of the assets financed directly translates to the quality of the securities issued by the securitization issuer. If the financed assets perform well, the securities will perform well; if the assets perform poorly, the performance of the securities will suffer. However, ABCP conduits are designed to issue commercial paper that is supported by credit and liquidity facilities provided by a regulated bank or other financial institution. In fact, an overwhelming majority of ABCP conduits are supported by letters of credit, revolving credit commitments and other support facilities from their sponsors that absorb credit losses on the assets financed by ABCP conduits before the ABCP investors absorb any losses. We refer to these types of credit enhancement as Program Support Facilities. ABCP conduit sponsors undertake substantial diligence and care in underwriting customer transactions in determining whether to provide those Program Support Facilities. Accordingly, ABCP investors do not primarily base their investment decisions on the credit quality of the assets that collateralize transactions in the conduits. ABCP investors' investment decisions include an evaluation of (i) the creditworthiness of the financial institutions that provide liquidity and credit support to the conduit issuer of the ABCP, (ii) the circumstances under which liquidity and credit support facilities may be drawn, (iii) the circumstances in which the conduit may be prohibited from issuing ABCP – in which case the asset performance risk shifts to the liquidity and credit support providers who are required to repay the maturing ABCP, and (iv) the experience and operational capability of the sponsor of the ABCP conduit. Most of these protections are not present in various types of securitized products.

Our members, both issuers and investors, believe that the purposes of the risk retention provisions of the Dodd-Frank Act would not be served by imposing additional risk retention obligations on sponsors that already provide for Program Support Facilities or on the customers of the ABCP conduits they sponsor. Sponsors of these ABCP conduits already assume or provide for the assumption of the risks of assets financed by ABCP conduits well in excess of 5% of the amount of those assets. In particular, no case has been made that incentives were not well-aligned between and among issuers of and investors in ABCP through the recent financial crisis. We are not aware of any losses by holders of ABCP that benefitted from 100% liquidity support and from Program Support Facilities of the types we suggest as permitted forms of risk retention, even in the worst U.S. financial crisis since the Great Depression. If the Proposed Regulations are finalized into rules as currently written, without accommodating the technical revisions reflected in Exhibit B hereto, appreciable reductions in ABCP lending volumes would result, ultimately causing the further deterioration of the availability of credit to American businesses and ultimately American consumers.

In conclusion, as we have emphasized in this section of the letter, for the past 30 years, ABCP has played an important role in the financing needs of many businesses. Over those years, the ABCP market has developed practices that align very well the interests of the ABCP conduits, their sponsors, the originator-sellers served and the investors. The ABCP market has performed very well throughout the financial crisis and investors, to our knowledge, have suffered no losses. We fully support risk retention for the ABCP market, but, as described above, we believe that the provisions in the Proposed Regulations will, without the modifications we suggest, unnecessarily impede this well-functioning and valuable financing tool.

ii. Limited Expansion of Horizontal Risk Retention

The commentary to the Proposed Regulations states that ABCP conduit sponsors may satisfy risk retention through one of the other non-ABCP-specific risk retention options. Program Support Facilities traditionally provided for by the sponsors of ABCP conduits, however, are not a permitted form of horizontal risk retention. We believe that this portion of the Proposed Regulations would benefit from the revisions to the horizontal risk retention provisions reflected in Exhibit B hereto. Because of the substantial support provided by these facilities and the reliance that ABCP investors place on this support and the substantial economic risk taken by the ABCP sponsor through its provision of such support, we believe a limited provision to allow a sponsor-provided Program Support Facility meeting the requirements set forth in our suggested revisions to the Proposed Regulations that absorbs at least 5% of credit losses before the ABCP holders absorb any such losses (e.g., through a subordinated letter of credit or otherwise) should be specifically identified in the final risk retention rule as an adequate form of risk retention.

Our proposed revisions to the rule would include Program Support Facilities as a form of permissible horizontal risk retention for ABCP conduits and the assets they fund. In addition to requiring that such facilities absorb 5% of credit losses that ABCP holders would otherwise incur, our proposal would further require that the program support provider be a regulated provider that is the ABCP conduit sponsor or a regulated entity that is an affiliate of the sponsor[73]; that one or more regulated providers provide 100% liquidity support to the relevant ABCP conduit; and that the program support provider adhere to the anti-hedging provisions set forth in the Proposed Regulations.[74]

Our proposal would also limit Program Support Facilities to irrevocable and unconditional letters of credit and other similar unconditional credit facilities. The fact that these facilities are not initially funded does not detract from the fact that they constitute risk retention. Section 941 of Dodd-Frank requires a securitizer to retain an economic interest in the credit risk of a securitized asset and the provision of a Program Support Facility certainly constitutes such an economic interest. The institutions providing these facilities have credit exposure in the form of contractual commitments to fund when drawn to pay ABCP. The interests of these institutions are therefore fully aligned with the investors in ABCP and as discussed elsewhere herein they have every incentive to assure that the transactions financed by the ABCP conduits they sponsor are well underwritten. Unlike investors in other securitization products, ABCP investors specifically underwrite and depend upon the ability of these support facilities to repay on a timely basis the ABCP they invest in. We also note that in recognition of the risks absorbed by these facilities when they are provided by banks, the full amount of a bank's exposure thereunder is taken into account in calculating the bank's required regulatory capital.

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[73] We have proposed revisions of the definition of the term sponsor under the Proposed Regulations and added a proposed definition of "eligible program support provider" to address certain technical issues and that would result, in our view, in the proper entity providing permitted Program Support Facilities to the relevant ABCP conduit. With respect to many ABCP conduits commonly thought of as "bank-sponsored," an affiliate of the bank providing the Program Support Facility may act as the administrator or structure customer transactions. We propose that the Program Support Facility may be provided by the bank even if such an affiliate, rather than the bank, is deemed to be the "sponsor" of the ABCP conduit for purposes of the risk retention rules. In the case of conduits that are not administered by a bank or affiliate of a bank, one or more regulated providers (as we define such term in our proposed revisions) may refer transactions to such ABCP conduits and provide a proportionate Program Support Facility. For such ABCP conduits, the purposes of the risk retention rules would be fulfilled, in our view, by making such banks collectively the "sponsors" of such ABCP conduits rather than the non-bank administrator in the limited context of the horizontal risk retention requirement.

[74] Some ABCP conduits have third party equity investors that absorb "first losses" that would otherwise be absorbed by these ABCP conduits, their ABCP investors, their liquidity providers, and their program support providers. Such equity investments constitute a relatively small percentage of the assets and liabilities of these ABCP conduits. Our proposed revisions would permit these equity investments to continue for ABCP conduits the sponsors of which would seek to avail themselves of our proposed Program Support Facility risk retention option. The percentage of such equity investments, however, would be limited to 1% of the outstanding face amount of ABCP of the relevant ABCP conduit and the required percentage of credit support to be provided pursuant to the related Program Support Facility would not be reduced by the percentage amount of any such equity investment.

Additionally, unfunded Program Support Facilities of the type we propose be eligible to satisfy risk retention requirements for ABCP conduit sponsors may be used by such sponsors to satisfy risk retention requirements under the Committee of European Bank Supervisors guidelines to Article 122A of the Capital Directive of the European Union, which became effective for new securitization transactions on January 1, 2011. It is our understanding that Article 122A applies to US-based ABCP conduits that sell their ABCP to European financial institutions covered by the Capital Directive or that are otherwise sponsored by or receive credit or liquidity support from such financial institutions. Failure to permit Program Support Facilities to qualify as permissible risk retention under the final US regulations will therefore force such sponsors to assure compliance with two sets of substantively different risk retention rules. Such compliance may prove burdensome and is, in our view, not offset by any meaningful additional protection for securitization market participants.

We are unaware of any incidents of non-payment by regulated providers (as defined in our suggested proposed revisions to the Proposed Regulation) when called upon to fund maturing ABCP in accordance with their contractual requirements to do so under these types of Program Support Facilities. The irrevocable and unconditional nature of these Program Support Facilities requires funding of maturing ABCP under all circumstances.

It is important to contrast this consistent performance with any incidents of disputable payments by counterparties in other types of transactions. These disputable payment incidents can be summarized in the following categories:

- Breaches of Representations and Warranties by Asset Sellers
- Canadian market ABCP – pre 2008
- Disputable payments by mono-line bond insurers
- Disputable by primary mortgage insurers

Obligations of providers under Program Support Facilities are in stark contrast to the obligations that an asset seller may have to repurchase assets transferred in a securitization due to a breach of representations or warranties. Such repurchase obligations may be subject to documentary requirements or to defenses and factual disputes as to whether a representation has been breached. Instances of failure to honor repurchase obligations have been identified by some investors as adding to losses of holders of mortgage-backed securities in certain segments of the securitization market. Providers of Program Support Facilities cannot invoke any such defenses to avoid their obligations under these facilities.

Prior to 2008, Canadian market asset-backed commercial paper (which was denominated in $CDN and only sold to Canadian investors) was supported by liquidity support of at least 100% from banks. However, most Canadian ABCP issuers used liquidity facilities with general market disruption language. The general market disruption language was drafted to state that the support providers only had to provide funding if it could be demonstrated that there was a "general market disruption."[75] During the first wave of short-term market disruption in the summer of 2007 some Canadian asset-backed commercial paper issuers were able to continue

[75] These liquidity contracts were drafted with this language as written. General market disruption was not a defined term with a standard for its determination.

issuing asset-backed commercial paper. Because that was the case, providers of liquidity support to other Canadian asset-backed commercial paper programs that could not reissue their asset-backed commercial paper claimed that a general market disruption did not occur and therefore did not provide funding under their liquidity support facilities. This led to the defaulting of several asset-backed commercial paper programs in the Canadian market. Liquidity and credit facilities that support ABCP do not contain such general market disruption language. Most relevant to our proposal, there was no failure in Canada to fund Program Support Facilities as we propose to define that term.

Monoline bond insurers have never represented themselves as having sufficient resources to repay commercial paper or other short-term maturing debt. The monoline payment promise has always been to pay current interest to insured investors and principal only at a legal final date – generally in the distant future; presumably after all relevant collateral to their insured obligations had been collected or written off. Monoline insurers incurred significant losses and had to write off significant capital due to poor performing collateral. As a result of this, some insurers had to marshal their remaining resources and either offer settlements to insureds or commute policies written. As a result of these factors, we are not proposing that insurance policies of the type written by monoline bond insurers be included as Program Support Facilities.

As is the case with monoline bond insurers, private mortgage insurance (PMI) providers have never been credit or liquidity providers to ABCP conduits. PMI providers operate differently than monoline bond insurers in that they can contest losses claimed by insureds for any number of reasons (similar to a broad line casualty insurance provider). PMI providers were affected by recent residential real estate valuation declines and have been noted to decline payment due to non-satisfaction of requirements such as representation and warranty breaches by mortgage originators. Entities providing liquidity and credit facilities to ABCP conduits have no similar contractual ability to contest their funding obligations under these facilities. PMI and similar forms of insurance would not be covered by our proposed definition of Program Support Facilities.

We understand that concern has also been raised that Program Support Facilities are not first loss protections and, therefore, cannot be used to meet risk retention requirements. We agree that the first loss protection in an individual ABCP conduit <u>transaction</u> is the overcollateralization or other protection provided by the originator-seller. The conservative nature of this first loss protection has historically protected banks from virtually all losses in ABCP conduit transactions. In turn, bank liquidity commitments that fund all outstanding ABCP so long as such first loss protection has not been exhausted have historically protected ABCP holders against any loss.

We appreciate that Section 9 of the Proposed Regulations recognizes this well-established protection and permits ABCP conduit sponsors to rely on the underlying originator-seller's first loss risk retention. From the perspective of an ABCP investor, however, an additional "first loss" protection is the Program Support Facility. The first loss protection provided by the customer is intended to protect the Program Support Facility because it would suffer the "first loss" if the customer provided protection failed to support full liquidity funding.

Given this fact, we believe a Program Support Facility should be an acceptable *alternative* form of risk retention for ABCP conduit programs.[76]

iii. Technical Corrections to the "Eligible ABCP Conduit" Alternative

If the risk retention rules are ultimately applied to ABCP conduit sponsors, we believe that the special option provided for such sponsors in the Proposed Regulations is an important alternative for sponsors that cannot themselves provide Program Support Facilities to satisfy any such risk retention requirement. We support the Joint Regulators' attempt to define the parameters for an eligible ABCP conduit and agree that only conduits meeting appropriate special requirements should have the benefit of the originator-seller risk retention option set forth in the Proposed Regulations. We believe that most of the special eligibility requirements set forth in the Proposed Regulations are appropriate and effectively promote the goal of protecting investors in these vehicles who depend on the quality of the program and its sponsor. These include requirements that the sponsor of the ABCP conduit approve each originator-seller financing assets in the conduit; establish asset criteria; approve all investments; monitor the assets and the borrowers; and ensure compliance with the conduits' credit and investment policies. The structural requirements that the issuing vehicle be isolated from the risk of bankruptcy of the originator-sellers and that the issuer have the benefit of 100% liquidity coverage from a regulated liquidity provider are also sound and consistent with current market practice.

We believe, however, that some of the requirements of the Proposed Regulations are technically unworkable and inconsistent with established market practice, and that imposing these requirements would reduce financing options available to U.S. companies without furthering the purposes of the Proposed Regulations. In particular, if an ABCP conduit sponsor seeks to rely on originator-seller risk retention in order to comply with the Proposed Regulations, the only permitted form of such risk retention is the originator-seller's retention of a horizontal residual interest. As described above, ABCP conduits currently fund a wide variety of assets. While many of those transactions are structured with originator-seller horizontal risk retention, many other transactions are structured in a manner that would satisfy one of the other general risk retention methods described in the Proposed Regulations. We see no policy reason why those risk retention methods should not be available for transactions that are funded with ABCP. As stated elsewhere in this letter, sponsors of ABCP conduits and their support providers have substantial incentives to assure that the amount and type of risk retention for transactions financed by these conduits are significant.

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[76] We note that the Committee of European Banking Supervisors (CEBS) explicitly recognized this distinction and determined that undrawn Program Support Facilities of the type described in this letter were nonetheless an appropriate form of such retention. See footnote 13 to Paragraph 57 of the *31 December 2010 CEBS Guidelines to Article 122a of the Capital Requirements Directive of the European Union,* which provides in full as follows:

> However, it is recognised that in certain circumstances (for instance, ABCP conduits) it [the LC] may constitute a second-loss exposure at the securitisation program-wide level, as a first-loss exposure at the transaction-specific level underlying this program-wide level is assumed by the originators or original lenders of the underlying exposures.

Conditioning an ABCP conduit sponsor's compliance with risk retention on whether each originator-seller complies in practice with risk retention requirements and has not violated the hedging prohibition of the proposed rule is not appropriate. For example, no sponsor could prevent or even know with certainty whether an originator-seller has violated the hedging prohibition. Instead, we propose that the sponsor cause the ABCP conduit to enter into an agreement with each originator-seller that requires such compliance.

For similar reasons, the requirement that a sponsor who relies on an originator-seller's risk retention monitor and ensure the seller's compliance with the risk retention rules, as currently written, would be impossible to satisfy. Instead, we propose that the Proposed Regulations permit ABCP conduit sponsors who rely on originator-seller risk retention to satisfy their compliance monitoring requirements if the transaction documents contain representations and warranties and covenants obligating the originator-seller to comply with risk retention requirements and to report any non-compliance to the sponsor. (See technical modifications to Section 9(c), set forth in Exhibit B hereto.)

Our suggested revisions to Section __.5(b) are needed in order to permit non-U.S. bank sponsors (which are typically not FDIC-insured institutions) to satisfy the horizontal cash reserve account approach by making available deposits that otherwise satisfy the conditions of Section __.5(b). Deposits with entities that are regulated providers, as contemplated by the Proposed Regulations, are considered to be cash-equivalents under Rule 2a-7 of the Investment Company Act of 1940, and so should satisfy the goals of the Proposed Regulations.

There are also a number of other technical requirements of the Proposed Regulations that could restrict ABCP conduits from investing in transactions that would otherwise be acceptable investments for eligible ABCP conduits under the Proposed Regulations. We do not believe that the purposes of the Proposed Regulations are served by these requirements. Furthermore, these requirements are contrary to industry practices and would effectively disqualify most, if not all, well-functioning ABCP conduits. Our proposed modifications to the rule attempt to address these technical elements. The problematic provisions and cross-references to our proposed modifications are as follows:

a. The requirement that the interests of an intermediate SPV selling assets to a conduit consist only of retained interests and interests sold to an ABCP conduit does not take into account that in many cases an intermediate SPV may also sell interests to other third parties. As an illustration, an ABCP conduit might purchase a security issued by a credit card master trust that issues different series of securities to various investors. In addition, ABCP conduits often participate in other multi-lender transactions, in which an intermediate SPV sells interests to ABCP conduits and ABCP conduit sponsors, as well as to non-ABCP conduit sponsoring banks, to achieve, among other things, diversification of funding sources and enhanced flexibility. So long as ABCP conduits negotiate the terms of their purchases in a manner consistent with their own underwriting criteria (taking into account the requirements of the final risk retention rules), we see no reason why participation by ABCP conduits in transactions funded by or with other third parties (be it bank or term market investors) should prevent ABCP conduits from being considered "eligible ABCP conduits." Our proposed technical modifications set forth in

Exhibit C hereto would permit sales to other parties (see deletions in (2) under the definition of Eligible ABCP conduit).

b. The requirement that the interests issued by the intermediate SPV be collateralized solely by assets from a single originator would preclude investment in an intermediate SPV backed by assets originated by more than one affiliated originator. This requirement would preclude multiple originators from financing assets through a single intermediate SPV (a practice that is currently fairly common); we see no useful policy goal in so limiting the investments that eligible conduits can make.[77] Our proposed technical modifications set forth in Exhibit C hereto modify this requirement to permit multiple affiliated originators (see (2) under definition of Eligible ABCP conduit).

c. The Proposed Regulations, as written, would appear to require an originator-seller to directly hold a horizontal interest. Frequently, ABCP conduit transactions are structured so that originator-sellers sell their entire interest in the securitized receivables to an intermediate SPV in exchange for cash consideration and an equity interest in the SPV. The SPV, in turn, would hold the retained interest. For so long as the originator-seller holds its equity interest in the SPV, it is exposed to the risk of the assets. Such indirect risk retention should satisfy the policy goals of the regulation and be permitted in the final rule. (See our technical modifications to Section 9(a)(1)(i) set forth in Exhibit B hereto.)

d. As drafted, the Proposed Regulations would require originator-sellers to sell the assets funded by the ABCP conduit to an intermediate SPV. Occasionally, a customer-formed SPV will directly fund the assets (frequently with an equity contribution to the SPV by the owner of the SPV, which also acts as collateral manager or servicer).[78] Also, the SPV may occasionally acquire the assets directly in connection with the sale of the assets of a business or other transaction. For so long as the entity owning the equity interest in the SPV directly or indirectly retains the appropriate risk, these transactions should qualify to be funded in an Eligible ABCP conduit. Also, originator-sellers may enter into transactions directly with an ABCP conduit without the use of an intermediate SPV. So long as the originator-seller retains the appropriate risk, these transactions should also qualify to be funded by an Eligible ABCP conduit.[79] (See our proposed technical modifications to the definition of originator-seller, set forth in Exhibit C hereto, which address these concerns.)

[77] Trade receivables financed by ABCP conduits in a single transaction, for example, are often originated by multiple affiliated originator-sellers. Structuring transactions in this manner is usually the most efficient form of this type of financing for both the securitizers and the ABCP conduit.

[78] For example, transactions pursuant to which ABCP conduits fund corporate loans are often structured such that ABCP conduit funding is provided directly to a special purpose vehicle that directly funds the loans and is managed by an affiliated entity. The owner of such a special purpose vehicle in these transactions makes an equity contribution to the special purpose vehicle that would provide the funds necessary to make the portion of such loans that is not covered by ABCP conduit funding of the transaction and that should constitute risk retention by such originator-seller.

[79] Transactions with customers of ABCP conduits, for example, have been structured as asset purchases directly with originator-sellers under repurchase agreements. The originator-seller in these transactions would retain 100% of the risk of the funded assets through its repurchase obligation.

e. Often in cross-border transactions, an ABCP conduit sponsor will create a separate entity that it also sponsors to enter into a customer transaction for legal reasons. The U.S. ABCP conduit will lend the proceeds of the ABCP to this entity, which in turn will finance the seller's assets. In these structures, liquidity facilities may be provided to this entity rather than to the ABCP conduit. Such related entities should be treated collectively as an ABCP conduit for purposes of risk retention. (See our proposed definition of ABCP conduit, set forth in Exhibit C hereto.)

f. The requirement that all securitization transactions in an ABCP conduit meet the risk retention requirements in order for the conduit to qualify for the ABCP risk retention option would place conduits in an untenable position with respect to transactions entered into before the effective date of the Proposed Regulations that do not comply with the requirements of the Proposed Regulations. Sponsors would have no contractual right to cause modifications of such non-complying transactions. We propose that the transaction qualification criteria apply only to transactions entered into after the effective date of the Proposed Regulations and post-effective date renewals and increases of existing transactions. (See our proposed technical modifications to Section 9(a)(1) and our proposed new definition of "pre-existing securitization transactions," set forth in Exhibit B hereto.)

g. Permissible support providers and liquidity providers should include central governments and agencies of central governments, and we have included such entities in our proposed definition of regulated provider, set forth in Exhibit C hereto.[80]

h. Finally, we believe that ABCP conduits that issue ABCP with maturities of up to 397 days should have the benefit of the ABCP risk retention option. ABCP of such tenor is regarded as an appropriate short-term investment eligible for purchase by money markets under Rule 2(a)(7) under the Investment Company Act of 1940. It should also be clarified in the final rule that ABCP consists only of promissory notes issued by an issuing entity as that term is defined in the Proposed Regulations. (See our proposed modifications to the definition of "ABCP" set forth in Exhibit C hereto.)

iv. Disclosure

Consistent with the disclosure requirements for other forms of sponsor-provided or arranged risk retention, sponsors using Program Support Facilities as a permissible form of risk retention expect to disclose the pertinent details of the entities providing such facilities and of the form, amount and nature of such facilities to ABCP investors and potential investors that would rely on such retention. Such disclosure should be in the form the proposed risk retention rule requires for liquidity facilities.

For those ABCP conduits that would rely upon the special originator-seller risk retention option provided for in the Proposed Regulations, we believe that disclosure of the names of those

[80] For example, Straight-A Funding, LLC is an ABCP conduit for which liquidity support is provided by the Federal Financing Bank and credit support is provided by the U.S. Department of Education.

originator-sellers as would be required by the Proposed Regulations is unnecessary, and would be counterproductive. Our investor members do not require these names (and some investors do not want these names) and many sellers into ABCP conduits do not want their names disclosed to investors. Imposing this disclosure requirement would cause most ABCP conduit sponsors not to choose the originator-seller risk retention option as they would lose both customers and investors by making this choice.

ABCP investors do not have credit recourse to originator-sellers of financed assets, and so, appropriately, do not make their investment decisions based on the names of the originator-sellers, but on the creditworthiness and capability of the sponsor and the ABCP sponsor's analysis of the credit quality of the financed assets. Referencing the names of the originator-sellers may in fact be misleading, or at least inappropriate, as investors may inadvertently be led to believe that they have some credit recourse to such originator-sellers. We also believe that disclosure of this information to investors would not further the goals of the Proposed Regulations. We understand from our discussions with some of you that the goal of the joint regulators in proposing these disclosure requirements was to allow for the monitoring by the joint regulators of originator-sellers with risk retention requirements. We believe such goal is accomplished by our proposal that disclosure of such information be made on a confidential basis to the relevant regulator upon its request rather than to investors.

Because ABCP is continuously offered and generally matures within a very short time frame, ABCP investors are continuously evaluating the merits of one ABCP program versus another and versus other alternative investments. Components of this evaluation are the relative experience of the program's sponsor and the relative strength of the program and of its liquidity and credit support providers. To assess this, ABCP investors require continuous and ongoing information about the liquidity and credit support providers, which is available to investors through current public filings made by such parties and news services that continuously report on the business affairs and credit quality of these parties.

The market has been very efficient in demanding and eliciting information regarding the performance of the ABCP programs and their underlying assets. Information provided periodically to investors has included: (1) the program purchase limits, the aggregate amount of outstanding ABCP, the aggregate amount of commitments, and the number of asset pools; (2) information on program assets by asset type, industry and financed asset purchase limits and default statistics; (3) any program-wide events of default and draws on program support facilities; and (4) the names of all liquidity and credit support providers. Accordingly, because the information provided to ABCP investors reflects the unique characteristics of the related ABCP program, and have been developed by ABCP conduits (or their sponsors) over time so as to be consistent with ABCP investor demands, we (including, without exception, our investor members) believe such information reporting is appropriate and sufficient for ABCP programs. Accordingly, our proposed modifications to the Proposed Regulations would require that an ABCP sponsor disclose to each investor before or contemporaneously with the first sale of ABCP to that investor and at least monthly thereafter (i) for ABCP conduit sponsors relying on originator-seller risk retention, the industry category (but not the name) of each originator-seller that will retain an economic interest in the securitization transaction under one of the permissible risk retention categories, including a description of the form, amount and nature of such interest and disclosure of any failure to comply and the status thereof; (ii) for ABCP conduit sponsors relying on a Program Support Facility to satisfy the requirements of the Proposed Regulations, a description of the material terms of such support and notice of any failure to fund; and (iii) in all cases, the name and form of organization of each liquidity support provider and the form, amount and nature of such liquidity coverage and notice of any failure to fund.

In connection with proposed changes to Regulation AB, the ASF ABCP Conduit Subforum, ASF ABCP Financial Intermediary Subforum and ASF ABCP Investor Subcommittee recently worked together to develop a detailed comment letter[81] proposing uniform information reporting standards for ABCP conduits. Our members continue to support such proposed reporting requirements, which do not require the disclosure of originator-seller names, as would be required by the Proposed Regulations.

We fully appreciate the need for disclosure in private transactions that enables investors to make informed decisions about the investments they are considering for purchase and informed analyses about the investments they own. We are confident that sponsors of ABCP conduits currently provide investors and potential investors in ABCP the information that such investors require and deem relevant and that disclosure to the relevant regulator of the information necessary to permit such regulators to monitor compliance by originator-sellers with risk retention requirements will accomplish your policy goals without unnecessary market disruption.

D. Credit and Charge Card ABS

i. Risk Retention for Credit and Charge Card ABS Generally[82]

a. Introduction

The alignment of economic interests has never been in question in credit and charge card ABS. Long before "skin in the game" became a topic of political debate, credit and charge card securitizers were holding seller's interests, recognized by the Joint Regulators in the proposal as an effective form of risk retention, and retaining other meaningful economic interests in their master trusts that have been extremely effective in aligning the interests of originators and securitizers with those of investors. In fact, the business models of credit and charge card securitizers are structured such that corporate profits are directly tied to the securitizer's interest in the residual amounts from the master trust, and only available to the business unit after covering payments and loss amounts allocated to investors and any related fees incurred by the revolving asset master trust (i.e., excess spread).

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[81] *See* ASF Comment Letter re ABCP under the SEC's proposed Regulation AB II, available at: http://www.americansecuritization.com/uploadedFiles/ASFRegABIIABCPCommentLetter8.2.10.pdf.

[82] We refer throughout this portion of our comment letter to "credit and charge card" securitizations, each of which employs a master trust issuance platform and involves the issuance of ABS backed by receivables that arise under revolving accounts (i.e., accounts whose balances fluctuate based upon ongoing extensions of credit). A revolving account may have terms that provide for a monthly payment of the full amount due (a charge card account) or a payment of less than the full amount due, where the balance carried forward is subject to finance charges (a credit card account). For the avoidance of doubt, we request that the regulations be revised to clarify that the term "revolving account" as used in those regulations includes both credit and charge card accounts.

The first securitization of credit card receivables was completed in 1987. The master trust structure was introduced shortly thereafter and, since that time, has been the primary source of financing for unsecured revolving consumer credit in the United States. Many banks securitize through master trust structures significant portions of their managed credit and charge card assets. Even during the stress of the recent financial crisis, credit and charge card ABS performance has been consistently strong.

To preserve securitization as a viable funding option for credit and charge card securitizers, and thereby increase the availability of affordable credit to consumers and businesses, it is critical that the proposed risk retention rules be appropriately revised to account for the nuanced and technical features of existing master trust structures. The risk retention rules should take into account the nature and characteristics of the assets, the securitization structures themselves and, perhaps most importantly, the manner in which securitizers have historically retained exposure to the credit risk of the assets they securitize.[83]

While we appreciate the Joint Regulators' stated intent to take these factors into account and recognition of the seller's interest as a critical and effective form of risk retention for revolving asset master trusts, the proposed regulations are too standardized in their requirements, and too limiting in their application, to provide workable risk retention options for credit and charge card securitization transactions. More specifically, neither the proposed seller's interest option nor the other proposed risk retention options are sufficiently tailored to account for the nuanced and technical features of the master trust structure.

Most importantly, we believe that the seller's interest option, which was intended to be consistent with existing industry practice, can be adjusted in a manner that preserves it as a workable risk retention option through the relatively discrete, but important, revisions we propose in this letter. However, other aspects of the proposed regulations have not been drafted with the features of a master trust structure in mind, and so will require more significant revisions if they are to become workable for credit and charge card securitization transactions. Specifically, we believe that (i) the horizontal risk retention option should be refined to align with the characteristics of subordinated classes in credit and charge card master trusts, (ii) credit and charge card securitizers should be permitted to combine different forms of risk retention, (iii) for all purposes under the risk retention regulation, an underlying credit or charge card master trust and a related issuance trust should be treated as a single issuing entity and a unitary issuance platform, and (iv) revolving asset master trusts should be exempt from the application of the premium capture cash reserve account requirements.

[83] Both the language and legislative history of Section 941 of Dodd-Frank indicate that Congress expects the Joint Regulators, in formulating these rules, to be mindful of these variables and to give due consideration to the findings and recommendations presented to Congress in certain risk retention studies and reports mandated by Section 941. *See*, e.g., 15 U.S.C. § 78o-11(c)(1)(E), (c)(2), (e); S. Rep. no. 111-76, at 130 (2010) ("The Committee believes that implementation of risk retention obligations should recognize the differences in securitization practices for various asset classes."). Section 941 of Dodd-Frank directed each of the Board of Governors of the Federal Reserve System and the Financial Services Oversight Council to study certain effects of the risk retention requirements and promptly report their findings to Congress. *See generally* Federal Reserve Study and FSOC Study.

Further, we believe that the proposed regulations should be sufficiently flexible to evolve to meet changing investor demands and to adapt to market innovations while continuing to ensure strong alignment of interests between sponsors and investors.

Failure to implement regulations that reflect current market practices could significantly increase the cost of capital to credit and charge card issuers, thereby restricting access to, and increasing the cost of, credit to consumers and businesses. We urge the Joint Regulators to adopt an approach to the seller's interest option and other aspects of the proposed regulations for this asset class that better reflects the manner in which credit and charge card securitizers have historically retained exposure to the credit risk of the receivables in the master trust and, therefore, that does not limit the ability of credit and charge card securitizers to access this market.

b. Existing Risk Retention Mechanisms in Credit and Charge Card Securitization

In a typical credit or charge card master trust, a single pool of revolving assets supports all outstanding ABS issued by the master trust from time to time. The originator, which is typically also the sponsor and the servicer (or an affiliate of these entities), initially designates credit or charge card accounts within its managed portfolio and transfers the current and future receivables and proceeds relating to those accounts to the master trust. From time to time, the originator may designate additional credit or charge card accounts and transfer the existing and future receivables and proceeds relating to those additional accounts to the master trust, typically in contemplation of future issuances of ABS or to maintain minimum pool balances as required by the governing program documents.[84] All accounts designated to the master trust must satisfy the eligibility criteria specified in the governing program documents.

Ongoing Account Ownership and Management: Notably, while the receivables arising in the accounts are transferred to the master trust, the accounts themselves are not and instead continue to be owned and managed by the originator. As the account owner, the originator continues to maintain its relationship with the cardholders and, as revolving accounts, the originator continues to make credit-granting and underwriting decisions in connection with ongoing extensions of credit on the accounts in accordance with the accountholder agreements. In addition, servicing of the accounts is almost always performed by the originator or one of its affiliates.[85] Ownership of the accounts, coupled with these ongoing relationships with the cardholders throughout the life of the accounts, evidence the ongoing interest of the originator in the economic performance of the accounts and receivables, which significantly mitigates the risk that the interests of the originator and investors could become misaligned.

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[84] In some cases, accounts designated to the master trust may subsequently be re-designated as removed accounts and the receivables and proceeds relating to those removed accounts may be reconveyed to the securitizer, which could arise in connection with charge-offs and account terminations or for other business reasons.

[85] We recognize that the Joint Regulators have expressed some concern in the context of other asset classes about a servicer's ability to service the accounts in a manner that would advance the interests of the sponsor or first-loss holder over those of investors. However, given the seller's vertical interest in all assets in the pool, its first-loss residual interest in excess spread, and its other retained economic interests (each of which is discussed in greater detail below), we are not aware of any circumstance in which the servicing by the sponsor or an affiliate would advance the interests of the sponsor at the expense of the interests of investors.

Seller's Interest: The seller's interest represents a vertical slice of the risks and rewards of all the receivables in the master trust and is a quintessential form of risk retention that operates to precisely align the economic interests of securitizers with those of investors. The receivables and other assets held by the master trust at any time are allocated between the investor interests and the seller's interest. The investor interests equal the aggregate interest of each series of ABS issued by the master trust from time to time and represent a proportional share in the assets of the master trust. The securitizer is required by the governing program documents to maintain a minimum pool balance in excess of the aggregate investor interests. The seller's interest is equal to the amount of this excess and, like the investor interest, represents a proportional share in the assets of the master trust. The seller's interest is issued at the time of the original transfer of receivables to the master trust, and although it fluctuates in size over time as new receivables are added, others are paid, and new series are issued or mature, there is no new issuance of the seller's interest in connection with the issuance to investors of any series, class or tranche of securities.

Finance charge collections, principal collections and loss amounts associated with charged-off receivables are initially allocated between the aggregate investor interests and the seller's interest.[86] While the allocation of collections and loss amounts between the investor interests and the seller's interest is pro rata during revolving periods, during other periods, including scheduled principal accumulation or scheduled principal amortization periods, the program documents for virtually all credit and charge card securitization transactions fix the allocation of principal collections to the relevant investor interests at the higher levels applicable before principal payments begin.[87] In some credit and charge card securitization transactions, the program documents may also subordinate collections allocable to the seller's interest to the investor interests.[88] In each of these cases, these mechanisms provide for the orderly and timely payment of the investor interests, and the seller's interest continues to represent an undivided interest in the entire pool of receivables that exposes the holder of the seller's interest to a proportional or greater share of the credit risk of those receivables as compared with the share borne by the aggregate investor interests.

[86] The collections and loss amounts allocated to the aggregate investor interests are then further allocated to the investor interests of each series to cover payments and loss amounts in accordance with the priority of payments waterfall established by the transaction documents for that series. In some credit or charge card master trusts, collections and loss amounts allocated to the investor interests of a series are then further allocated to the investor interests of each class of such series and then applied to each such class in accordance with the priority of payments waterfall established by the transaction documents for that series.

[87] By comparison, the allocation of losses between the investor interests and the seller's interest remains pro rata at all times. This fixing of allocations of collections to the investor interests operates as a form of subordination of the seller's interest, by deferring a full allocation of collections to the seller's interest when a series or class of investor interests is in a scheduled principal accumulation or scheduled principal amortization period. Because this mechanism merely defers (rather than reduces) the allocation of collections to the seller's interest, it represents a subordination in the timing of payments to the seller's interest rather than a credit subordination of the seller's interest.

[88] For example, some master trusts may use collections allocable to the seller's interest to cover shortfalls, if any, remaining after the application of collections allocable to the investor interests. This mechanism represents a credit subordination of the seller's interest to the investor interests.

First-Loss Residual Interest in Excess Spread and Certain Trust Account Deposits: In addition to its allocable share of collections and loss amounts, the seller holds a residual interest in the excess spread of each series. Excess spread for any series is the remaining finance charge collections allocated to the investor interests of that series available each month after covering payments and loss amounts allocated to those investor interests and any related servicing or other fees incurred by the master trust, and thus is only available to the seller if the assets perform well enough to cover all such payments, losses and fees. The seller also holds a residual interest in funds on deposit in certain trust accounts supporting the investor interests of each series, to the extent of any surpluses available each month after covering payments and loss amounts allocated to those investor interests, as well as any amounts remaining on deposit in the trust accounts upon payment in full of the series or class of investor interests to which the trust accounts relate.[89] These finance charge collections and trust account deposits are the first sources to cover loss amounts allocated to the investor interests and, as such, serve as credit support to the investor interests. As the contingent recipient of these cash flows and deposited funds, the seller has considerable incentives to optimize excess spread by establishing a level of portfolio yield commensurate with the level of credit exposure, which directly aligns with the interests of investors.

All of these features of credit and charge card securitization platforms represent extremely significant ongoing interests in the economic performance of the accounts and receivables and are, therefore, highly effective in aligning the interests of securitizers with those of investors. The consistent performance of credit and charge card ABS, particularly during the recent credit crisis, evidences the effectiveness of the risk retention mechanisms already imbedded in credit and charge card securitization platforms.

c. Linked and Delinked Issuance Structures

In broad terms, there are two principal issuance structures in use by credit and charge card master trusts in the market today: "linked" and "delinked" structures. In the linked issuance structure, senior securities and subordinated securities of the same series are issued in classes at the same time. In the delinked issuance structure, senior securities and subordinated securities of the same series are issued in classes at different times. Securities within any senior or subordinated class are issued in discrete "tranches." Each tranche within a class may be issued at different times and on different terms (e.g., with different scheduled maturities and coupons). Each tranche of the same class of securities outstanding at any time enjoys the same rights, privileges and priorities as each other tranche of the same class of securities.[90]

In a linked issuance structure, therefore, the capital structure for a series of ABS is typically established and complete at the time that series is issued. By comparison, in a delinked

[89] These trust accounts could be cash collateral, reserve, spread or similar accounts that serve as additional resources from which to cover payments and loss amounts allocated to those investor interests. Such trust accounts may be funded from proceeds of the transaction at closing, from collections on the trust assets in excess of those necessary to make current payments on the ABS interests, or from both such sources.

[90] Often a delinked structure is established by placing a master trust "collateral certificate" into a second trust that issues the delinked securities. See our discussion under "*Two-Tiered Credit and Charge Card ABS Issuance Platforms*" later in this section of our comment letter.

issuance structure, the capital structure for a series of ABS is dynamic, since the amount and terms of each tranche of such series of ABS outstanding from time to time change as new tranches of such series are issued and previously-issued tranches of such series amortize and mature.

Illustrations of the linked and delinked structures are included as Exhibit D to this letter.

ii. Seller's Interest

a. Definition of "Seller's Interest" and Related Risk Retention Provisions

Our credit and charge card securitizers strongly believe that the "seller's interest" as currently utilized in revolving asset master trust securitizations is the most critical form of risk retention for the market as it exists today and they strongly support the Joint Regulators' stated intent to define the seller's interest in a manner consistent with market practice. The seller's interest, in essence, represents a vertical slice of the risks and rewards of all the receivables in the master trust and is, therefore, a quintessential form of risk retention that operates to align the economic interests of securitizers with those of investors. The seller's interest also represents a fundamental structural component of every credit and charge card securitization program. It is, therefore, critical that the seller's interest mechanism embodied in the proposed regulations align with market practice. As proposed, however, the definition and related risk retention provisions are inconsistent with market practice in significant respects. Consequently, we are extremely concerned that, if adopted as proposed, this critical form of risk retention will be unavailable to virtually every existing credit and charge card master trust.

Restructuring existing master trusts to satisfy the proposed seller's interest mechanism would, for all practical purposes, be impossible. The fundamental legal and structural features of a master trust, including the nature and terms of the seller's interest, are established in the related program documents at the inception of the master trust. Thereafter, each ABS issuance forms a part of, and is subject to, the more complete structure of the master trust. As a result, efforts to restructure these master trusts to satisfy the proposed seller's interest mechanism would require extensive amendments to the program documents that would fundamentally redefine the legal and structural features of the master trust, including the terms and structure of the master trust's outstanding ABS. Such amendments might well be adverse to existing investors and would, therefore, require the consent of at least the majority of all investors. Obtaining the required investor consent would be extremely difficult or impossible when, in many cases, these master trusts have thousands of investors.

We request, therefore, that the definition and related risk retention provisions be revised in the following ways to align the seller's interest mechanism under the proposed regulations with market practice:

Pari Passu: Clause (2) of the proposed definition of "seller's interest" contemplates an ABS interest "…that is pari passu with all other ABS interests issued by the issuing entity with respect to the allocation of all payments and losses prior to an early amortization event (as defined in the transaction documents)." We have the following concerns with this standard:

1. As described above, collections and loss amounts are initially allocated between the seller's interest and the aggregate investor interests, rather than between the seller's interest and each other ABS interest. Accordingly, while the seller's interest represents a proportional share in the assets of the master trust, its allocable share of collections and losses should be expressed in relation to the investor interests in the aggregate.

2. As described above, the allocation of collections and loss amounts between the investor interests and the seller's interest is pro rata during revolving periods. However, virtually all credit and charge card securitization transactions fix the allocation of principal collections to the relevant investor interests during other periods, including scheduled principal accumulation or scheduled principal amortization periods, and in some cases may also subordinate collections allocable to the seller's interest to the investor interests. In each of these cases, the seller's interest continues to represent a proportional share in the assets of the master trust that exposes the holder of the seller's interest to a proportional *or greater* share of the credit risk of those assets relative to the share borne by the aggregate investor interests.

To address the concerns outlined above, we request that the proposed definition be revised to indicate that the seller's interest is an ABS interest "that represents a fractional undivided interest in the entire pool of receivables in the master trust, that adjusts for fluctuations in the outstanding principal balances of the receivables and that exposes the holder to a proportional or greater share of the credit risk of the receivables as compared with the share borne by the aggregate investor interests."

Measuring the Amount and Duration of the Required Risk Retention: Paragraph (a) of Section __.7 of the proposed regulations sets out the general requirement that "[a]t the closing of the securitization transaction and until all ABS interests in the issuing entity are paid in full, the sponsor retains a seller's interest of not less than five percent of the unpaid principal balance of all the assets owned or held by the issuing entity…." We have the following concerns with this standard:

1. As described above, the amount of the seller's interest at any time equals the portion of the unpaid principal balance of the receivables in excess of the unpaid principal amount of the aggregate investor interests. As a result, all other things being equal, an increase in the investor interests (e.g., in connection with the issuance of additional ABS) results in a corresponding decrease in the amount of the seller's interest and, conversely, a decrease in the investor interests (e.g., as a result of the payment of maturing ABS) results in a corresponding increase in the amount of the seller's interest. Given this inverse, binary relationship between the investor interests and the seller's interest, the program documents for some credit and charge card securitization platforms establish the minimum required seller's interest by reference to the unpaid principal balance of the outstanding investor interests, rather than the unpaid principal balance of the assets of the issuing entity. As a result, we request that the proposed regulations be revised to require that the 5% required seller's interest be measured in relation to the unpaid principal balance of the outstanding investor interests rather than the assets of the issuing entity.

2. In a revolving asset master trust, the seller's interest adjusts continuously due to fluctuations in the outstanding principal balances of the receivables in the master trust and changes in the number (and principal amount) of series or classes of investor interests outstanding from time to time. As a result, the proposed regulations should be revised to clarify that, at any specified time, the 5% required seller's interest is to be measured by reference to the assets and liabilities of the master trust as of a current point in time. As proposed, market participants are concerned that the regulation could be misinterpreted to require that the 5% required seller's interest be measured by reference to the assets and liabilities of the master trust as of a closing date and, thereafter, that the seller's interest must be maintained at that closing-date level regardless of subsequent fluctuations in the assets and liabilities of the master trust.

3. Regulatory efforts to align the interests of a securitizer with the interests of investors should be relevant only so long as ABS interests in the issuing entity are held by unaffiliated third parties, rather than until all ABS interests are paid in full. As a result, the proposed regulations should be revised to require that the securitizer retain the 5% required seller's interest only until, at the latest, such time as the ABS interests held by unaffiliated third parties are paid in full.

To address the concerns outlined above, we request that paragraph (a) of Section __.7 of the proposed regulations be revised to require that at the closing of the securitization transaction and until all ABS interests *held by unaffiliated third parties* are paid in full, the securitizer retain a seller's interest that, *as of each measurement date*, is in an amount not less than 5% *of the unpaid principal balance of all investor interests in the issuing entity outstanding at that time*.[91] For purposes of determining the amount of the seller's interest at any time, a "measurement date" means (i) at the closing of each securitization transaction, the most recent date as of which the seller's interest is to be measured in accordance with the related program documents that occurred on or prior to the related closing date and (ii) each subsequent date as of which the seller's interest is to be measured in accordance with the related program documents.

Funds on Deposit in Excess Funding Accounts: Under current market practice, if the amount of the seller's interest is reduced below a minimum level established under the program documents, the seller is required to designate additional, eligible credit or charge card accounts and transfer the receivables and proceeds relating to those accounts to the master trust in an amount that is sufficient to reinstate the seller's interest to equal or exceed such minimum level. If the seller is unable to or does not designate additional, eligible accounts, certain collections on the master trust assets that are to be paid to the holder of the seller's interest are instead deposited in an excess funding account (sometimes referred to as a special funding account) to maintain the seller's economic interest in the master trust. For purposes of determining the amount of risk retained by the securitizer under the seller's interest provisions of the proposed regulations, amounts in these excess funding or special funding accounts should be included when measuring the amount of the seller's interest.

[91] As discussed under *"Transition – Credit and Charge Card Revolving Asset Master Trusts"* later in this section of our comment letter, we believe that further guidance on transition and compliance with the final regulations is necessary in the case of revolving asset master trusts, and we make a request for certain further revisions to paragraph (a) of Section __.7 in the context of those discussions.

Disclosure: Paragraph (b) of Section __.7 of the proposed regulations sets out certain disclosure requirements that a sponsor must satisfy when utilizing the seller's interest risk retention option, including the amount of the seller's interest that the sponsor will retain at the closing of the securitization transaction and the amount that the sponsor is required to retain under the risk retention regulations. We have the following concerns with these disclosure requirements:

1. The Joint Regulators indicate that the term "asset-backed security" as defined in Section 3(a)(77) of the Exchange Act appears to include securities issued in transactions that are registered with the SEC under the Securities Act and securities that are issued in transactions that are exempt from such registration. Issuers operating in the public market are well acquainted with the prescribed disclosure framework that applies to SEC-registered transactions. The private market has, however, been the market in which new financing products have first developed because, in the absence of a prescribed disclosure framework, issuers and investors can tailor the characteristics of the securities, and the disclosure and information that the investors will require, before investors commit to buying those securities. Our credit and charge card securitizers are concerned, therefore, by the prospect of imposing mandated disclosure requirements in connection with transactions where disclosure practices have otherwise been market driven. Accordingly, we request that the disclosure requirements proposed in connection with the risk retention regulations be limited to those securities transactions that are required to be registered with the SEC under the Securities Act.[92]

2. As noted above, the amount of the seller's interest at any time equals the portion of the unpaid principal balance of the receivables in excess of the unpaid principal amount of the aggregate investor interests at such time. Because the principal balance of the receivables and the principal amount of the investor interests are in a continual state of flux, it is not possible for the sponsor to know or predict what the amount of the seller's interest will be at any future date, including any prospective closing date. We request, therefore, that paragraph (b)(1) of Section __.7 of the proposed regulations be revised to require that the sponsor disclose the amount of the seller's interest that the sponsor retained on the most recent measurement date occurring prior to the date such information was first provided to potential investors prior to sale of the related ABS.[93]

3. Paragraph (b)(3) of Section __.7 of the proposed regulations requires disclosure of "[t]he material assumptions and methodology used in determining the aggregate dollar amount of ABS interests issued by the issuing entity in the securitization transaction, including those pertaining to any estimated cash flows and the discount rate used." This disclosure appears to be relevant to the vertical and horizontal risk retention provisions because the dollar amount of the ABS interests issued by the issuing entity is relevant when calculating the baseline risk retention requirements under those provisions. In the case of

[92] As a general matter, we believe that any disclosure requirements proposed in connection with the risk retention regulations would be better addressed in the relevant body of disclosure regulations that govern such transactions (e.g., Regulation AB), instead of on an ad hoc or piecemeal basis outside that body of disclosure regulations.
[93] As used here, the term "measurement date" is used in the same manner as described under *"—Measuring the Amount and Duration of the Required Risk Retention"* above.

the seller's interest, on the other hand, the baseline risk retention requirement is proposed to be based on the unpaid principal balance of the master trust assets (or, assuming our comments above are given effect, based on the unpaid principal balance of the outstanding investor interests). We request, therefore, that Section __.7(b) of the proposed regulations be revised to delete paragraph (3).

b. Who Retains the Seller's Interest

While Section 15G of the Exchange Act generally provides that the Joint Regulators should apply risk retention requirements to a "securitizer" of ABS, which term includes both the depositor and sponsor for the ABS, the proposed regulations require that the seller's interest be retained by the sponsor. In cases where two or more entities are each sponsors for a single securitization transaction, the proposed regulations would require that one of the sponsors satisfy the risk retention requirements. The hedging, transfer and financing restrictions included in the proposed regulations would prohibit a sponsor from transferring any interest that it is required to retain under the rule to any person other than an affiliate whose financial statements are consolidated with those of the sponsor, referred to as a "consolidated affiliate."[94]

In many credit and charge card securitization transactions, the sponsor sells or transfers receivables, directly or indirectly, to an affiliated depositor that, in turn, transfers the receivables to the master trust. In these cases, the seller's interest is initially issued to, and held by, the depositor (in exchange for the receivables transferred by the depositor to the master trust), rather than by the sponsor. In some of these cases, the depositor is a direct or indirect wholly-owned subsidiary of the sponsor, but in other cases the depositor is an affiliate of the sponsor that is under common control with the sponsor by a direct or indirect common parent.[95] There are also credit and charge card securitization transactions in which two or more affiliated sponsors sell or transfer receivables to two or more affiliated depositors for a single master trust and each depositor, in turn, transfers its respective receivables to the master trust and holds a portion of the seller's interest.[96] For example, in some cases, the program documents may require the depositors to maintain an aggregate minimum seller's interest in excess of 5%, but neither depositor holds a portion of the seller's interest that, by itself, would equal or exceed the 5% threshold.

The proposed regulations are, therefore, inconsistent with long-standing market practice and the terms and structure of all credit and charge card securitization transactions involving a multi-step transfer of receivables to the master trust. To address these inconsistencies, we request that the regulations be revised to align the risk retention mechanisms under the proposed regulations with established market practice.

1. We request that the regulations be revised to permit the seller's interest to be held directly by the depositor initially (i.e., without requiring that the seller's interest first be held by

[94] References throughout the credit and charge card ABS section of our comment letter to a "consolidated affiliate" or to "consolidated affiliates" are intended to be references to such term as we request that it be defined, as indicated in this section of our comment letter.
[95] Illustrations of each of these arrangements are included in Exhibit E to this letter.
[96] An illustration of this type of arrangement is included in Exhibit F to this letter.

the sponsor with assignment to the depositor thereafter), so long as the depositor is a consolidated affiliate.

2. In cases where two or more affiliated entities are each depositors for a single master trust, we request that the regulations be revised to clarify that the risk retention requirements are satisfied so long as each depositor is a consolidated affiliate and the portions of the seller's interest held by each such depositor aggregate to meet or exceed the 5% threshold.

3. We request that the definition of the term "consolidated affiliate" be revised to clarify or provide that the term includes an entity (other than the issuing entity) that is under common control with the sponsor by a direct or indirect common parent (e.g., the sponsor and affiliated entity are "sister" or similar entities), where the financial statements of the sponsor and the affiliated entity are consolidated with those of the direct or indirect common parent. The proposed regulations indicate that the rule permits a transfer to one or more consolidated affiliates because the required risk exposure would remain within the consolidated organization and, therefore, would not reduce the organization's financial exposure to the credit risk of the securitized assets. We believe this rationale applies equally in a case where the required risk exposure is retained by one or more entities whose financial statements, together with those of the sponsor, are consolidated with those of a common parent, because the required risk exposure would remain within a consolidated organization whose consolidating entity – the sponsor's direct or indirect parent – both owns and controls the sponsor. The consolidating parent's ownership of the sponsor aligns the economic interests of the parent with those of the sponsor and enables the parent to control and direct the underwriting standards and risk management practices adopted and applied by the sponsor.

   To address our request, we believe that the definition of "consolidated affiliate" should be revised as follows: "*Consolidated affiliate* means, with respect to the sponsor, an entity (other than the issuing entity) whose assets and liabilities are included with those of the sponsor in the consolidated, combined, or other financial statements of a parent consolidated group or organization under applicable accounting standards."[97]

4. Finally, we request that the regulations be revised to clarify that the risk retention requirements are satisfied so long as the portions of the seller's interest held by the sponsor and its consolidated affiliates aggregate to meet or exceed the 5% threshold.

iii. Additional Forms of Risk Retention in Credit and Charge Card ABS

Our credit and charge card securitizers strongly believe that a range of risk retention options should be available for credit and charge card securitizations and are pleased that the proposed regulations outline a menu-of-options approach to risk retention. While it is critical that the seller's interest as currently utilized in revolving asset master trusts be a permissible form of risk retention, it should not be the exclusive form. To preserve the strong alignment of

[97] This proposed definition of "consolidated affiliate" is based on the definition of consolidated affiliate in FAS 166 with appropriate revisions to reflect the context of a securitization transaction.

interests between credit and charge card securitization sponsors and investors and access to credit for consumers and businesses, the risk retention requirements must be sufficiently flexible to reflect current market practices.

a. Combining Different Forms of Risk Retention

Credit and charge card securitizers also believe that they should be able to satisfy the risk retention requirement through a combination of the options available. The proposed "L-shaped" risk retention option, which combines equal amounts of vertical and horizontal risk retention, acknowledges the principle that different forms of risk retention can be combined to reach the 5% threshold. We see no reason why this principle should be applied in such a limited manner so long as, in the aggregate, the retained exposures aggregate to at least 5%.

At a minimum, credit and charge card securitizers should have an option comparable to the proposed L-shaped risk retention option that combines the seller's interest (which, as noted above, represents a vertical slice of the risks and rewards of all the receivables in the master trust) with horizontal risk retention. It seems incongruous that each of the seller's interest and horizontal risk retention can independently satisfy the risk retention requirement, but a combination of the two would not. In many cases, particularly in the current, distressed capital markets, a credit or charge card securitizer or a consolidated affiliate may retain all or a portion of the most subordinated class or classes of a series of ABS. These retained subordinated ABS interests represent risk retention mechanisms that investors may expect or demand as a condition to purchase credit or charge card ABS. If the securitizer is not able to combine these different forms of risk retention to reach the 5% threshold, the securitizer may be required to hold considerably more exposure than the required level, potentially increasing the costs of securitization relative to other funding options available to the sponsor, which in turn would lead to a contraction in available credit for consumers and businesses.

b. Horizontal Risk Retention: Definition of "Eligible Horizontal Residual Interest"[98]

In many cases, a credit or charge card securitizer or one or more of its consolidated affiliates may retain all or a portion of the most subordinated interests in a series of ABS, which may take the form of a subordinated tranche of a class or series or an equity interest in, or debt obligation of, the master trust. These subordinated interests are structured to absorb credit losses before more senior tranches and are, in fact, sized based on the amount of subordination needed to protect more senior classes in extreme loss scenarios. As a result, our credit and charge card securitizers strongly believe that the retention of these subordinated interests is highly effective in aligning the interests of securitizers and investors and should, therefore, qualify as permissible forms of horizontal risk retention for credit and charge card securitization transactions. The proposed definition of "eligible horizontal residual interest" does not, however, align well with the characteristics of the subordinated interests in credit and charge card master trusts, and so we

[98] With regard to the proposed horizontal risk retention option, our credit and charge card securitizers support and endorse the comments made in this letter by securitizers in other asset classes, but also wish to provide further comment in certain areas that are particularly relevant to credit and charge card securitizers.

request that the definition be revised in the following ways in order for horizontal risk retention to be a meaningful and workable option for credit and charge card securitizers.

Loss Allocation: Clause (1) of the proposed definition of "eligible horizontal residual interest" contemplates an ABS interest that "…*is allocated all losses on the securitized assets* [other than losses absorbed through a premium capture cash reserve account] until the par value of such ABS interest is reduced to zero." [Emphasis added.] We have the following concerns with this standard:

1. Loss allocation mechanisms and the manner in which losses are subsequently recovered vary significantly across asset classes and transaction structures. This is particularly true of credit and charge card securitizations. As noted above, in virtually every credit and charge card securitization transaction, loss amounts associated with charged-off receivables are initially allocated pro rata between the seller's interest and the aggregate investor interests. As a threshold matter, therefore, a horizontal residual interest in a credit or charge card securitization transaction, such as a subordinated class of a series of ABS, is never allocated *all* losses on the securitized assets because the seller's interest initially receives its pro rata allocable share of loss amounts associated with charged-off receivables.

2. The portion of these loss amounts that is allocated to the investor interests in the aggregate, thereafter, may be further allocated among various series of investor interests. Accordingly, although the most subordinated class of a series of ABS in a credit or charge card securitization transaction may absorb the losses allocated to its series before more senior classes in its series, as a general matter, that subordinated class will not absorb losses allocated to the interests of any other series of ABS.

3. The seller's residual interest in excess spread and in funds on deposit in certain trust accounts are the first interest in most credit and charge card ABS structures to absorb losses, even before the "most subordinated" class or tranche of securities. Similarly, there may be other ABS interests retained by the sponsor or its consolidated affiliates that absorb losses before the "most subordinated" class or tranche of securities. The mere existence of the seller's interest and these first-loss residual interests should not prevent the most subordinated class or tranche of a series of ABS from qualifying as an "eligible horizontal residual interest" as long as the seller's interest and these other first-loss residual interests are held by the sponsor and its consolidated affiliates.

To address the concerns outlined above, we request that clause (1) of the proposed definition of "eligible horizontal residual interest" be revised to reflect that, in the case of revolving asset master trusts, an ABS interest will qualify if (i) the sponsor or its consolidated affiliates hold the seller's interest, including the right to receive excess spread on the securitized assets and (ii) there are no other ABS interests that absorb losses allocated to the related series prior to such ABS interest that are not held by the sponsor or its consolidated affiliates.

Subordinated Payments: Clause (2) of the proposed definition of "eligible horizontal residual interest" contemplates an ABS interest that "…has the most subordinated claim to payments of both principal and interest by the issuing entity." We have the following concerns with this standard:

1. As described above, a master trust issues ABS from time to time in one or more series, each with its own capital structure comprised of more senior classes or tranches of such series and more subordinated classes or tranches of such series. On any distribution date, although the most subordinated class of each outstanding series may have the most subordinated claim to payments of both principal and interest from collections on the receivables with respect to its series, no such subordinated class would have any claim or priority to such payments in respect of any other series issued by the master trust. Similarly, in a delinked structure, although the tranches comprising the most subordinated class of a series, individually and collectively, may have the most subordinated claim to payments of both principal and interest from collections on the receivables with respect to such series, no one tranche of that most subordinated class will have a more subordinated claim to such payments than the other tranches of that class.

2. In some revolving asset master trusts there may be other ABS interests held by the sponsor or its consolidated affiliates that are the last to receive payments of principal and interest from collections on the receivables. In addition, as described above, there may be funds on deposit in certain trust deposit accounts that may be applied toward payments of principal or interest on only the most subordinated class or tranches of ABS interests of any series. The mere existence of these other ABS interests or trust deposit accounts should not prevent an interest from qualifying as an "eligible horizontal interest" as long as the sponsor or its consolidated affiliates holds any such ABS interest or the residual interest in any such trust deposit account.

To address the concerns outlined above, we request that clause (2) of the proposed definition of "eligible horizontal residual interest" be revised to reflect that, in the case of revolving asset master trusts, as to any series of ABS, a class of such series will qualify if it has the most subordinated claims to payments of both principal and interest from collections on the receivables with respect to such series (other than ABS interests held by the sponsor or its consolidated affiliates), and any tranche comprising a class of such series will qualify if the tranches comprising such class at any time have the most subordinated claims to payments of both principal and interest from collections on the receivables with respect to such series (other than ABS interests held by the sponsor or its consolidated affiliates).

Principal Payments: Clause (3) of the proposed definition of "eligible horizontal residual interest" contemplates an ABS interest that "…until all other ABS interests in the issuing entity are paid in full, is not entitled to receive any payments of principal made on a securitized asset, *provided*, *however*, [such ABS interest] may receive its current proportionate share of scheduled payments of principal received on the securitized assets in accordance with the transaction documents." We have the following concerns with this standard:

1. As described above, a master trust may issue ABS from time to time in one or more series, each with its own capital structure comprised of more senior classes of such series

and more subordinate classes of such series. At any given time, some master trust series may be in their revolving periods while other series may be in a scheduled principal accumulation period or scheduled principal amortization period. While it may be the case that, as to any series of ABS, the most subordinated class of such series is not entitled to receive payments of principal until such time as each more senior class of such series is paid in full, it is commonplace and expected that, as to any series in a principal accumulation period or principal amortization period, each class of such series may be paid in full while other series remain outstanding and in their revolving periods.

In a delinked issuance structure, senior securities and subordinated securities of the same series are issued in tranches at different times and on different terms. As a result, tranches of subordinated securities amortize and mature on schedules independent of tranches of senior securities, and it is commonplace and expected in a delinked master trust that subordinated tranches will amortize and mature at times while senior tranches remain outstanding. Scheduled maturities of subordinated tranches are, of course, closely monitored to ensure that the principal amount of subordinated tranches outstanding at any time is sufficient to maintain the required subordination levels.

2. Clause (3) of the proposed definition makes reference to "scheduled payments of principal received on the securitized assets." In the context of credit and charge card master trusts, the receivables arising in the credit or charge card accounts do not typically have "scheduled" payment terms.

3. Our credit and charge card securitizers feel strongly that clause (3) of the definition of "eligible horizontal residual interest" is unworkable in the context of existing credit and charge card master trust structures and that clauses (1) and (2) of the proposed definition of "eligible horizontal residual interest" as modified after giving effect to the revisions we have proposed above are sufficient to align the interests of the sponsor with those of the investors.

To address the concerns outlined above, we request that clause (3) of the proposed definition of "eligible horizontal residual interest" be revised to reflect that this clause should not apply in the case of a revolving asset master trust.

iv. Changes in Form of Risk Retention in Credit and Charge Card ABS

Our credit and charge card securitizers also strongly believe, particularly in the context of revolving asset master trusts, that they should not be required to hold their exposure in the same form throughout the life of a transaction (or, as recommended in this letter, the required risk retention holding period), much less throughout the life of the master trust itself, so long as the securitizer maintains the specified minimum level of exposure and reports any material realignment. Unlike amortizing securitization structures, revolving asset master trusts are structured to issue ABS interests in different series or classes from time to time over a period of many years or even decades. Credit and charge card securitizers would be disadvantaged relative to securitizers using amortizing securitization structures if they were required to hold their exposure in the same form throughout the life of the master trust.

v. Two-Tiered Credit and Charge Card ABS Issuance Platforms

Some credit and charge card master trust platforms are structured so that the asset pool directly supporting the issued ABS consists of one or more financial assets that represent an interest in, or the right to the payments or cash flows of, an underlying pool of receivables. In each instance, these structures are used solely to facilitate the structuring of the ABS transaction and not to resecuritize other outstanding securities, and the issued ABS are primarily serviced by cash flows from the underlying pool of receivables.

The most common example of this structure in the credit and charge card ABS sector today is an "issuance trust" structure, where a previously-established master trust issues to a subsequently-established issuance trust an interest – often referred to as a "collateral certificate" – representing a beneficial interest in the pool of credit or charge card receivables held by the master trust. The issuance trust then issues its own ABS in series backed directly by the collateral certificate and indirectly by the credit or charge card receivables held by the master trust. An illustration of an issuance trust structure is included as Exhibit G to this letter.

The SEC has previously recognized that these structures and underlying interests do not raise the same issues as may arise in the resecuritization of other underlying securities because they are merely facilitating structural devices that form a part of a unitary issuance platform. Accordingly, the SEC has excluded these structures from regulation as resecuritization transactions where the following conditions are met:

- Both the issuing entity for the issued ABS and the entity issuing the underlying interest have been established under the direction of the same sponsor and depositor;
- The underlying interest was created solely to satisfy legal requirements or otherwise facilitate the structuring of the ABS transactions;
- The underlying interest is not part of a scheme to avoid the requirements of the regulatory scheme; and
- The underlying interest is held by the issuing entity and is a part of the asset pool for the issued ABS.

Our credit and charge card securitizer members and our investor members agree that, where the conditions outlined above are met, an underlying credit or charge card master trust and a related issuance trust should be treated as a single issuing entity and a unitary issuance platform for all purposes under the risk retention regulations to avoid the imposition of a redundant layer of risk retention. We request, therefore, that the proposed regulations be revised to exclude these structures from regulation as resecuritization transactions and the imposition of an unnecessary, additional layer of risk retention requirements.

vi. Transition – Credit and Charge Card Revolving Asset Master Trusts

Section 15G does not apply to ABS issued before the effective date of the final risk retention regulations.[99] In the case of revolving asset master trusts that were formed prior to the effective date, and that have issued ABS before the effective date and intend to issue ABS after the effective date, we believe that further guidance on transition and compliance with the final regulations is necessary.

As a practical matter, credit and charge card ABS issued before the effective date of the final regulations may not be 15G-compliant ABS because neither the ABS themselves nor the revolving asset master trust would have been structured to meet the regulations' risk retention requirements.[100] Our credit and charge card securitizers strongly believe that, inasmuch as the final regulations apply only prospectively, when measuring the amount of required risk retention, only ABS that are issued on or after the effective date of the final regulations should be covered, even if the master trust was formed and had issued ABS prior to the effective date.

In the case of a credit or charge card securitizer that seeks to rely on the seller's interest risk retention option, our credit and charge card securitizers believe, therefore, that paragraph (a) of Section __.7 of the proposed regulations should be revised to require that the seller retain a seller's interest that, as of each measurement date, is in an amount not less than 5% of the unpaid principal balance of all investor interests (as defined in the applicable transaction documents) in the issuing entity *that were issued on or after the effective date of the final regulations* and that are outstanding as of the related measurement date.

In the case of a credit or charge card securitizer that seeks to rely on another risk retention option (e.g., horizontal or vertical risk retention), our credit and charge card securitizers believe that the relevant provisions of the proposed regulations should be revised to make clear that, in the case of a revolving asset master trust, the baseline risk retention requirement is to be measured in relation to each ABS interest in the issuing entity *issued on or after the effective date of the final regulations*.

If the Joint Regulators were not to make these revisions to the regulations, the economic effect on credit and charge card securitizers would be the same as if Section 15G were applied to all ABS issued by the master trust, regardless of the effective date of the final risk retention regulations. Moreover, in practical terms, a credit or charge card securitizer would have no risk retention option other than the seller's interest option because it would be extremely difficult (in the case of the horizontal option), or impossible (in the case of the vertical and L-shaped options), prospectively to satisfy any of the other risk retention requirements on a trust-wide basis. Finally, the availability of even the seller's interest option also assumes that all of our

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[99] In the case of residential mortgage-backed securities, the regulations become effective one year after publication of the final regulations in the Federal Register and, in the case of all other asset-backed securities, two years after such publication.

[100] For example, many master trusts have only 4% minimum required seller's interests, and the calculation itself may be based on either the unpaid principal balance of the receivables in the master trust or the unpaid principal balance of the aggregate investor interests.

comments on the definition of seller's interest and on the mechanism itself are reflected in the final regulations.

vii. Premium Capture Cash Reserve Account

The Joint Regulators propose to adjust the required amount of risk retention to account for any excess spread that is monetized at the closing of a securitization transaction. If a sponsor structures a securitization to monetize excess spread, the proposed regulation is intended to "capture" the premium or purchase price received on the sale of the tranches that monetize the excess spread and require that the sponsor place such amounts into a separate trust account for use to cover losses on the trust assets before such losses are allocated to any other interest or account. Our credit and charge card securitizers have several comments and observations relating to this proposed premium capture mechanism.

First, as discussed above, both the seller's interest itself and the interest of the seller in excess spread are fundamental elements of all credit and charge card securitization structures. Since the credit and charge card ABS originator retains its ownership of the accounts, the originator maintains its relationship with the cardholders and, as revolving accounts, continues to make credit-granting and underwriting decisions in connection with ongoing extensions of credit throughout the life of the accounts. With revolving accounts the originator is continually originating new receivables and underwriting and reassessing the credit risk associated with the accounts. As part of that process, the originator is also continually re-pricing credit risk and refining its pricing models in an effort to establish a level of portfolio yield commensurate with the level of credit exposure, and thereby optimize excess spread. Unlike amortizing trusts, excess spread in revolving asset master trusts is directly connected to the dynamic process of re-extending credit and the manner in which the originator manages its credit or charge card business over time. As a practical result, a sponsor in a credit or charge card securitization transaction is discouraged from monetizing excess spread, in large part, because its value is dependent upon the sponsor's ongoing origination practices, underwriting standards, pricing models and credit risk management, all of which are commercially-sensitive proprietary information that is critical to the competitive position and viability of their businesses.

Second, as drafted, the premium capture mechanism does not take the features of revolving asset master trusts into account and so cannot be applied to credit or charge card securitization transactions. For example, where a credit or charge card securitizer is relying on the seller's interest or the horizontal risk retention option, Sections __.12(a)(1) and __.12(a)(2)(i) of the proposed regulations require the sponsor to fund a premium capture cash reserve account at closing of the securitization transaction in an amount equal to the positive difference between the gross proceeds received by the sponsor and 95% of the par value of all ABS interests in the issuing entity issued as part of the securitization transaction. In a revolving asset master trust, however, an ABS interest issued at any particular time may be supported by ABS interests (e.g., the seller's interest or one or more classes or tranches of subordinated securities) that are issued at different times, both before and after the subject ABS interest is issued. As a result, it is not clear which ABS interests would be viewed as having been issued as "part of the securitization transaction."

For example, where the credit or charge card securitizer is relying on the seller's interest risk retention option, the seller's interest will have been issued at the inception of the master trust, but it appears that the seller's interest should be a factor in the premium capture formula described above since we understand the 5% spread between the gross proceeds and the par value of the ABS interests to represent the amount of the baseline required risk retention.[101] Similarly, where the credit or charge card securitizer is relying on the horizontal risk retention option, the subordinated securities supporting a particular ABS interest at any time may have been issued at any point in time before or after such ABS interest was issued. Consequently, as to any ABS interest, it is not clear how to apply the premium capture formula at the time such ABS interest is issued.

Third, the Joint Regulators base the premium capture proposal on concerns that, by monetizing excess spread before the performance of the securitized assets can be observed and unexpected losses realized, sponsors may be able to reduce their economic exposure in the transaction and in the credit quality of the underlying securitized assets. In the context of revolving asset master trusts, however, as discussed throughout this section of our comment letter, sponsors retain significant ongoing economic exposures in credit and charge card securitization transactions that remain throughout the life of the transaction. Furthermore, the historical performance of the securitized revolving assets is readily observable, as are historical losses. Indeed, historical performance data for the asset pool is routinely disclosed to investors. As a result, assuming for argument's sake that a credit or charge card securitizer sought to monetize excess spread, the securitizer would do so in a manner where the historical performance and credit characteristics of the asset pool were disclosed to investors. Accordingly, the concerns giving rise to the premium capture proposal are not presented in the context of a revolving asset master trust.

In light of these comments and observations, our credit and charge card securitizers believe it would be most appropriate to exempt revolving asset master trusts from the application of this premium capture mechanism. In the alternative, the rule would have to be revised to take the features of revolving asset master trusts into account before it could be applied to credit or charge card securitization transactions.

viii. Discretionary Authority Regarding Forms of Risk Retention

As we have indicated throughout this section of our letter, neither the proposed seller's interest option nor the other proposed risk retention options that purport to be available to credit and charge card securitizers are sufficiently tailored to account for the nuanced and technical features of the master trust structure. Further, because the proposed risk retention regulations are not sufficiently flexible, if adopted as proposed, they will impede market innovation and the ability to meet changing investor demands.

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[101] If, as we believe, the seller's interest is intended to be a factor in the premium capture formula, the rule should clarify the value that should be assigned to the seller's interest, since the seller's interest risk retention option is proposed to be measured by reference to the unpaid principal balance of the master trust assets (or, if our requested revisions are made, the unpaid principal balance of all investor interests) but the premium capture formula is calculated by reference to the par value of the ABS interests.

Although we have addressed specific instances in which the proposed regulations should be adjusted to reflect current features of the master trust structure, our credit and charge card issuers agree that the large number of complex features of the structure and the variances among existing master trust structures make it impossible to address all of the nuance and technicalities of the structure in narrowly tailored risk retention regulations. Furthermore, it is impossible to predict the direction of future market developments that may be as effective, or even more effective, as existing structures in aligning the interests of credit and charge card securitizers with those of investors.

We therefore respectfully request that, in the absence of adopting a principles-based approach to risk retention regulations, the Joint Regulators incorporate into the final regulation a provision that operates to delegate to one of the Joint Regulators the authority and discretion to give credit under the risk retention regulations to ABS interests that for one reason or another might not meet the technical requirements of the regulations, but are no less effective in aligning interests as intended under the proposal. Our credit and charge card issuers agree that, in order to ensure consistency in the application of the regulations, such authority should rest with a single regulatory authority. Since, in the structured finance market, the SEC is the regulatory authority that establishes the terms on which ABS transactions may be registered under the Securities Act of 1933 or, through various safe harbors, exempt from such registration, it would make sense for the SEC to hold this discretionary authority.

E. Student Loan ABS

Introduction

Student loans have traditionally fallen into the following two categories: (i) student loans originated under the Federal Family Education Loan Program under Title IV of the Higher Education Act ("FFELP") which, in effect, carry a guarantee by the federal government, and continue to be held on the balance sheets of numerous state agencies, banks and finance companies, and (ii) non-government guaranteed private student loans which typically supplement the federal student loan programs, and are either financed through securitization or are retained for investment by financial institutions, funds or other investors.

i. Exemption for FFELP ABS

Established in 1965, FFELP provided for the origination of loans pursuant to minimum prescribed criteria to "qualified students" who are enrolled in eligible institutions, or to parents of dependent students, to finance their educational costs. A "qualified student" is an individual who is a U.S. citizen, national or permanent resident; has been accepted for enrollment or is enrolled and is maintaining satisfactory academic progress at a participating educational institution and meets certain other requirements for the particular loan program. In addition, federally insured consolidation loans have been originated for FFELP borrowers following the completion of their education. Loans originated under FFELP are guaranteed by the federal government and administered by guarantee agencies. FFELP loans were originated by commercial banks, thrifts, nonprofit organizations, independent finance companies, and credit unions, and are often held in an investment portfolio or securitized.

The Proposed Regulations do not include an exemption for FFELP loan securitizations from the risk retention requirements. Instead, Proposed § __.21(b)(1) fully exempts any securitization transaction if the asset-backed securities issued in the transaction are collateralized solely (excluding cash and cash equivalents) by assets that are fully insured or guaranteed as to the payment of principal and interest by the United States or an agency of the United States. As noted above, FFELP permitted eligible lenders[102] to originate loans that were guaranteed by the federal government.[103] Under FFELP, loans provided a government guaranty of 97 to 100 percent of the defaulted principal and accrued interest (in accordance with statutory requirements) in the event that the student defaulted on the loan, so long as the loan was serviced in accordance with Department of Education guidelines.[104] As noted in the Proposing Release, part of the justification for the exemption of FFELP loan securitizations is that the "federal department or agency issuing, insuring or guaranteeing the ABS or collateral would monitor the quality of the assets securitized, consistent with the relevant statutory authority."[105] Through the guaranty program administered by the Department of Education, that is certainly the case.

Other types of federally insured or guaranteed loans are designated in the Proposed Regulations as exempt from the risk retention requirements under Proposed § __.21(a)(1): securitizations that are collateralized by "residential, multifamily, or health care facility mortgage loan assets that are insured or guaranteed as to the payment of principal and interest by the United States or an agency of the United States." For example, as noted in the Proposing Release: the "Department of Veterans Administration also guarantees between 25 percent and 50 percent of lender losses in the event of residential borrower defaults. United States Department of Agriculture Rural Development also guarantees a sliding amount against loss of up to 90 percent of the original loan amount for single family loans."[106] Each of these types of loans is only partially guaranteed, but the implication from the Proposing Release is that a securitization of these loans would be exempt from the risk retention rules.

For the reasons set forth above, we believe that the guaranty by the federal government for FFELP loans warrants a general class exemption for FFELP loan securitizations from the risk retention requirements in the Regulations.

If the Joint Regulators do not believe that a general class exemption for FFELP loans in the Regulations (as ultimately adopted) is warranted, an exemption would also be appropriate

[102] As defined under the *Higher Education Act of 1965*.
[103] *See* Federal Housing Finance Agency Regulatory Interpretation 2009-RI-01, dated June 4, 2009, concluding that "the federal guarantee for defaulted [guaranteed student loans originated under FFELP] does run to the direct benefit of the holder of those loans," available at: http://www.fhfa.gov/Default.aspx/webfiles/13430/RI_2009-RI-01_Fed_G-Student_Loans.pdf.
[104] In addition to borrower default, FFELP provides for the same guaranty against the death, bankruptcy or permanent, total disability of the borrower; closing of the borrower's school prior to the end of the academic period; false certification by the borrower's school of his eligibility for the loan; and an unpaid school refund. The federally mandated guaranty has decreased slightly over time. Currently, the required guaranty percent of the principal and accrued interest is as follows: 100% for loans initially disbursed before October 1, 1993; 98% for loans initially disbursed between October 1, 1993 and July 1, 2006; and 97% for loans initially disbursed on or after July 1, 2006.
[105] *See* page 24137 of the Proposing Release.
[106] *See* page 24136 of the Proposing Release.

under Section 941(c)(1)(B)(ii) of Dodd-Frank due to their negligible credit risk.[107] That section provides for a downward adjustment of the five percent risk retention requirement if prescribed underwriting criteria are met "that specify the terms, conditions, and characteristics of a loan within the asset class that indicate a low credit risk with respect to the loan." While this adjustment provision is meant to prescribe specific underwriting that indicates a low credit risk, we point out that the explicit guaranty of FFELP loans as a result of the federal government's guaranty substantially insulates the ABS from any material credit performance issues.

We also note that implementing risk retention requirements on outstanding FFELP loans, which complied with government-specified parameters in the first place (and were not subjected to commercial underwriting standards), will not impact future underwriting standards for this product as FFELP was eliminated as of July 2010 under the Health Care and Education Reconciliation Act of 2010. Although ASF supports Dodd-Frank's goal of encouraging sound underwriting decisions by improving the alignment of interests among sponsors of securitizations, originators of loans and investors in ABS, this goal would not be served by requiring risk retention in FFELP transactions. We believe an adjustment down to zero would be appropriate given these special circumstances.[108]

Numerous state agencies and various banks and finance companies continue to hold outstanding FFELP loans on their balance sheets. Requiring securitizers of FFELP loans to retain risk would make securitization a less attractive option and these loans would be more likely to remain on the balance sheets of these institutions, invariably tying up significant amounts of capital that could otherwise be extended in the form of private loans or other forms of financial assistance to students. As noted in the Federal Reserve Study, "[M]any financial institutions hold significant legacy portfolios of FFELP loans, and some still sell these loans to each other. Risk retention requirements may damp these whole loan sales if it becomes more costly to finance these loans via securitization."[109] With respect to state and nonprofit agencies, programs awarding grants and other forms of financial assistance for students will receive a boost from new capital.

According to the Department of Education, approximately $390 billion of FFELP loans are outstanding and not owned by the federal government.[110] A portion of these loans are in existing securitizations and a portion are held in inventory by financial institutions, some of which are financed in facilities (such as the Straight A Funding conduit supported by the Department) that are maturing and are likely not to be renewed. During the last three years, a significant number of outstanding FFELP securitizations have been subjected to restructurings and there have been new issuances of FFELP backed student loan ABS. We are advised by our

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[107] We also note that a more general exemption is set forth under Section 941(c)(1)(G)(i), which requires that the regulations provide for "a total or partial exemption of any securitization, as may be appropriate in the public interest and for the protection of investors."
[108] Alternatively, the risk retention requirement could be measured against the uninsured portion of the FFELP loans collateralizing the securitization, so, for example, the risk retention required could equal five percent of three percent of the aggregate principal balance of the collateral, assuming a pool of FFELP loans that were insured at 97% of the outstanding principal and interest.
[109] *See* Federal Reserve Study at page 79.
[110] *See* Department of Education, "FY 2010 Agency Financial Report—U.S. Department of Education," page 48, available at: http://www2.ed.gov/about/reports/annual/2010report/3-financial-details.pdf.

members that this activity can be expected in the foreseeable future. In fact, for 2011 based on publicly available data, student loans rank second among types of non-mortgage assets securitized.[111] **Finally and perhaps most significantly, our members, including both issuers and sponsors of student loan backed securitizations and the investors who purchase the student loan ABS that are issued thereby, uniformly and wholeheartedly support a general class exemption from the risk retention rules for FFELP loan securitizations.**

ii. Risk Retention for Private Student Loans

As discussed in the ASF Comment Letter re Risk Retention for Student Loan ABS, the securitizer (or an affiliate) of a private student loan securitization generally retains ownership of the first-loss piece of the transaction. The first-loss piece is an equity ownership or debt interest in an issuing entity that is subordinated to all tranches of issued ABS and represents the right to receive cashflow at the most subordinated level of the flow of funds. We believe that this form of "horizontal slice" risk retention, which has been utilized in past private student loan securitizations, can be effective in aligning incentives between securitizers and investors, due, in large part, to the amount of credit risk to which such interest is exposed. Our student loan ABS sponsor members have indicated to us that their future transactions would likely employ the "eligible horizontal residual interest" form of risk retention set forth in the Proposing Release, although some have indicated that future structures may employ other forms of risk retention included in the Proposed Regulations. Thus, to the extent that the Joint Regulators find that risk retention for private student loans is warranted, we strongly support that sponsors be permitted to choose from the proposed menu of risk retention structures that are included in the Proposed Regulations as appropriate for student loan backed ABS.

F. Equipment Loan ABS

i. Qualifying Equipment Commercial Loans

Our equipment sponsor members ("Equipment Sponsors") support the efforts of the Joint Regulators in drafting and setting forth a proposal addressing the myriad of issues required under Dodd-Frank. The Joint Regulators have proposed, pursuant to Section 15G(c)(1)(B)(ii) of Dodd-Frank, a zero percent risk retention requirement for ABS issuances collateralized by qualifying "commercial loans." As noted by the Joint Regulators, "[u]nder Section 15G, the regulations issued by the Joint Regulators must include underwriting standards for…commercial loans…."[112] Furthermore, "these underwriting standards…must specify terms, conditions, and characteristics of a loan within such asset class that indicate low credit risk with respect to the loan."[113] However, the underwriting standards initially proposed as § __.18(A) for qualifying commercial loans are not relevant to equipment commercial loans, which are a frequently securitized type of commercial loans. In fact, equipment ABS issuance represents a significant portion of the overall ABS market (as of May 23, 2011 equipment ABS accounted for

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[111] Source: RBS Securities Inc. "ABS Market Update" as of May 2, 2011.
[112] Credit Risk Retention, 76 Fed. Reg. 24,090, 24,129 (proposed Apr. 29, 2011)(to be codified at 12 C.F.R. 43, 12 C.F.R. 244, 12 C.F.R. 373, 12 C.F.R. 1234, 17 C.F.R. 246 and 24 C.F.R. 267).
[113] Credit Risk Retention, 76 Fed. Reg. at 24,130.

approximately 8% of all public ABS issuance).[114] In addition, the category "Equipment Loans and Leases" was identified as a separate asset class and was one of only eight loan categories, along with ABCP, that were studied by the Board in the Federal Reserve Study.[115] As a result, the underwriting standards relating to qualifying commercial loans should be supplemented to address these frequently securitized commercial loans as Section 15G(c)(2)(A)[116] on its face requires through its use of the broad term "commercial loans." Notably, equipment commercial loans meet the current definition of "commercial loan" as proposed by the Joint Regulators. It is only the underwriting standards set forth in the Proposed Regulations that do not reflect actual industry underwriting practices and standards for the origination of equipment commercial loans. In short, the Equipment Sponsors do not believe that an equipment ABS transaction has ever been executed that would meet the criteria set forth in the Proposed Regulations or that originating qualifying loans would be economically feasible for them. Unless the Joint Regulators develop underwriting standards that are consistent with the equipment industry practice, the Equipment Sponsors expect that the qualifying commercial loan exception as initially proposed will remain wholly unused by Equipment Sponsors, despite the clear Congressional intent to foster the financing of the commercial loan asset class.

Although Dodd-Frank uses the generalized term of "commercial loans", the Equipment Sponsors suggest that the Joint Regulators, in enacting regulations to realize the Congressionally mandated objectives, avoid the impossible task of trying to develop one set of universal underwriting standards that would apply to all types of commercial loans. As noted by the Joint Regulators, "[c]ommercial loans encompass a wide variety of credit types and terms,"[117] and significant variation exists in the factors that are determinative with respect to underwriting standards that are applicable to, and appropriate for, each type of commercial loan collateralizing asset-backed securities. As a result, the Equipment Sponsors believe it would be most appropriate for the regulations to set forth underwriting standards that are tailored to the unique underwriting considerations relevant to equipment commercial loans. To successfully implement the legislative requirements, the Equipment Sponsors suggest that, in addition to the term "commercial loan" and its related underwriting standards, which would remain applicable to other types of commercial loans, the Joint Regulators should follow a simple and straight-forward approach for industry participants by creating a separate qualifying commercial loan category of "equipment commercial loans". The Equipment Sponsors propose the new term "equipment commercial loan," which would have underwriting standards and other requirements targeted specifically to this important category of commercial loans.[118]

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[114] Based on information obtained from Thompson Reuters in May 2011 (via International Financing Review).

[115] Federal Reserve Study at pg. 6. The Federal Reserve Study defines "Equipment Loans and Leases" as "loans and leases extended to facilitate the purchase or lease of business, industrial, and farm equipment, including 'large ticket' items such as bulldozers and backhoes and 'small ticket' items such as computers and copiers." *Id* at 23.

[116] Sec. 15G(c)(2)(A) provides as follows: "ASSET CLASSES.—The regulations prescribed under subsection (b) shall establish asset classes with separate rules for securitizers of different classes of assets, including residential mortgages, commercial mortgages, commercial loans, auto loans, and any other class of assets that the Federal banking agencies and the Commission deem appropriate."

[117] Credit Risk Retention, 76 Fed. Reg. at 24,131.

[118] If a new category of equipment commercial loans is not created as requested herein, the Equipment Sponsors request that the final rules clarify that the exclusion in the definition of "commercial loan" in §___.16 of the

In order to properly define an equipment commercial loan category to include only an appropriate loan, the Equipment Sponsors propose to define "equipment commercial loan" as "a loan or a finance lease[119] made to a company or an individual secured by equipment to be used by such company or individual in a trade or business or for other commercial purposes, including loans or finance leases related to[120] (a) trucking or transportation equipment; (b) motor coaches or buses; (c) construction or mining equipment; (d) agricultural equipment; (e) landscape equipment; (f) engines or engine systems; (g) recreational vehicles for commercial use; (h) forestry equipment; (i) healthcare related equipment, (j) boats and other maritime equipment, (k) electronics or other technological equipment; and (l) industrial or commercial equipment, including equipment used for printing and publishing, manufacturing, retailing, distributing or wholesaling; and which, with respect to each of the foregoing, may include any accompanying component attachments and accessions; provided however, that an equipment commercial loan does not include a loan or lease secured by aircraft, railcars or containers."[121]

The Equipment Sponsors would like to first highlight that, with respect to underwriting equipment commercial loans, as an industry, the focus includes the type and use of the equipment, in addition to the credit quality of the applicant. Unlike other types of commercial loans, which may include secured or unsecured loans, the proposed equipment commercial loan definition would require that ***all*** such loans be secured by equipment as set forth above. This equipment is often vital to the success of the obligor's business so such obligor's motivation to keep the loan[122] in good standing is very high. This equipment is generally income-producing to the obligor (or is otherwise critical to the obligor's business) and has a long useful life. Furthermore, typical loan terms for equipment commercial loans are such that the obligor has beneficial equity value in the equipment after the loan maturity or end of lease, as applicable. Based on these factors unique to underwriting equipment commercial loans, the Equipment Sponsors have crafted underwriting standards that analyze not only the ability of the obligor to repay,[123] but that also consider the motivation of the obligor to repay and the value of the equipment (which typically serves as valuable security in the event of a default by an obligor). As a result, through this time-tested approach to underwriting standards for equipment commercial loans, the equipment commercial loan industry has been very successful in

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Proposed Regulations for "[l]oans for the purpose of financing agricultural production" does not include agricultural equipment loans.

[119] A finance lease is the functional equivalent of a loan in this context. The lessee (the party leasing the equipment) is deemed to be the beneficial owner of the leased equipment, and the lessor (or its assignee) is deemed to hold a security interest (pursuant to Sections 1-201(35) and 1-203 of the UCC) in the leased equipment. Typically, any lease transferred to a trust that has a nominal termination value should be deemed to be a finance lease. For example, any lease with a $1 termination value should be treated as a finance lease.

[120] Loans and leases relating to each asset type identified in the proposed definition of equipment commercial loan are contemplated as "Equipment loans and leases" by the Federal Reserve Study and each is also frequently financed in the securitization markets. Federal Reserve Study, *supra* note 4, at 23.

[121] The Federal Reserve Study noted that "[l]eases of aircraft, railcars, and container leases are also routinely securitized, but these securitizations are not usually considered 'equipment' ABS." Federal Reserve Study, *supra* note 4, at 23.

[122] References in this Section F.i. and in Exhibit J to "loans" also include finance leases. Similarly, references in this Section F.i. and in Exhibit J to "obligors" also include borrowers and lessees under finance leases.

[123] However, the underwriting standards utilized by Equipment Sponsors to assess the ability of an obligor to repay are not those proposed by the Joint Regulators in § ___.18(b) of the Proposed Regulations.

establishing underwriting standards that result in equipment loans that historically have had very low loss levels, as Exhibit H reflects. As shown in the Federal Reserve Study (see Exhibit I), during the 2006-2010 period "a handful of equipment ABS classes have experienced downgrades, but most securities have had stable performance or even upgrades over time."[124] As another indicator of the strong performance of equipment ABS through the recent downturn, the Federal Reserve Study has also shown that the percentage of equipment asset-backed securities that were rated CCC+ or lower (securities rated CCC+ or lower are considered likely to default) by Standard & Poor's in January of each year between 2006 through 2010 was 0.0% in every year.[125] The Board of Governors of the Federal Reserve System also stated in the Federal Reserve Study that "[e]quipment loan and lease ABS in general, and the triple-A rated securities, in particular, have displayed strong performance throughout the financial crisis.... As in the auto sector, most of the downgrades that have occurred have been associated with the downgrades of the monoline bond insurers.... [T]he downgrades not related to bond insurer ratings have been relatively small, usually on the order of one or two notches."[126] The Federal Reserve Study also recommends implementing asset-specific requirements to directly address the fundamental incentive problems of each asset type, and further states that additional incentives to promote the quality of the assets being securitized may not be necessary in some circumstances.[127] In line with this historically successful approach, the Equipment Sponsors are proposing in Exhibit J underwriting standards that are applicable to equipment commercial loans and which they believe will result in ABS collateralized by pools of the highest caliber of equipment commercial loans. The proposed standards are designed to result in an asset-backed security that would be expected to perform well even during market downturns, as equipment ABS collateralized by pools with similar criteria and thresholds performed during the last market downturn.

If an underwriting standard was included in the proposal for commercial loans but is omitted from Exhibit J, this was because after carefully considering every item in §__.18(A), the Equipment Sponsors determined that satisfaction of the item was not "consistent with industry standards for evaluating the financial condition and repayment capacity of a borrower" on an equipment commercial loan, as was the Joint Regulators' stated goal in developing these standards.[128] On the contrary, for items excluded from the list proposed by the Equipment Sponsors, such requirements are not customarily obtained or performed by Equipment Sponsors in connection with equipment commercial loans. Furthermore, the Equipment Sponsors indicated that: (1) if they did change their origination standards to allow them to assemble such pools of proposed qualifying commercial loans it would most likely restrict businesses' access to credit and drive away all but the least creditworthy customers[129]; (2) the criteria regarding debt-to-income and other numeric standards do not comport with their general business models; and (3) any effort to implement a "parallel" origination structure under which qualifying assets could be generated would be so expensive and difficult to administer that its cost would eclipse the

[124] Federal Reserve Study, *supra* note 4, at 64-65.
[125] *Id.* at 49-50.
[126] *Id.* at 63.
[127] *Id.* at 83-85.
[128] Credit Risk Retention, 76 Fed. Reg. at 24,131.
[129] More creditworthy borrowers presumably would be able to receive financing from lenders that were following today's standard origination processes and were not demanding additional documentation, for example, in order to conform to the qualifying commercial loan exception.

benefits the Equipment Sponsors would recognize from lower required risk retention. Instead, the Equipment Sponsors have proposed requirements that would be consistent with industry underwriting standards for equipment commercial loans and that would result in equipment ABS that could be expected to perform very well as demonstrated through the performance of similar ABS during the recent economic downturn.

In addition to the proposed underwriting standards for individual loans set forth in Exhibit J, as required by the Congressional requirements for zero risk retention set forth in Section 15G(c)(2)(B), the Equipment Sponsors believe that investors would benefit from a minimum weighted average loan-to-value for the pool of collateral backing the equipment ABS. As a result, in Exhibit J, the Equipment Sponsors propose that any ABS transaction seeking to benefit from the exception for qualifying equipment commercial loans must also be collateralized by a pool of equipment commercial loans that has a weighted average loan-to-value percentage below a maximum percentage that the Equipment Sponsors believe would result in equipment ABS that is of the highest quality. Finally, because the Equipment Sponsors believe that underwriting experience is critical to the equipment ABS performance, the Equipment Sponsors have proposed in proposed §____.18(A)(a)(1)(B) that only sponsors that have, or that have an affiliate that has, performed underwriting assessments of equipment commercial loans for at least three years be allowed to utilize the exception for qualifying equipment commercial loans.

ii. Equipment Sponsor Views on Proposed Forms of Risk Retention

The Equipment Sponsors, like the Auto Sponsors, believe that the changes that are requested in "Auto Sponsor Views on Proposed Forms of Risk Retention for Auto ABS"[130] are equally necessary and applicable for Equipment Sponsors, and the Equipment Sponsors fully support these requests for the reasons set forth therein and below.[131] In addition, the Equipment Sponsors believe that if changes are not made as requested in such section, the Equipment Sponsors would encounter the same types of problems and businesses would suffer similar difficulties accessing credit as is described with respect to Auto Sponsors and customers and businesses in such section.

Specifically, the Equipment Sponsors fully support the requested changes under:

- *"Horizontal Risk Retention: Definition of 'Eligible Horizontal Residual Interest'."*[132] As is the case for motor vehicle securitizations, in equipment securitizations the sponsor or an affiliate generally retains ownership of the bottom of the waterfall, or first-loss position, in the transaction by holding a "subordinated residual interest." This subordinated residual interest operates in the same way in equipment securitizations as it does for motor

[130] Section B.i.
[131] While the Equipment Sponsors do not disagree with the Auto Sponsors as to the matters discussed under "Representative Sample" (see Section B.i.d.), the Equipment Sponsors do not believe that this will be a commonly used method of risk retention by Equipment Sponsors, so the Equipment Sponsors do not include the requests under that section in their request hereunder.
[132] Section B.i.a.

vehicle securitizations as outlined above.[133] The Equipment Sponsors also strongly believe that retention of this subordinated residual interest is highly effective in aligning incentives between securitizers and investors and that allowing retention of such interests should be a permissible form of horizontal risk retention for equipment ABS. Therefore Equipment Sponsors believe that the final rules should allow risk retention by this time-tested means and request that the definition be modified as requested above[134] in Section B.i.a. for the reasons stated therein and in this section. Equipment Sponsors believe that the historical performance of equipment securitizations illustrates that retention of a subordinated residual interest in its present form provides an appropriate alignment of interests between securitizers and investors. If the proposed revisions are not made, virtually all equipment securitization programs would need to be significantly restructured in order to take advantage of horizontal risk retention. Requiring restructuring of equipment securitizations as a cost of horizontal risk retention would only hinder the issuance of equipment ABS and negatively impact the availability of credit to businesses. Furthermore, the restructured securitizations would have far more complex collection and reporting procedures and cashflow allocation mechanics than traditional equipment securitizations. This added complexity would make these traditionally sound securitization structures more difficult for the Equipment Sponsors to establish and maintain.

- *"Horizontal Risk Retention: Valuing the Retained Interest's 'Par Value'."*[135]

As is the case for motor vehicle securitizations, the subordinated residual interests that are typically structured in equipment ABS transactions (and that the Equipment Sponsors believe should qualify for horizontal risk retention purposes) have neither stated principal amounts nor calculated par values.[136] The Equipment Sponsors also interpret the Proposed Regulations to allow calculation of the "par value" of these residual ABS interests according to any reasonable methodology, so long as the material features of the methodology and the results of the calculation are disclosed to investors in accordance with subsection (c)(3) of the Horizontal Risk Retention section. Like the Auto Sponsors, the Equipment Sponsors also request that this interpretation be confirmed in the final release. The Equipment Sponsors also expect that the two calculation methodologies proposed in Section B.i.b.1. and 2. will often be used to value eligible horizontal residual interests in their securitizations. We further request that these two methodologies be acknowledged as permissible, but non-exclusive, valuation methods for eligible horizontal residual interests in equipment ABS. Furthermore, the Equipment Sponsors

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[133] For instance, the descriptions under "Loss Allocation", "Subordinated Payments", and "Principal Payments" that describe motor vehicle loan and lease ABS interests, automobile floorplan loan ABS interests, typical motor vehicle loan and lease securitization or automobile floorplan loan securitization features or structural aspects are equally true for equipment loan and lease ABS interests, equipment floorplan loan ABS interests, typical equipment loan and lease securitization and equipment floorplan loan securitization features and structural aspects, respectively. See Section B.i.a.1., 2., and 3.

[134] Section B.i.a.

[135] Section B.i.b.

[136] To the extent that one or more components of the eligible horizontal residual interest did have a stated principal amount (e.g., if the most subordinated tranche of ABS other than the residual interest were retained by the sponsor in addition to the residual interest) then presumably the then-outstanding principal amount of that component would be included as a component of the eligible horizontal residual interest's value on any date of determination.

hereby also request each of the changes requested under "Discounted Cashflows Approach"[137] and "Balance Sheet Approach"[138] for the reasons stated therein and in this section.

- "*Reserve Accounts*."[139] The Equipment Sponsors are also in favor of allowing sponsors to hold a combination of exposures to satisfy the risk retention obligations, as described above under "'Blended' Risk Retention." To facilitate this, like the Auto Sponsors, the Equipment Sponsors request that cash that is in a securitization's reserve account and that is available to fund shortfalls in payments on the ABS interests should be a permissible form of risk retention, distinct from Horizontal Risk Retention. We request, therefore, that Section ___.5(b) be set forth as a separate section that permits a reserve account to be established to satisfy the risk retention requirements. In addition, in order to ensure that the reserve accounts that are currently maintained in equipment securitizations are permissible forms of risk retention, the Equipment Sponsors hereby also request each of the changes requested under "Master Trusts," "Investments," and "Releases to the Sponsor"[140] for the reasons stated therein[141] and in this section.

- "*Seller's Interest*."[142] The Equipment Sponsors are also generally in favor of the proposed provisions regarding the use of the seller's interest as an appropriate form of risk retention for revolving asset master trusts. However, to accommodate the structure of the seller's interest in a typical equipment floorplan loan securitization,[143] the Equipment Sponsors request that the provisions of § __.7 regarding revolving asset master trusts and the related definitions be revised as described above under "Seller's Interest" in Section B.i.e.

- "'*Blended' Risk Retention*."[144] As mentioned above, the Equipment Sponsors are also in favor of allowing sponsors to hold a combination of exposures to satisfy the risk retention rules. As a result, the Equipment Sponsors hereby also request each of the changes

[137] In addition, many equipment ABS transactions also utilize a "discount factor" or "advance rate" which determines the initial principal amount of the equipment ABS by setting it equal to, for example: (i) the aggregate of the present value of the scheduled and unpaid payments on each of the equipment commercial loans in an asset pool discounted monthly at an annual rate equal to a specified discount factor, or (ii) the aggregate of an advance rate multiplied by the principal balance of each equipment commercial loan in an asset pool. Either method of calculation results in additional overcollateralization, and this should be permitted to be included in the calculated value of the retained horizontal interest as described under "Discounted Cashflows Approach" in Section B.i.b.1. above.

[138] Section B.i.b.2.

[139] Section B.i.c.

[140] Section B.i.c.1., 2., and 3.

[141] The descriptions under "Master Trusts," "Investments," and "Releases to the Sponsor" that describe typical motor vehicle securitization or automobile floorplan loan securitization features or structural aspects (such as reserve accounts and investments), as applicable, are equally true for typical equipment securitization and equipment floorplan securitization features and structural aspects, as applicable.

[142] Section B.i.e.

[143] The descriptions under "Seller's Interest" that describe typical automobile floorplan loan securitization features or structural aspects are equally true for typical equipment floorplan loan securitization features and structural aspects.

[144] Section B.i.f.

requested under "'Blended' Risk Retention"[145] above for the reasons stated therein, which are equally true with respect to Equipment Sponsors and equipment securitizations.

- "*Maintaining the Retained Exposures*."[146] The Equipment Sponsors also interpret the risk retention rules as intending to require a sponsor to maintain a fixed percentage of exposure to a securitization over time rather than a fixed amount of exposure. As a result, the Equipment Sponsors hereby also request each of the changes requested under "Maintaining the Retained Exposures"[147] above for the reasons stated therein, which are equally applicable with respect to Equipment Sponsors and equipment securitizations.

iii. Equipment Investor Views on Proposed Forms of Risk Retention

Our equipment ABS investors believe that the comments set forth above in "Auto Investor Views on Proposed Forms of Risk Retention for Auto ABS"[148] are equally necessary and applicable for equipment ABS, and the equipment investors incorporate those comments herein.

G. CLOs

i. Collateralized Loan Obligations in General; How CLOs Differ from Traditional Asset-Backed Securities and Collateralized Debt Securities Backed by Traditional Asset-Backed Securities

The earliest collateralized debt securities ("CDOs") were structured in the late 1980s and early 1990s. These CDOs generally fell into two categories: collateralized loan obligations ("CLOs"), which were collateralized by interests in syndicated bank loans, and collateralized bond obligations ("CBOs"), which were collateralized by interests in corporate bonds. Over time, the CDO market expanded to include a broader range of collateral, including CDOs backed by traditional asset-backed securities ("ABS CDOs"), such as residential or commercial mortgage loans, automobile loans or leases or student loans. For the reasons set forth below, we believe that CLOs should be considered as an asset class that is separate from other CDOs, in particular, separate from ABS CDOs. As a result, we believe the Joint Regulators should reconsider whether CLOs should be subject to the credit risk requirements of Dodd-Frank.

CLOs involve the issuance of debt and equity securities which are backed by cash flows generated by loans to large and medium sized corporate obligors by a newly created entity established solely for the purpose of acquiring such loans and issuing such securities. CLOs, traditionally, have been offered in the U.S. in reliance on Rule 144A under the Securities Act, to "qualified institutional buyers" under the Securities Act and other investors who are "qualified purchasers" under the Investment Company Act. CLOs provide an important and substantial source of financing for both large and medium sized U.S. borrowers. CLOs also permit a broad group of both U.S. and non-U.S. investors to diversify their portfolios by giving them access, which they would not otherwise have, to the syndicated loan asset class.

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[145] Section B.i.f.
[146] Section B.i.g.
[147] Section B.i.g.
[148] Section B.iii.

CLOs, however, differ dramatically from traditional asset-backed securities and from ABS CDOs. First, unlike traditional asset-backed securities, such as securities backed by residential or commercial mortgage loans, automobile loans or leases or student loans, the vast majority of CLOs are "arbitrage" or "managed" CLOs ("Managed CLOs") that acquire their underlying corporate loans in the secondary market. The loans securing Managed CLOs are selected by a party known as a "collateral manager" and such CLOs are more similar to traditional pooled investment vehicles than to traditional asset-backed securities. The collateral manager (who is often an institutional asset management firm) of Managed CLO selects the loans for the related Managed CLO issuing entity to purchase in the open market pursuant to a series of trades with a variety of counterparties who may be the original lenders or lenders who acquired such loans in the secondary loan market. When a Managed CLO purchases a syndicated loan, it effectively becomes a lender to the related borrower. The parameters governing what loans may be purchased are set forth in the operative documents for the Managed CLO. As a result, the vast majority of CLOs do not participate, directly or indirectly, in the origination, negotiation or structuring of the corporate loans backing such CLOs. As such, the vast majority of CLOs, unlike traditional asset-backed securities, are not transactions based upon the "originate to distribute" model of securitization.

Second, the syndicated loans that back Managed CLOs are markedly different from the assets that back traditional asset-backed securities and ABS CDOs. Specifically, Managed CLOs typically invest in pools of syndicated loans that are diversified across industries (typically, with no single industry constituting more than 8% to 12% of the syndicated loans in any Managed CLO). As a result, Managed CLOs, unlike ABS CDOs, are not subject to the risk of any single industry or group of correlated industries. The loans underlying Managed CLOs are broadly syndicated loans with large and medium corporate borrowers (as opposed to individuals). The terms of CLO loans are individually negotiated by the borrower and lender and, thus, the terms of the assets backing CLOs are not homogenous (unlike the relatively homogenous terms of the assets backing traditional asset-backed securities and ABS CDOs). The loans backing CLOs typically have been subject to substantially more diligence than the assets backing ABS CDOs, with each original lender and each subsequent lender performing their own credit analysis and due diligence. In the case of a Managed CLO, this analysis and due diligence is performed by the collateral manager. In addition, the obligors on CLO loans, typically, are large and medium sized public companies and, as a result, CLO managers and investors have at their disposal significant information and a variety of analytic tools permitting them to assess risks posed by the loans backing CLOs. Furthermore, the obligors on CLO loans typically provide periodic financial reports and, as a result, such loans are "transparent" (unlike a traditional asset-backed security where the underlying obligors have no similar reporting obligations). Moreover, most of the loans (or the related borrowers) acquired by a CLO are rated and monitored by one or more rating agencies. Finally, because Managed CLOs typically invest in broadly syndicated loans, there is a secondary market for these loans. This permits CLO managers to trade in and out of positions and provides Managed CLO issuers with liquidity that is greater than the liquidity for the assets backing traditional asset-backed securities and ABS CDOs.

In large part due to the foregoing, historically, CLOs have performed in a predictable, and relatively strong, manner. The performance of CLOs has not been immune to the effects of general economic conditions, but, throughout the financial crisis, CLOs have performed in a manner generally reflective of global economic conditions. During the financial crisis, 435 ABS CDOs triggered an event of default, but no managed CLO defaulted.[149] In fact, Moody's has noted that "[despite] the sharpest economic contraction since the Depression, CLOs deteriorated largely as one would expect under such circumstances, with widespread downgrades, but few actual defaults.[150] In addition, the performance of CLOs has improved as the economy has improved (with the result that the securities issued by many CLOs have recently been upgraded).

ii. Should Dodd-Frank's Section 941 Risk Retention Requirement Apply to Managed CLOs?

Both the risk retention requirement of Section 941 of Dodd-Frank and the language permitting exemptions from the risk retention requirement and setting forth the standards for exemption reflect the fundamental legislative intent behind Section 941. Specifically, in adopting the risk retention requirement of Section 941, as well as the other provisions of subtitle D of Dodd-Frank relating to improvements to the asset-backed securitization process, Congress sought to address what it perceived as flaws in the securitization process that contributed to or precipitated the recent financial crisis. Chief among these flaws was the perceived deterioration in credit underwriting standards, particularly in the residential mortgage market, as a result of the transfer of ownership to capital markets investors, through securitization, of newly originated assets which, prior to the advent of securitization, had traditionally been held in the portfolio of the asset originator or purchased by institutional whole loan purchasers who performed thorough due diligence. Therefore, it has been suggested, the separation of loan origination and ownership reduces the traditional incentives for asset originators to ensure that the assets they originate are of high quality.

Our view is that the imposition of a risk retention obligation in the context of Managed CLOs would not serve any of the premises underlying Section 941. The underlying corporate loans are not originated with the intent or purpose that such loans will be securitized and the terms of such loans are not dictated or otherwise influenced solely by the possibility that they will be included in a Managed CLO. As such, we believe that expanding (or interpreting) the Section 941 risk retention requirements to apply to Managed CLOs would serve no public interest, would not further the protection of investors and would not further any of the premises underlying Section 941 because doing so would have no effect, directly or indirectly, on the creation of the corporate loans underlying such Managed CLOs, the underwriting policies of the originators of such corporate loans or the terms and structure of such corporate loans.

iii. Is There a "Sponsor" of a Managed CLO Who Should be Subject to the Section 941 Risk Retention Requirements?

If, notwithstanding the foregoing, it is determined that the Section 941 risk retention requirements should apply to Managed CLOs, the Proposed Regulations state that the entities

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[149] As of Jan. 25, 2011, per S&P. "Cash Flow and Hybrid CDO Event of Default Notices Received as of Jan. 25, 2011," S&P.

[150] *See* Jeremy Gluck, "CLOs versus CDOs: It's the 'L' That Matters" (July 2010) ("Gluck CLO Article") at Moody's CLO Interest, available at http://v3.moodys.com/researchdocumentcontentpage.aspx?docid=PBS_SF210409.

that act as the "Sponsors" of such CLOs would be required to retain risk in such transactions. The "Sponsor" is defined in the Proposed Regulations as "a person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, directly or indirectly, including through an affiliate, to the issuer." In the vast majority of CLOs, no party fits the definition of Sponsor because the assets in Managed CLOs are acquired in the market and are not transferred, directly or indirectly, by the CLO Manager (or any other party) to the Managed CLO issuer.[151] Notwithstanding the foregoing, footnote 42 of the Proposed Regulations concludes (without explanation) that "in the context of collateralized loan obligations (CLOs), the CLO manager generally acts as the sponsor by selecting the commercial loans to be purchased" by the issuer. We do not believe that the conclusion reached by footnote 42 of the Proposed Regulations is consistent with the definition of the term Sponsor which identifies the Sponsor as the person who both (1) organizes (or initiates) an asset-backed securities transaction and (2) sells (or transfers) assets to the issuer in such transaction. The authority of the Joint Regulators is limited by the plain language of Section 941 (including the definition of Sponsor). We believe that footnote 42 is inconsistent with the statutory authority of the Joint Regulators in that it imposes a risk retention obligation on CLO managers that do not fall within the scope of the plain language of Section 941. In addition, for the reasons discussed above, we do not believe that expanding the scope of the definition of Sponsor to include CLO managers would serve any of the public interests that underlie Section 941 and justify the imposition of a risk retention requirement. In addition, as described below in Section iv, the public policy underlying Section 941 of making certain that the interests of investors are aligned with the interests of the CLO manager is already addressed in existing Managed CLO structures which provide for the CLO managers to receive a small portion of their compensation senior to the payment of interest to investors and the remainder of their compensation subordinate to the payment of the rated debt issued by the related Managed CLO together with, in certain Managed CLO transactions, an incentive payment which is paid pari passu with the equity issued by such CLOs. CLO managers are, in essence, hired by the Managed CLO investors to select and monitor the portfolio of the Managed CLO (often based upon portfolio parameters that investors have input in establishing), and the compensation of the CLO manager is based upon the performance of the Managed CLO portfolio and the principal balance of the assets under management. CLO managers are not paid any fee relating to asset origination.

[151] Frequently, a portion of the corporate loans to be included in a CLO are "warehoused" for a brief period of time prior to the issuance of such CLO by the CLO issuer or an affiliate of the underwriter of such CLO. A portion of such corporate loans are warehoused because (1) the rating agencies (and investors) prefer to rate (and invest) in CLOs which have identified a substantial proportion (usually at a minimum of 50%) of the corporate loans to be initially held by the CLO issuer and (2) the "negative carry" (or difference between the interest accrued on the CLO's assets and the interest accrued on the CLO's liabilities) is reduced if, at closing, a portion of the CLO's assets constitute corporate loans (instead of cash or cash equivalents). Rarely, if ever, do the parties bearing the risk of such corporate loans during this "warehouse" period have any, direct or indirect, involvement in the origination, negotiation or structuring of such corporate loans. As a result, we do not think that the fact that a portion of the corporate loans in a CLO are warehoused for a brief period of time should alter the conclusion that in the vast majority of CLOs no party fits the definition of "Sponsor".

iv. Risk Retention in the Context of CLOs

The Proposed Regulations currently contemplate that a Sponsor's risk retention obligation could be satisfied by the Sponsor retaining (a) a 5% "vertical slice" of each interest issued in an asset-backed securities transaction, (b) a 5% "horizontal" first-loss slice representing a subordinate interest in the issuer that bears losses on the assets before any other classes of interest or (c) a 5% "L-shaped" slice of the interests issued in an asset-backed securities transaction.[152] The entities that manage CLOs typically are institutional asset managers, but only a select few have the economic wherewithal to retain risk through any of the contemplated approaches. Furthermore, it is likely that the imposition of a risk retention obligation on CLO managers will make CLOs economically unattractive to the very limited number of CLO managers who have funds which would permit them to retain risk in the CLOs that they manage. As a result, we believe that if risk retention is determined, as a general rule, to apply to CLOs and if such risk retention may only be satisfied (by CLO Managers or other parties) through the approaches contemplated by the Proposed Regulations, CLOs are likely to cease to be a viable financing option. This will have the result of (1) eliminating an important source of financing for both large and medium sized U.S. borrowers and (2) making it infeasible for a substantial group of investors to diversify their portfolios by getting exposure to the commercial loan asset class. The CLO market attracts capital from domestic U.S. and foreign investors (which is evidenced by the fact that many foreign institutions are actively hiring U.S. asset managers with expertise in the corporate loan market). Eliminating CLOs, or substantially reducing the ability of parties to structure CLOs in an economically attractive manner, will substantially reduce the financing available to large and medium sized corporate borrowers. This will, in turn, result in it becoming more difficult for large and medium sized corporate borrowers to finance (and expand) their operations and the cost of such financings is likely to increase. Reducing the capital that is available to U.S. borrowers, and increasing the cost of such capital (as so limited), could have a substantial and negative impact on the U.S. economy. In addition, eliminating (or otherwise limiting) CLOs will prevent (or reduce the ability of) many U.S. and non-U.S. investors from diversifying their portfolios through investment in the commercial loan asset class. This could have the potential result of reducing the returns on such portfolios and increasing the risk represented by such portfolios.

We, however, believe that Managed CLOs already incorporate structural features which address the concerns behind Section 941 such that the imposition on CLO managers of an additional risk retention obligation is not necessary in the context of Managed CLOs. Specifically, the primary public policy goal behind the risk retention requirement is to align the interests of the Sponsor of an asset-backed securitization transaction with the interests of investors. The manager in the vast majority of Managed CLOs receives compensation in the form of a senior fee (paid prior to the interests issued in the Managed CLO), a subordinate fee (paid subordinate to all interests issued in the Managed CLO other than the most subordinate

[152] The Proposed Regulations also contemplate that a Sponsor could satisfy its risk retention obligation by retaining (a) a 5% "seller's interest" in securitizations structured using a master trust or (b) a 5% representative sample of assets that exposes the Sponsor to credit risk which is the equivalent to that of the securitized assets. CLOs are not issued using a master trust structure and the corporate loans underlying CLOs are individually negotiated and unique. As a result, neither of these approaches to risk retention would be feasible in the context of a CLO.

interest issued in the Managed CLO) and, frequently, an incentive fee (usually paid *pari passu* with the most subordinate interest issued in the Managed CLO, but often only paid after the holders of such subordinate interest have received a specified targeted return on their investment). In addition, in some cases, the CLO manager or an affiliate thereof may elect to purchase a small portion of the equity (i.e., the most subordinate interest) issued in such Managed CLO or, one or more other interests representing part of the Managed CLO capital structure. As a result, Managed CLOs are structured in a manner designed to align the interests of the CLO manager with the interest of the investors in the various classes of interest issued by the Managed CLO. In essence, the manager in a Managed CLO is no different than the manager of a traditional mutual fund that invests in bonds. The incentive of the manager of a bond mutual fund is aligned with those of the investors in such fund through the bond mutual fund manager's fee structure. No bond mutual fund manager is required to retain a separate interest in his/her mutual fund, because the fee structure (and such manager's desire to maintain his/her reputation in the industry) is viewed by the market and regulators as sufficient to align the interests of such manager with those of investors. The same is true in the context of a Managed CLO. As such, we believe that the policy concerns behind Section 941 are already appropriately addressed by the fee structures existing in Managed CLO transactions, and that a separate risk retention obligation is not necessary in the contexts of Managed CLOs.

v. Qualifying Commercial Loans in the Context of Managed CLOs; Developing a Safe Harbor that Would Permit Managed CLOs to Continue to Operate as a Source of Funding for U.S. Borrowers

The Proposed Regulations provide that asset-backed securitizations where the underlying assets are limited to "qualified commercial loans" ("QCLs") would not be subject to risk retention requirements. Unfortunately, as written, the QCL definition would have no practical significance for CLOs because the corporate loans backing CLOs are individually negotiated and none of such loans would comply with the terms as written.

If risk retention is determined to, as a general rule, apply to CLOs, we ask that the Joint Regulators create a "safe harbor" which would set forth the circumstances where risk retention would not be necessary in the context of a CLO. These circumstances would be designed to limit the applicability of the safe harbor to CLOs backed by syndicated corporate loans in contexts where (1) the interests of the CLO manager are aligned with those of the CLO investors and (2) the concerns raised by the "originate to distribute" model of securitization do not exist.

vi. Conclusions

We believe that the Joint Regulators should reconsider whether CLOs should be subject to the risk retention requirements of Dodd-Frank. CLOs provide an important source of financing for both large and medium U.S. borrowers. We believe that if risk retention in the form currently contemplated by the Proposed Regulations is imposed on CLOs, and, in particular, CLO managers, CLOs are likely to cease as a viable financing option. Because Managed CLOs are secondary market transactions, our view is that the imposition of risk retention in the context of Managed CLOs would not serve any of the concerns that are the premise of Section 941. We also believe that footnote 42 is inconsistent with the statutory authority of the Joint Regulators in that it imposes a risk retention obligation on CLO managers that does not fall within the scope of the plain language of Section 941. Finally, we also believe that Managed CLOs, currently incorporate structural fees (in particular CLO manager fee structures) that already align the interests of CLO managers with those of investors and, as such, a separate risk retention obligation is not necessary in the context of Managed CLOs.

If the Joint Regulators conclude, however, that risk retention, as a general rule, apply to CLOs, we urge the Joint Regulators to consider defining a CLO safe harbor which would set forth the specific circumstances where risk retention would not be necessary in the context of CLOs. We believe that a safe harbor could be designed to limit its applicability to Managed CLOs backed by syndicated corporate loans in contexts where (1) the interests of the CLO manager are aligned with those of investors and (2) the concerns of the "originate to distribute" model of securitization do not exist.

H. Municipal Bond Repackagings

We believe that another type of securitization that should be fully exempted from the risk retention requirements is any securitization involving the repackaging of municipal bonds, *i.e.*, any securitization transaction if the asset-backed securities issued in the transaction are collateralized by obligations of states, political subdivisions of states or other local governmental entities.

The most common form of such municipal bonds repackaging is often referred to in the marketplace as "tender option bonds" or "TOBs." A typical TOBs transaction consists of the deposit of a single issue of highly rated, long-term municipal bonds in a trust and the issuance by the trust of two classes of securities: a floating rate, puttable security (the "floaters"), and an inverse floating rate security (the "residual"). No tranching is involved. The holders of floaters have the right, generally on a daily or weekly basis, to put the floaters for purchase at par, which put right is supported by a liquidity facility delivered by a highly rated provider and causes the floaters to be a short-term security. The floaters are in large part purchased and held by money market mutual funds. The residual is held by a longer term investor (bank, insurance company, mutual fund, hedge fund, etc.). The residual investors take all of the market and structural risk related to the TOBs structure, with the floaters investors only taking limited, well-defined insolvency and default risks associated with the underlying municipal bonds, which risks are equivalent to those associated with investing in such municipal bonds directly. The TOBs securities are offered pursuant to robust disclosure documents setting forth a detailed description of the TOBs structure and the core legal documents, as well as a description of the tax treatment of the securities and the private placement nature of the offering. The disclosure documents also direct the sophisticated investors to information concerning the underlying municipal bonds and the liquidity provider.

The TOBs market, which has been in existence for nearly two decades, has come to play an important role in the larger municipal finance market by bringing together issuers of fixed rate, long-term debt and buyers of variable rate, short-term instruments. While, as noted above, in many respects the risks associated with owning floaters are no different than those associated with owning the underlying municipal bonds directly, the critical difference is that such municipal bonds would likely not be eligible investments for most money market mutual funds and other floaters investors. Accordingly, the floaters created under the numerous TOBs programs have become a critical component of the investment portfolios of the short-term tax-exempt money market funds that have become such a fundamental fixture on the financial landscape of the United States. This is particularly the case when, as in recent years, municipal issuers are constrained by various forces from entering the short-term debt market directly. It is noteworthy that no abuses in regard to the risk profile or return on investment were identified in connection with TOBs programs during the recent market disruptions. Indeed, the largely unfettered right to put the floaters, for any reason, to the liquidity provider, whether for reasons related to the performance of the underlying assets or for market reasons, is a distinguishing feature of the TOBs structure.

Proposed Section __.21(a)(3) provides an exemption from the risk retention requirements for any asset-backed security that is a security issued or guaranteed by any state of the United States, by any political subdivision of a state or territory or by any public instrumentality of a state or territory that is exempt from the registration requirements of the Securities Act. We believe that Section __.21 should be expanded to provide an exemption from the risk retention requirements for any securitization that is collateralized solely (excluding cash and cash equivalents) by a security that is, or securities that are, of the type described in Section __.21(a)(3), pursuant to the discretion granted to the Joint Regulators in Section 15G(c)(1)(G)(i) of the Exchange Act, which provides that "a total or partial exemption of any securitization [may be granted], as may be appropriate in the public interest and for the protection of investors."

We believe that such exemption from the risk retention requirements for municipal bonds repackaging transactions is appropriate in the public interest and for the protection of investors as contemplated by Section 15G(c)(1)(G)(i) of the Exchange Act quoted above. We offer the following three rationales for such belief.

First, we refer to the treatment of obligations of the United States and agencies of the United States under the Proposed Regulations. Specifically, proposed Section __.21(b) fully exempts any securitization transaction if the asset-backed securities issued in the transaction are either collateralized by obligations issued by such federal entities, collateralized by assets secured as to payment by such federal entities or themselves guaranteed as to payment by such federal entities. The commentary states that such exemption is supported by the fact that the "federal department or agency issuing, insuring or guaranteeing the ABS or collateral would monitor the quality of the assets securitized." The commentary uses similar language in support of the exemption for municipal obligations pursuant to Section __.21(a)(3) described above, noting "the role of the State or municipal entity in issuing, insuring, or guaranteeing the ABS or collateral." We assert that this exemption for municipal obligations is under-inclusive. Specifically, we believe that the same rationale which underlies the exemption for any securitization with collateral issued, insured or guaranteed by the United States or any agency of the United States supports the exemption from the risk retention requirements for any securitization that is collateralized solely by obligations of state or local governmental entities.

Second, we assert that municipal bonds repackaging securitizations are not the type of securitizations that prompted Congress to enact Section 15G, but rather are securitizations inadvertently caught up in the regulatory net cast by Congress largely because of the broad statutory definition of asset-backed securities. Indeed, municipal bonds repackaging transactions are not perceived in the marketplace as being asset-based securitizations at all. This point was made by several market participants in August 2010 in response to the SEC's proposed rule with respect to asset-backed securities, including the revision of Regulation AB under the Securities Act and the Exchange Act.[153] The SEC has tacitly acknowledged that asset-based securities with assets consisting of municipal obligations are different from other asset-backed securities. *See, e.g.*, Rule 2a-7 under the Investment Company Act (distinguishing "Conduit Securities" and "Government Securities" in several places).

Third, we emphasize the vital connection between the municipal bonds repackaging market, particularly the TOBs market, and the greater municipal finance market, *i.e.*, bringing together long-term state and local governmental issuers and short-term investors, mentioned above. Imposing the risk retention requirements on these securitization transactions likely would cause fewer of these securitization transactions to be done. This reduction of access to the short-term market will reduce the liquidity of municipal bonds, which will lead to an increase in the borrowing costs for municipalities and other issuers of municipal bonds, all at a time when many state and local governmental entities are in serious need of cash for important public projects and essential governmental activities. Correspondingly, there will be decrease in short-term investments available for the tax-exempt money market funds, which have become a key component of the investment portfolios of individuals of all income brackets, which is particularly problematic in light of the recent changes to Rule 2a-7 regarding daily and weekly liquidity requirements. All this would occur with little or no apparent benefit to market participants.

I. Corporate Debt Repackagings

Similarly to municipal bond repackagings, we believe that the Joint Regulators should exercise the express exemptive authority granted to them in Section 941 of the Dodd-Frank Act to fully exempt corporate debt repackagings from the risk retention requirements, as the application of those requirements do not further the public policy behind Section 941.

Corporate debt repackagings ("Corporate Debt Repackagings") are created by the deposit of corporate debt securities purchased by the sponsoring institution in the secondary market into a trust which issues certificates backed by cash flows on the underlying corporate bonds. Corporate Debt Repackagings are generally issued in order to (i) provide access by individual investors to the corporate debt market through the offering of trust certificates having minimum denominations lower than those typically associated with the underlying security or (ii) allow corporate debt to be combined with interest rate or currency swaps in order to provide institutional investors with a preference for floating rate instruments the opportunity to invest in corporate debt having a fixed interest rate, to allow institutional investors with a preference for fixed rate instruments the opportunity to invest in corporate debt having a floating interest rate or to allow institutional investors to receive payments in currencies other than the currency in which

[153] *See* Regulation AB Comment Letters by Bank of America (August 2, 2010), available at: http://www.sec.gov/comments/s7-08-10/s70810-108.pdf, and JPMorgan Chase & Co. (August 2, 2010), available at: http://www.sec.gov/comments/s7-08-10/s70810-110.pdf.

the underlying corporate debt securities are denominated. Institutional transactions generally involve a small number of investors and are tailored to meet the investment objectives of the particular investors.

Corporate Debt Repackagings are commonly issued as registered securities under existing Form S-3 and, to the extent that the debt of a single issuer or a group of affiliated issuers of the underlying corporate debt securities represents 10% or more of the asset pool, unless the pool assets are backed by the full faith and credit of the United States, the financial information required by Item 1112 of Regulation AB is provided to investors in the trust certificates, generally through incorporation by reference as contemplated in Item 1100(c)(1) of Regulation AB or by reference as contemplated in Item 1100(c)(2) of Regulation AB. Corporate Debt Repackagings are also offered privately in reliance on Rule 144A under the Securities Act, generally to customers of the sponsor who indicate, through reverse inquiry, that they hold corporate debt securities with payment characteristics that they would like to change through the addition of swaps, as described in the preceding paragraph.

Corporate Debt Repackagings are generally considered asset-backed securities and are, therefore, likely encompassed within the broader definition of Exchange Act ABS added by the Dodd-Frank Act, although nowhere are they expressly addressed in Section 941 or the proposed credit risk regulations. While Section 941 of the Dodd-Frank Act, in the first instance, required the Joint Regulators to prescribe regulations requiring most securitizers to retain an economic interest in a portion of the credit risk for the securitized assets,, Section 941 of the Dodd-Frank Act also permits the Joint Regulators to provide for a total or partial exemption of any securitization, "as may be appropriate in the public interest and for the protection of investors" and further grants the Joint Regulators the power to "jointly adopt or issue exemptions, exceptions or adjustments to the rules issued under this section, including exemptions, exceptions or adjustments for classes of institutions *or assets* (emphasis added) relating to the risk retention requirement..." Section 941 further provides any exemption, exceptions or adjustment adopted by the Joint Regulators "shall (A) help insure high quality underwriting standards for the securitizers and the originators of assets that are securitized or available for securitization; and (B) encourage appropriate risk management practices by the securitizers and originators of assets, improve the access of consumers in businesses to credit unreasonable terms, or otherwise be in the public interest and for the protection of investors."

Both the risk retention requirement of Section 941 and the language permitting exemptions from the risk retention requirement and setting forth the standards for exemption reflect the fundamental legislative intent behind Section 941. Specifically, in adopting the risk retention requirement of Section 941, as well as the other provisions of subtitle D of the Dodd-Frank Act relating to improvements to the asset-backed securitization process, Congress sought to address what it perceived as flaws in the securitization process that contributed to or precipitated the recent financial crisis. Chief among these was the perceived deterioration in credit underwriting standards, particularly in the residential mortgage market, as a result of the transfer of ownership to capital markets investors, through securitization, of newly originated assets which, prior to the advent of securitization, had traditionally been held in the portfolio of the asset originator or purchased by institutional whole loan purchasers who performed thorough due diligence. Therefore, it has been suggested, the separation of loan origination and ownership reduces the traditional incentives for asset originators to ensure that the assets they originate are of high quality. The expansion of the definition of asset-backed security to include collateralized debt obligations, collateralized bond obligations, collateralized debt obligations of asset-backed securities and collateralized debt obligations of collateralized debt obligations, reflects the legislative understanding that the existence of so-called "second generation" securitizations, i.e. securitizations of previously issued interests in other securitizations, may have helped to exacerbate the deleterious effects of separation of loan origination and loan ownership.

To address the perceived problem of separation of asset origination from ownership, Section 941 of the Dodd-Frank Act attempts to align the interest of securitizers of assets with that of investors in securitization by mandating the Joint Regulators to require securitizers to retain at least a 5% economic interest in the securitization. In theory, because the originator would be exposed to the same economic consequences of the performance of the assets as third party investors, the securitizer would be incentivized to securitize only high quality assets and to originate, or encourage third party originators to originate, only high quality, properly underwritten assets.

Regardless of whether one accepts the premise underlying Section 941 that the best way to align the incentives of originators and issuers with investors in securitization, and thereby promote higher quality underwriting, is through risk retention, the policy it seeks to support clearly has no applicability to Corporate Debt Repackagings. Unlike traditional asset-backed securities, such as securities backed by residential or commercial mortgage loans, automobile loans or leases, or student loans, Corporate Debt Repackagings are not part of the process of directly or indirectly financing the origination of consumer loans or other financial assets. Instead, they represent the reoffering of existing debt securities of corporate issuers acquired in the secondary market. Those corporate debt securities are not created by the underlying corporations with the intention or expectation that they will be acquired and securitized, and the existence or terms of those corporate debt obligations are not dictated or influenced by the possibility that they be included in Corporate Debt Repackagings. The sponsor of a Corporate Debt Repackaging will not acquire the underlying corporate bonds directly from the issuer thereof nor will the bonds represent an unsold allotment held by the sponsor. Accordingly, the retention of an interest in the corporate bonds underlying a Corporate Debt Repackaging would serve no public interest nor further the protection of investors, as such risk retention would have no effect, directly or indirectly, on the creation of the asset underlying the securitization, the credit quality of which is solely dependent on the credit of the issuer of the underlying corporate bond and not a third party, such as a mortgagor or automobile purchaser, that is the subject of credit underwriting. We find implicit support for that conclusion in the Federal Reserve Study, which suggested tailoring mechanisms to align incentives to different asset classes. While the Federal Reserve Study addressed nine different asset classes, it made no mention of Corporate Debt Repackagings, presumably because the logic behind Section 941 of the Dodd-Frank Act simply does not apply to that asset class. In that regard, Corporate Debt Repackagings are distinguishable from collateralized debt obligations, the assets of which consist of ABS, primarily RMBS, and which, as discussed above, are perceived to influence the process in which credit is extended to the borrower of the underlying assets.

J. Other Asset Classes

i. Esoteric Asset Classes

In addition to the core group of assets set forth above, there are numerous other assets that have been securitized in the past, each with their own distinct characteristics and nuances. Some of these assets include: equipment-related assets, such as tractors and other farm equipment, insurance-related assets, intellectual property, municipal bonds, mutual fund fees, church loans, mobile home parks, servicing advances, timber, pay day loans, tax liens, cell towers, time share receivables, transportation assets, aircraft leases, railcars, and shipping containers and vessels. The purpose of this list is solely to illustrate the depth and range of these types of products and does not represent any view on whether or not a particular product would be an Exchange Act ABS. All of these asset classes have their own securitization structures and practices that differ in important respects across each category based on a variety of factors, including the nature and characteristics of the assets, the historical development and credit performance of each asset class and the securitization structures themselves. When crafting risk retention rules and providing appropriate exemptions, the Joint Regulators should consider the very large and growing universe of asset classes that exist beyond the core classes. Each of these esoteric asset classes provides necessary funding to various businesses and industries, and it is critical that the Proposed Regulations do not inhibit their growth.

ii. Collateralized Security Issuances

We are concerned that the Proposed Regulations, as written, could unintentionally include within their scope certain securities which are, either directly or through a guarantee, full-recourse corporate obligations of a creditworthy entity that is not a special-purpose vehicle ("SPV"), but are also secured by a pledge of financial assets. The credit analysis of these securities will consider both the key characteristics of these assets and also the credit quality of the issuing or guaranteeing entity who stands behind the securities. In some cases, these securities may be structured using an SPV that in effect acts as a finance subsidiary, pledging collateral to support payment on the securities with a guarantee of payment from the corporate parent who stands behind the securities. Although backed by pools of self-liquidating assets, these securities do not serve the same purpose, or present the same set of risks, as "asset-backed securities," which the Proposed Regulations intend to regulate.

In such cases, we are concerned that it would be difficult to distinguish between the credit of the corporate issuer or guarantor and that of the pledged assets in determining whether payments to the holders of such security "depend primarily on cash flow from the asset" that collateralizes it, as is prescribed by the Proposed Regulations. As written, and particularly given the explicit characterization in the Proposing Release of foreclosure and sale proceeds as cashflow from the collateral, the Proposed Regulations could potentially be construed to include within the scope of the risk retention requirements any security backed by any self-liquidating financial assets. Currently, various secured issuances that generally meet this description are not considered by the market to be securitizations, as the added recourse to the issuing or guaranteeing corporate entity substantially differentiates the risks associated with such securities from those unique to asset-backed securities.

It is a distinguishing feature of securitizations that the credit risk of the assets is borne primarily by investors, rather than the securitizer. This "transfer" of credit risk through the securitization is the reason why the risk retention rules have been proposed to align incentives between issuers and investors. However, in contrast, a collateralized security issuance with full recourse to the parent issuing entity retains the credit risk in the performance of the pledged assets, as the guarantor or issuer remains obligated to make required payments to investors to the extent that the cashflows of the pledged assets fail to make payments in full. There is no need to require risk retention because the credit risk of the assets has not been transferred to investors in the first place; it remains with the issuer and any guarantor of the securities.

We are requesting that the Joint Regulators provide a bright-line "safe harbor" to ensure that such collateralized security issuances do not unintentionally fall within the scope of the risk retention requirements and to provide the market with certainty with regard to the future application of the Proposed Regulations. Such a safe harbor should provide guidance as to circumstances under which the risk retention requirements would not apply even though a security is collateralized by self-liquidating financial assets. Specifically, we suggest that the Joint Regulators clarify that any security that is (directly or through a guarantee) a full-recourse, general obligation of an entity that (a) is not a special-purpose vehicle and (b) at the time of issuance has outstanding debt securities that meet [the standards adopted by the SEC in its current rulemaking to replace references to investment-grade credit ratings in the issuer qualifications to file registration statements on Form S-3] should not be considered to receive payments that depend primarily on cash flow from any assets pledged to support its repayment, and therefore should not be considered an "asset-backed security," whether or not that security is issued by an entity that is a special-purpose vehicle or is secured by self-liquidating financial assets.

IX. <u>Conclusion</u>

ASF has been a strong and vocal advocate for targeted securitization market reforms and we continue to work with regulators to identify and implement them. ASF supports efforts to align the incentives of issuers with securitization investors and we believe these incentives should encourage the application of sound underwriting standards by both the originator and securitizer in connection with the assets that are securitized. In addition, we support efforts to promote appropriate transparency and standardization in securitization disclosure and transaction documents. ASF will continue to work to provide industry comment on all proposals issued by the various regulatory agencies as well as to promulgate best practices for securitization governance in order to restore confidence in this very important market. Where regulators are tasked with implementing reforms, we support uniform implementation across regulators supported by comprehensive industry and public comment.

*   *   *   *

ASF very much appreciates the opportunity to provide the foregoing comments in response to the Joint Regulators' Proposing Release. Should you have any questions or desire any clarification concerning the matters addressed in this letter, please do not hesitate to contact me at 212.412.7107 or at tdeutsch@americansecuritization.com, or Evan Siegert, ASF Managing Director and Senior Counsel, at 212.412.7109 or at esiegert@americansecuritization.com.

Sincerely,

Tom Deutsch

Tom Deutsch
Executive Director
American Securitization Forum

EXHIBIT A

PROPOSED REGULATION MODIFICATIONS FOR AUTO ABS

****

§ __.2 Definitions.

. . .

Eligible horizontal residual interest means, with respect to any securitization transaction, an ABS interest ***or ABS interests*** in the issuing entity that:

(1) ***If the transaction documents expressly set forth the order in which losses that are incurred on the securitized assets are to be allocated to the ABS interests,*** ~~Is~~ ***is*** allocated all losses on the securitized assets ***(or for an ABS interest that is part of a series issued by a revolving asset master trust, is allocated all losses that are allocated to that series)*** (other than losses that are first absorbed through the release of funds from a premium capture cash reserve account, if such an account is required to be established under § __.12 of this part) until the par value of such ABS interest is reduced to zero;

(2) ***Either (a)*** ~~H~~***h***as the most subordinated claim to payments of ~~both~~ principal ***of all ABS interests of the same series that are entitled to receive principal payments on each payment date and has the most subordinated claim to payments of interest of all ABS interests of the same series that are entitled to receive interest payments on each payment date or (b) is entitled to payments on each payment date only after all other ABS interests of the same series have been paid all principal and interest due on that payment date*** ~~and interest by the issuing entity~~; and

(3) Until all other ABS interests in the issuing entity are paid in full***, either (a)*** is not entitled to receive any payments of principal made on a securitized asset, provided, however, an eligible horizontal residual interest may receive its current proportionate share of scheduled payments of principal received on the securitized assets in accordance with the transaction documents ***or (b) if the transaction documents do not provide for the separate collection and distribution of interest, scheduled payments of principal and unscheduled payments of principal on the securitized assets, is not entitled to receive payments unless the aggregate percentage decrease in the outstanding principal balance or securitization value, as applicable, of all related ABS interests that do not comprise the eligible horizontal residual interest since the closing date is at least equal to the percentage equivalent of the aggregate decrease in the principal balance or securitization value, as applicable, of the securitized assets plus the aggregate decrease (if any) in the amount on deposit in any reserve accounts since the closing date divided by the sum of the principal balance or securitization value, as applicable, of the securitized assets as of the cutoff date plus the amount on deposit in any reserve accounts on the closing date); provided, however, that securitizations that are subject to clause (b) and feature a revolving period will be subject to this limitation only after the end of the revolving period for the related ABS interests and then only by reference***

to the related series' designated portion of the aggregate principal balance or securitization value, as applicable, of the securitized assets.

. . .

Securitized asset means an asset that:

(1) Is transferred, sold, or conveyed to an issuing entity; and

(2) Collateralizes the ~~ABS interests~~ ***investor interests*** issued by the issuing entity.

. . .

Seller's interest means an ABS interest***, ABS interests or portions thereof***:

(1) In ~~all of~~ the ***securitized*** assets ~~that: (i) Are~~ owned or held by the issuing entity~~; and (ii Do not~~ ***other than those that*** collateralize ~~any~~ other ***specified*** ABS interests issued by the issuing entity;

(2) That is pari passu ***or subordinate to*** ~~with all other ABS~~ ***each series of investor*** interests issued by the issuing entity with respect to the allocation of all ~~payments~~ ***collections*** and losses ***with respect to the securitized assets*** prior to an early amortization event (as defined in the transaction documents); and

(3) That adjusts for fluctuations in the outstanding principal balances of the securitized assets.

§ __.3 Base risk retention requirement.

. . .

(c) Affiliates. Any economic interest in the credit risk of the securitized assets in accordance with any one of § ___.4 through § ___.11 of this part by an entity that is a consolidated affiliate of the sponsor of the related securitization transaction shall be treated for all purposes under this [subpart B] as retention of that economic interest by the sponsor for so long as that entity remains a consolidated affiliate of the sponsor.

§ __.5 Horizontal risk retention.

(a) General Requirement. At the closing of the securitization transaction, the sponsor retains an eligible horizontal residual interest in an amount that is equal to at least five percent of the par value of all ABS interests in the issuing entity issued as part of the securitization transaction.

~~(b)~~ ***[Part (b) moved to § __.5A and additions/deletions are marked there]***

(~~c~~ ***b***) <u>Disclosures</u>. A sponsor utilizing this section shall provide, or cause to be provided, to potential investors a reasonable period of time prior to the sale of the asset-backed securities in the securitization transaction and, upon request, to the Commission and its appropriate Federal banking agency, if any, the following disclosure in written form under the caption "Credit Risk Retention":

(1) ~~If the sponsor retains risk through an eligible horizontal residual interest:~~

~~(i)~~ The amount (expressed as a percentage and dollar amount) of the eligible horizontal residual interest the sponsor will retain (or did retain) at the closing of the securitization transaction, and the amount (expressed as a percentage and dollar amount) of the eligible horizontal residual interest that the sponsor is required to retain under this section; and

(~~ii~~ ***2***) A description of the material terms of the eligible horizontal residual interest to be retained by the sponsor;

~~(2)~~ ***[Part (c)(2) moved to § __.5A and additions/deletions are marked there]***

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

§ __.5A <u>Reserve accounts</u>.

(a) <u>General Requirement</u>. ~~In lieu of retaining an eligible horizontal residual interest in the amount required by paragraph (a) of this section, t~~***T***he sponsor may, at closing of the securitization transaction, cause to be established and funded, in cash, a ~~horizontal cash~~ reserve account in ~~the~~ ***an*** amount ***that is equal to at least five percent of the par value of all ABS interests in the issuing entity issued as part of the series that is supported by the reserve account,*** provided that the account meets all of the following conditions:

(1) The account is held by the trustee (or person performing similar functions) in the name and for the benefit of the issuing entity;

(2) Amounts in the account are invested ~~only in:~~

~~(i) United States Treasury securities with maturities of 1 year or less; or~~

~~(ii) Deposits in one or more insured depository institutions (as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813)) that are fully insured by federal deposit insurance; and~~ ***according to the same investment criteria that are set forth in the transaction documents regarding investments of***

amounts on deposit in other trust accounts relating to the same series of ABS interests, or a subset of those other permitted investments.

(3) Until all ABS interests in the issuing entity are paid in full or the issuing entity is dissolved:

(i) Amounts in the account shall be released to satisfy payments on ABS interests in the issuing entity on any payment date on which the issuing entity has insufficient funds from any source (including any premium capture cash reserve account established pursuant to § __.12 of this part) to satisfy an amount due on any ABS interest; and

~~(ii) No other amounts may be withdrawn or distributed from the account except that:~~

~~(A) Amounts in the account may be released to the sponsor or any other person due to the receipt by the issuing entity of scheduled payments of principal on the securitized assets, provided that, the issuing entity distributes such payments of principal in accordance with the transaction documents and the amount released from the account on any date does not exceed the product of:~~

~~(1) The amount of scheduled payments of principal received by the issuing entity and for which the release is being made; and~~

~~(2) The ratio of the current balance in the horizontal cash reserve account to the aggregate remaining principal balance of all ABS interests in the issuing entity; and~~

(~~B~~ ***ii***) Interest on investments made in accordance with paragraph (~~b~~ ***a***)(2) may be released once received by the account**.**

(~~c~~ ***b***) Disclosures. A sponsor utilizing this section shall provide, or cause to be provided, to potential investors a reasonable period of time prior to the sale of the asset-backed securities in the securitization transaction and, upon request, to the Commission and its appropriate Federal banking agency, if any, the following disclosure in written form under the caption "Credit Risk Retention":

. . . ~~(2) If the sponsor retains risk through the funding of a horizontal cash reserve account:~~

(i) The dollar amount to be placed (or placed) by the sponsor in the ~~horizontal cash~~ reserve account and the dollar amount the sponsor is required to place in such an account pursuant to this section; and

(ii) A description of the material terms of the ~~horizontal cash~~ reserve account; ~~and~~

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

§ __.6 ~~L-Shaped~~ *Blended* risk retention.

(a) General requirement. At the closing of the securitization transaction, ***the sum of (i) if the sponsor retains an interest in each class of ABS interests in the issuing entity, the percentage interest in any class so retained multiplied by the face value or, if applicable, the calculated value of each such ABS interest; provided, that the percentage interest for any class may be no greater than the lowest percentage interest retained in any other ABS interest that is subordinate in its right to receive payments of principal to such class's right to receive payments of principal and in its rights to receive payments of interest to such class's right to receive payments of interest, (ii) if the sponsor retains an eligible horizontal residual interest, the calculated value of that interest minus the calculated value of that portion of the eligible horizontal residual interest retained pursuant to clause (i), (iii) if the sponsor establishes a reserve account, the amount on deposit in the reserve account (without duplication of any amount included in the calculated value of an eligible horizontal residual interest pursuant to clause (ii)), (iv) if the sponsor retains a seller's interest, the percentage of the collections on the assets that is allocated at closing to the related series multiplied by the principal balance of the seller's interest and (v) if the sponsor establishes a representative sample pool, the aggregate unpaid principal balance or securitization value, as applicable, of the assets in such pool, equals not less than five percent of the aggregate ABS interests in the issuing entity***. ~~the sponsor~~:

~~(1) Retains not less than 2.5 percent of each class of ABS interests in the issuing entity issued as part of the securitization transaction; and~~

~~(2) Retains an eligible horizontal residual interest in the issuing entity, or establishes and funds in cash a horizontal cash reserve account that meets all of the requirements of § __.5(b) of this part, in an amount that in either case is equal to at least 2.564 percent of the par value of all ABS interests in the issuing entity issued as part of the securitization transaction other than any portion of such ABS interests that the sponsor is required to retain pursuant to paragraph (a)(1) of this section.~~

(b) Disclosure requirement. A sponsor utilizing this section shall comply with all of the disclosure requirements set forth in § __.4(b)**,** ~~and~~ § __.5(c) ***and § __.5A(b)*** of this part.

§ __.7 <u>Revolving asset master trusts</u>.

(a) <u>General requirement</u>. At the closing of the securitization transaction and until all ABS interests in the issuing entity are paid in full, the ~~sponsor~~ ***depositor*** retains a seller's interest of not less than five percent of the ~~unpaid~~ ***outstanding*** principal balance of ~~all the assets~~ ***the investor interests*** owned or held by the issuing entity provided that:

(1) The issuing entity is a revolving asset master trust; and

(2) All of the securitized assets are loans or other extensions of credit that arise under revolving accounts ***or financing arrangements, or participation or other interests therein, including collateral certificates or similar interests in a trust or other entity that holds such assets***.

§ __.8 Representative sample.

(a) <u>In general</u>. At the closing of the securitization transaction, the sponsor retains ownership of a ~~representative sample of the~~ ***designated*** pool of assets ~~that are designated for securitization in the securitization transaction and draws from such pool all of the securitized assets for the securitization transaction~~, provided that:

(1) At the time of issuance of asset-backed securities by the issuing entity, the unpaid principal balance of the assets comprising the representative sample retained by the sponsor is equal to at least 5~~.264~~ percent of the unpaid principal balance of all the securitized assets in the securitization transaction; and

(2) The sponsor complies with paragraphs (b) through (***f***~~g~~) of this section.

(b) <u>Construction of representative sample</u>.

(1) <u>Designated pool</u>. ***The assets included in the designated pool must meet all eligibility criteria set forth in the transaction documents for assets that were included in the securitized pool.*** ~~Prior to the sale of the asset-backed securities as part of the securitization transaction, the sponsor identifies a designated pool (the ―designated pool‖) of assets:~~

~~(i) That consists of a minimum of 1000 separate assets;~~

~~(ii) From which the securitized assets and the assets comprising the representative sample are exclusively drawn; and~~

~~(iii) That contains no assets other than those described in paragraph (b)(1)(ii) of this section.~~

~~(2) Random selection from designated pool. (i) Prior to the sale of the asset-backed securities as part of the securitization transaction, the sponsor selects from the assets that~~

~~comprise the designated pool a sample of such assets using a random selection process that does not take account of any characteristic of the assets other than the unpaid principal balance of the assets.~~

~~(ii) The unpaid principal balance of the assets selected through the random selection process described in paragraph (b)(2)(i) must represent at least 5 percent of the aggregate unpaid principal balance of all the assets that comprise the designated pool.~~

(3) Equivalent risk determination. Prior to the sale of the asset-backed securities as part of the securitization transaction, the sponsor determines, using a statistically valid methodology, that ***the mean of the FICO scores, outstanding principal balance and remaining terms of the assets in a sample of assets drawn from the designated pool*** ~~for each material characteristic of the assets in the designated pool, including the average unpaid principal balance of all the assets, that the mean of any quantitative characteristic, and the proportion of any characteristic that is categorical in nature, of the sample of assets randomly selected from the designated pool pursuant to paragraph (b)(2) of this section~~ is within a 95 percent two-tailed confidence interval of the mean ~~or proportion, respectively,~~ of the same characteristic of the assets in the designated pool.

(c) Sponsor policies, procedures and documentation.

(1) The sponsor has in place, and adheres to, policies and procedures for:

(i) Identifying and documenting the material characteristics of assets included in the designated pool;

(ii) Selecting assets ~~randomly~~ in accordance with paragraph (b)(***1***~~2~~) of this section;

(iii) Testing ~~the randomly selected~~ ***a*** sample of assets for compliance with paragraph (b)(***2***~~3~~) of this section;

(iv) Maintaining, until all ABS interests are paid in full, documentation that clearly identifies the assets included in the representative sample ~~established under paragraphs (b)(2) and (3) of this section~~; and

(v) Prohibiting, until all ABS interests are paid in full, assets in the representative sample from being included in the designated pool of any other securitization transaction.

(2) The sponsor maintains documentation that clearly identifies the assets in the representative sample established under ~~paragraphs (b)(2) and (3)~~ of this section.

~~(d) Agreed upon procedures report.~~

~~(1) Prior to the sale of the asset-backed securities as part of the securitization transaction, the sponsor has obtained an agreed upon procedures report that satisfies the requirements of paragraph (d)(2) of this section from an independent public accounting firm.~~

~~(2) The independent public accounting firm providing the agreed upon procedures report required by paragraph (d)(1) of this section must at a minimum report on whether the sponsor has:~~

~~(i) Policies and procedures that require the sponsor to identify and document the material characteristics of assets included in a designated pool of assets that meets the requirements of paragraph (b)(1) of this section;~~

~~(ii) Policies and procedures that require the sponsor to select assets randomly in accordance with paragraph (b)(2) of this section;~~

~~(iii) Policies and procedures that require the sponsor to test the randomly-selected sample of assets in accordance with paragraph (b)(3) of this section;~~

~~(iv) Policies and procedures that require the sponsor to maintain, until all ABS interests are paid in full, documentation that identifies the assets in the representative sample established under paragraphs (b)(2) and (3) of this section; and~~

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

(***d***~~e~~) <u>Servicing</u>. Until such time as all ABS interests in the issuing entity have been fully paid or the issuing entity has been dissolved:

(1) Servicing of the assets included in the representative sample must be conducted by the same entity and under the same contractual standards as the servicing of the securitized assets; and

(2) The individuals responsible for servicing the assets included in the representative sample or the securitized assets must not be able to determine whether an asset is owned or held by the sponsor or owned or held by the issuing entity***, provided that individuals responsible for directing collections on assets to accounts for the benefit of the sponsor or the issuing entity are permitted to identify collections for such purpose***.

(***e***~~f~~) <u>Sale, hedging or pledging prohibited</u>. Until such time as all ABS interests in the issuing entity have been fully paid or the issuing entity has been dissolved, the sponsor:

(1) Shall comply with the restrictions in § __.14 of this part with respect to the assets in the representative sample;

(2) Shall not remove any assets from the representative sample; and

(3) Shall not cause or permit any assets in the representative sample to be included in any designated pool or representative sample established in connection with any other issuance of asset-backed securities.

(g) Disclosures.

~~(1) Disclosure prior to sale.~~ A sponsor utilizing this section shall provide, or cause to be provided, to potential investors a reasonable period of time prior to the sale of the asset-backed securities as part of the securitization transaction and, upon request, to the Commission and its appropriate Federal banking agency, if any, the following disclosure with respect to the securitization transaction in written form under the caption "Credit Risk Retention":

(***1***~~i~~) The amount (expressed as a percentage of the designated pool and dollar amount) of assets included in the representative sample and to be retained (or retained) by the sponsor, and the amount (expressed as a percentage of the designated pool and dollar amount) of assets required to be included in the representative sample and retained by the sponsor pursuant to this section;

(***2***~~ii~~) A description of the material characteristics of the designated pool, including, but not limited to, the average unpaid principal balance of all the assets, the means of the ~~quantitative characteristics and the proportions of categorical characteristics~~ ***FICO scores, outstanding principal balance and remaining terms*** of the assets, appropriate introductory and explanatory information to introduce the characteristics, the methodology used in determining or calculating the characteristics, and any terms or abbreviations used;

~~(iii) A description of the policies and procedures that the sponsor used for ensuring that the process for identifying the representative sample complies with paragraph (b)(2) of this section and that the representative sample has equivalent material characteristics as required by paragraph (b)(3) of this section;~~

~~(iv) Confirmation that an agreed upon procedures report was obtained pursuant to paragraph (d) of this section; and~~

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

~~(2) Disclosure after sale. A sponsor utilizing this section shall provide, or cause to be provided, to the holders of the asset-backed securities issued as part of the securitization transaction and, upon request, provide, or cause to be provided, to the Commission and its appropriate Federal banking agency, if any, at the end of each distribution period, as specified in the governing documents for such asset-backed securities, a comparison of the performance of the pool of securitized assets included in the securitization transaction for the related distribution period with the performance of the assets in the representative sample for the related distribution period.~~

~~(3) Conforming disclosure of representative sample. A sponsor utilizing this section shall provide, or cause to be provided, to holders of the asset-backed securities issued as part of the securitization transaction and, upon request, provide to the Commission and its appropriate Federal banking agency, if any, disclosure concerning the assets in the representative sample in the same form, level, and manner as it provides, pursuant to rule or otherwise, concerning the securitized assets.~~

§ __.14 <u>Hedging, transfer and financing prohibitions</u>. . . .

(f) <u>Permissible Transactions</u>. Nothing in this Section __.14 prohibits a retaining sponsor from taking any actions with respect to any ABS interests or other assets, including ABS Interests or other assets that it previously retained to comply with subpart B of this part with respect to a securitization transaction, if following such actions the sponsor will continue to retain ABS interests and/or assets pursuant to subpart B of this part in respect of the related securitization that are not subject to hedging arrangements prohibited by clause (b) or clause (c) or non-recourse financing prohibited by clause (e) and are in an aggregate amount that is at least equal to five percent of the par value of all outstanding ABS interests issued by the related issuing entity.

EXHIBIT B

PROPOSED REGULATION MODIFICATIONS FOR ABCP

****

Proposed Regulation Modifications – Horizontal Risk Retention

****

§ __.5 Horizontal risk retention.

(a) General requirement. At the closing of the securitization transaction,

(1) the sponsor retains an eligible horizontal residual interest in an amount that is equal to at least five percent of the par value of all ABS interests in the issuing entity issued as part of the securitization transaction, or

(2) if such securitization transaction is funded by an ABCP conduit, the sponsor of such ABCP conduit causes one or more eligible program support providers to provide program support that benefits the holders of the ABCP of such ABCP conduit, provided that:

(i) Such program support obligates each program support provider to either pay ABCP or otherwise cover the credit risk of the asset interests held by such ABCP conduit (in each case to the extent of the required retention amount) before the ABCP holders incur any loss;

(ii) The aggregate amount of such program support is equal to at least 5% of the par value of outstanding ABCP of such ABCP conduit plus the par value of any permitted first loss protection;

(iii) One or more regulated providers have entered into a legally binding commitment to provide at least 100 percent liquidity coverage (in the form of a lending facility, an asset purchase agreement, a repurchase agreement, or other similar arrangement that may be conditional or unconditional) to all the ABCP issued by the ABCP conduit by lending to, or purchasing assets from, the ABCP conduit in the event that funds are required to repay maturing ABCP issued by the ABCP conduit; and

(iv) Each eligible program support provider complies with the provisions of § ___.14 of this part with respect to such program support except with respect to any permitted first loss protection.

(b) Option to hold base amount in horizontal cash reserve account. In lieu of retaining an eligible horizontal residual interest in the amount required by paragraph (a) of this section, the sponsor may, at closing of the securitization transaction, cause to be established and funded, in cash, a horizontal cash reserve account in the amount specified in paragraph (a), provided that the account meets all of the following conditions:

(1) The account is held by the trustee (or person performing similar functions) in the name and for the benefit of the issuing entity;

(2) Amounts in the account are invested only in:

(i) United States Treasury securities with maturities of 1 year or less; or

(ii) Deposits in one or more ~~insured depository institutions (as defined in Section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813)) that are fully insured by federal deposit insurance; and~~regulated providers.

(3) Until all ABS interests in the issuing entity are paid in full or the issuing entity is dissolved:

(i) Amounts in the account shall be released to satisfy payments on ABS interests in the issuing entity on any payment date on which the issuing entity has insufficient funds from any source (including any premium capture cash reserve account established pursuant to §__.12 of this part) to satisfy an amount due on any ABS interest; and

(ii) No other amounts may be withdrawn or distributed from the account except that:

(A) Amounts in the account may be released to the sponsor or any other person due to the receipt by the issuing entity of scheduled payments of principal on the securitized assets, provided that, the issuing entity distributes such payments of principal in accordance with the transaction documents and the amount released from the account on any date does not exceed the product of:

(1) The amount of scheduled payments of principal received by the issuing entity and for which the release is being made; and

(2) the ratio of the current balance in the horizontal cash reserve account to the aggregate remaining principal balance of all ABS interests in the issuing entity; and

(B) Interest on investments made in accordance with paragraph (b)(2) may be released once received by the account.

(c) Disclosures. A sponsor utilizing this section shall provide, or cause to be provided, to potential investors a reasonable period of time prior to the sale of the asset-backed securities in the securitization transaction (or, in the case of ABCP, before or contemporaneous with the first sale of ABCP to each investor and, thereafter, no less frequently than each calendar month that such investor holds any ABCP), and, upon request, to the Commission and ~~to~~ its appropriate Federal banking agency, if any, the following disclosure in written form under the caption ~~"Credit~~"Credit Risk ~~Retention"~~Retention":

(1) If the sponsor retains risk ~~through an eligible horizontal residual interest~~pursuant to paragraph (a)(1) of this section:

(i) The amount (expressed as a percentage and dollar amount) of the eligible horizontal residual interest the sponsor will retain (or did retain) at the closing of the securitization transaction, and the amount (expressed as a percentage and dollar amount) of the eligible horizontal residual interest that the sponsor is required to retain under this section; and

(ii) A description of the material terms of the eligible horizontal residual interest to be retained by the sponsor~~:~~;

(2) If the sponsor utilizes one or more program support providers to retain risk pursuant to paragraph (a)(2) of this section:

(i) the amount (expressed as a percentage and as a dollar amount) of the program support that each program support provider will retain (or did retain) and the amount (expressed as percentage and as a dollar amount) of the program support each program support provider is required to retain under this section;

(ii) a description of the material terms of the program support provided by each program support provider, and, if such sponsor determines that any such eligible program support provider has failed to maintain program support in compliance with the requirements of paragraph (a) (2), notice of such failure; and

(iii) the name and form of organization of each regulated provider that provides liquidity support to the ABCP conduit, including a description of the form, amount and nature of such liquidity support, and, if such sponsor determines that such regulated provider has failed to provide the required liquidity support, notice of such failure;

(3) If the sponsor retains risk through the funding of a horizontal cash reserve account:

(i) The dollar amount to be placed (or placed) by the sponsor of the horizontal cash reserve account and the dollar amount the sponsor is required to place in such an account pursuant to this section; and

(ii) A description of the material terms of the horizontal cash reserve account; and

(~~3) The~~4) Unless the sponsor is utilizing paragraph (a)(2) of this section, the material assumptions and methodology used in determining the aggregate dollar amount of ABS interests issued by the issuing entity in the securitization transaction, including those pertaining to any estimated cash flows and the discount rate used.

Proposed Regulation Modifications – Eligible ABCP Conduits

****

§ __.9 Eligible ABCP conduits.

(a) In general. A sponsor satisfies the risk retention requirement of § __.3 of this part with respect to the issuance of ABCP by an eligible ABCP conduit in a securitization transaction if:

(1) ~~Each originator-seller of the ABCP conduit:~~for each securitization transaction of such ABCP conduit (other than a pre-existing securitization transaction or a securitization transaction that is otherwise exempt from the risk retention requirements of this part), the sponsor causes the ABCP conduit to enter into an agreement with an originator-seller (and, if applicable, one or more affiliates) for such securitization transaction that requires such originator-seller(s) to:

(i) ~~Retains an eligible horizontal residual~~Retain, directly or through its ownership interest in ~~each intermediate SPV established by or on behalf of that originator-seller for purposes of issuing interests collateralized by assets of such intermediate SPV~~an intermediate SPV, an economic interest in the credit risk of the assets collateralizing the interest in such assets sold, pledged, transferred or issued to the eligible ABCP conduit in the same form, amount, and manner as would be required under any one of § __.~~5(a)~~4 through § __.8 or § __.10 of this part if ~~the~~such originator-seller~~ was~~(s) were the only sponsor of the ~~intermediate SPV~~securitization transaction; and

(ii) ~~Complies~~ Comply with the provisions of § __.14 of this part with respect to the ~~eligible horizontal residual~~retained economic interest ~~retained~~ pursuant to paragraph (a)(1)~~(I)~~ of this section as if it were a retaining sponsor with respect to such interest~~;~~ sold, pledged, transferred or issued to the eligible ABCP conduit; and

(2) The sponsor~~;~~:

(i) ~~Establishes the eligible ABCP conduit; (ii)~~ Approves each originator-seller permitted to sell, pledge or transfer assets, directly or indirectly through an intermediate SPV, to the ~~eligible~~ ABCP conduit and each intermediate SPV;

(~~iii~~ii) Establishes criteria governing the assets that the originator-sellers referred to in ~~paragraph (a)~~clause (2)(~~ii) of this section~~i) are permitted to sell, pledge or transfer ~~to an intermediate SPV; (iv) Approves all interests in an~~

~~intermediate SPV to be purchased~~that will be funded by the ~~eligible~~ ABCP conduit;

(~~v~~iii) Administers the ~~eligible~~ ABCP conduit by monitoring the interests ~~in any intermediate SPV acquired by the~~sold, pledged or transferred to the ABCP conduit and the assets collateralizing those interests, arranging for debt placement, compiling monthly reports, and ensuring compliance with the ABCP conduit documents and with the ABCP conduit's credit and investment policy; and

(~~vi~~iv) Maintains and adheres to policies and procedures for ensuring that the conditions in this ~~paragraph~~clause (~~a~~2) have been met.

(b) Disclosures. (1) A sponsor utilizing this section shall provide, or cause to be provided, to each potential ~~investors a reasonable period of time prior to the sale of any~~investor in the ABCP ~~by~~of the eligible ABCP conduit ~~as part of the securitization transaction~~before or contemporaneous with the first sale of ABCP to such investor and thereafter no less frequently than each calendar month that such investor holds any such ABCP and, upon request, to the Commission and its appropriate Federal banking agency, if any, in written form~~ under the caption "Credit Risk Retention", the name and form of organization of:~~,

(~~1) Each~~i) the industry category of each originator-seller that will retain (or has retained) an ~~eligible horizontal residual~~economic interest in the securitization transaction pursuant to this section, including a description of the form, amount (expressed as a percentage and as a dollar amount)~~,~~ and nature of such interest;~~ and~~

(~~2) Each~~ii) the name and form of organization of each regulated~~ liquidity~~ provider that provides liquidity support to the eligible ABCP conduit, including a description of the form, amount and nature of such liquidity ~~coverage~~support, and, if such sponsor determines that such regulated provider has failed to provide the required liquidity support, notice of such failure; and

(iii) if such sponsor determines that an originator-seller has failed to comply with the risk retention requirements of its securitization transaction, notice of such failure and status (waived, plan for resolution, wind-down).*

(2) A sponsor utilizing this Section shall also provide, upon request, to the appropriate Federal banking agency or, if the sponsor is not a bank or an affiliate of a bank, to the Commission, the name of each originator-seller required to retain risk under this Section. Such

* The disclosure requirements in § ___.9(b)(1) are consistent with the proposals made by the American Securitization Forum ("ASF"), on behalf of the ASF ABCP Investor Subcommittee and the ASF ABCP Financial Intermediary Subforum, in its Comment Letter dated August 2, 2010 relating to Release Nos. 33-9117; 34-61858 (File No. S7-08-10).

information shall be treated as exempt confidential information for purposes of the Freedom of Information Act.

(c) Duty to comply.

~~(1) The retaining sponsor shall be responsible for compliance with this section. (2)~~ A ~~retaining~~ sponsor relying on this section~~: (i) Shall~~ shall maintain and adhere to policies and procedures that are reasonably ~~designated~~designed to monitor compliance by each originator-seller of the eligible ABCP conduit with the requirements of ~~paragraph (a)(1) of~~ this section; ~~and (ii) In the event that the sponsor determines that an originator-seller no longer complies with the requirements of paragraph (a)(1) of this section, shall promptly notify the holders of the ABS interests issued in the securitization transaction of such noncompliance by such originator-seller~~provided that the retaining sponsor may rely on written covenants and representations and warranties by the originator-seller in determining whether each originator-seller is in compliance with such requirements.

EXHIBIT C

Proposed Definition Modifications for ABCP

****

ABCP means an asset-backed ~~commercial paper~~promissory note that has a maturity at the time of issuance not exceeding ~~nine months~~397 days, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

~~Eligible~~ ABCP conduit means one or both of the following, as the context requires: an issuing entity that issues ABCP and any special purpose vehicle that (1) uses the proceeds of ABCP issued by an ABCP conduit that is an issuing entity to acquire interests in one or more securitization transactions and (2) is sponsored by the same person that sponsors such issuing ABCP conduit.

Eligible ABCP conduit means an ABCP conduit provided that:

(1) The ~~issuing entity~~ABCP conduit is bankruptcy remote or otherwise isolated for insolvency purposes from the sponsor of the ~~issuing entity~~ABCP conduit and from any intermediate SPV;

(2) The interests issued, pledged, sold or transferred by an intermediate SPV to the ~~issuing entity~~ABCP conduit are collateralized solely by the assets originated or acquired by ~~a single originator-seller;(3) All of the interests issued by intermediate SPV are transferred to~~ one or more ~~ABCP conduits or retained by the~~affiliated originator-~~seller~~sellers or the intermediate SPV; and

(~~4~~3) ~~A~~One or more regulated ~~liquidity provider has~~providers have entered into a legally binding commitment to provide, in the aggregate, at least 100 percent liquidity coverage (in the form of a lending facility, an asset purchase agreement, a repurchase agreement, or other similar arrangement that may be conditional or unconditional) to all the ABCP issued by the ~~issuing entity~~ABCP conduit by lending to, or purchasing assets from, the ~~issuing entity~~ABCP conduit in the event that funds are required to repay maturing ABCP issued by the ~~issuing entity~~ABCP conduit.

Eligible program support provider means one or more regulated provider(s) that (i) is a sponsor of the ABCP conduit for which it provides such support, or (ii) is an affiliate of such sponsor.

Intermediate SPV means~~, with respect to an originator-seller,~~ a special purpose vehicle that:

(1) Is bankruptcy remote or otherwise isolated for insolvency purposes from ~~the~~each originator-seller~~; (2) Purchases assets from the originator-seller~~ of such intermediate SPV; and

(~~3~~2) Issues, sells, pledges or transfers interests collateralized by such assets to one or more ABCP conduits.

Originator-seller means~~ an entity that creates assets through one or more extensions of credit and sells those assets (and no other assets) to an~~, a person that originates and sells or pledges assets to one or more ABCP conduits or, with respect to an originator-seller that acts through an intermediate SPV, an originator that sells assets to an intermediate SPV or, if the intermediate SPV directly originates assets, each entity that owns a direct or indirect equity interest in such intermediate SPV, which ~~in turn~~intermediate SPV sells, pledges or transfers interests collateralized by those assets to one or more ABCP conduits.

Permitted first loss protection means, with respect to any ABCP conduit, first loss protection provided by a person not affiliated with the sponsor of such ABCP conduit to such ABCP conduit or its eligible program support provider, provided that such protection represents not more than 1% of the face amount of the outstanding ABCP of such ABCP conduit.

Pre-existing securitization transaction means a securitization transaction entered into by an ABCP conduit prior to the effective date of this regulation, except to the extent that, after the effective date of this part (i) the duration of any funding commitment of the ABCP conduit or any of its liquidity providers made directly to an originator-seller or to an intermediate SPV under such transaction is extended or (ii) the amount of any such funding commitment is increased.

Program support means irrevocable and unconditional credit facilities in the form of one or more (i) letters of credit or (ii) other arrangements or facilities that provide comparable credit support.

Regulated~~ liquidity~~ provider means:

(1) A depository institution (as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813));

(2) A bank holding company (as defined in 12 U.S.C. 1841), or a subsidiary thereof;

(3) A savings and loan holding company (as defined in 12 U.S.C. 1467a), provided all or substantially all of the holding company's activities are permissible for a financial holding company under 12 U.S.C. 1843(k), or a subsidiary thereof;~~ or~~

(4) A foreign bank whose home country supervisor (as defined in § 211.21 of the Federal Reserve Board's Regulation K (12 CFR 211.21)) has adopted capital standards consistent with the Capital Accord of the Basel Committee on Banking Supervision, as amended, and that is subject to such standards, or a subsidiary thereof; or

(5) any central government or agency, department, ministry or central bank of a central government.

Sponsor means a person who

(i) organizes and initiates a securitization transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuing entity~~.~~; or

(ii) in the case of an ABCP conduit, (1) administers such ABCP conduit and arranges for it to enter into securitization transactions, (2) selects and structures the securitization transactions entered into by such ABCP conduit, or (3) solely for purposes of § ___.5 of this part, if the administrator of such ABCP conduit is not a regulated provider or an affiliate of a regulated provider, one or more regulated providers that refer securitization transactions to an ABCP conduit and provide program support to the ABCP conduit.

EXHIBIT D

LINKED AND DELINKED STRUCTURES IN CREDIT CARD ABS

Illustration 1: Linked Structure

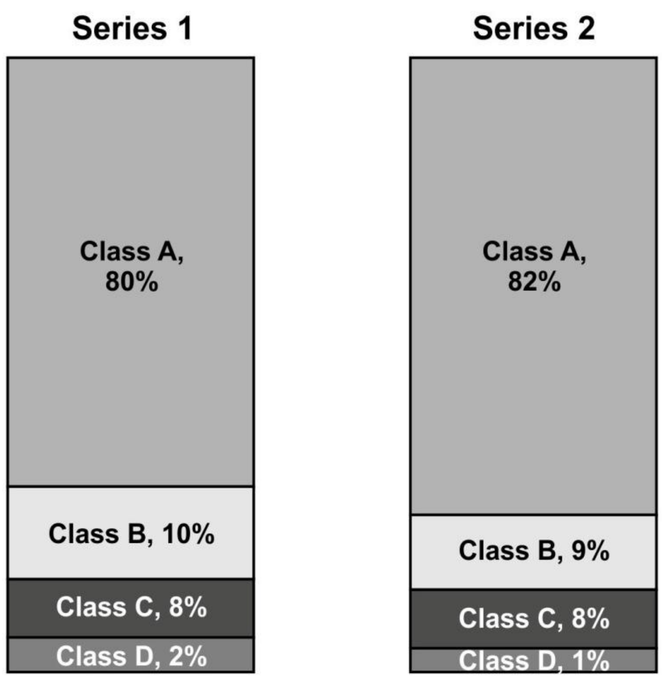


Illustration 2: Delinked Structure

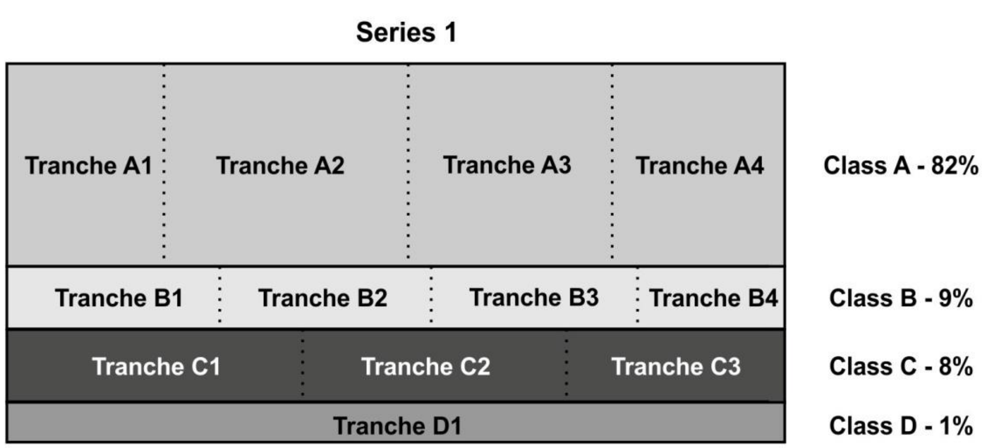
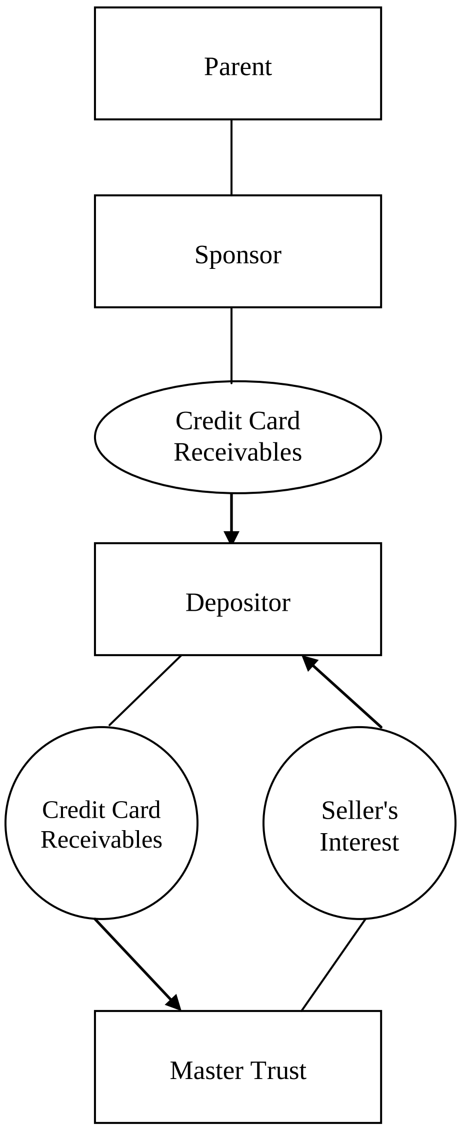
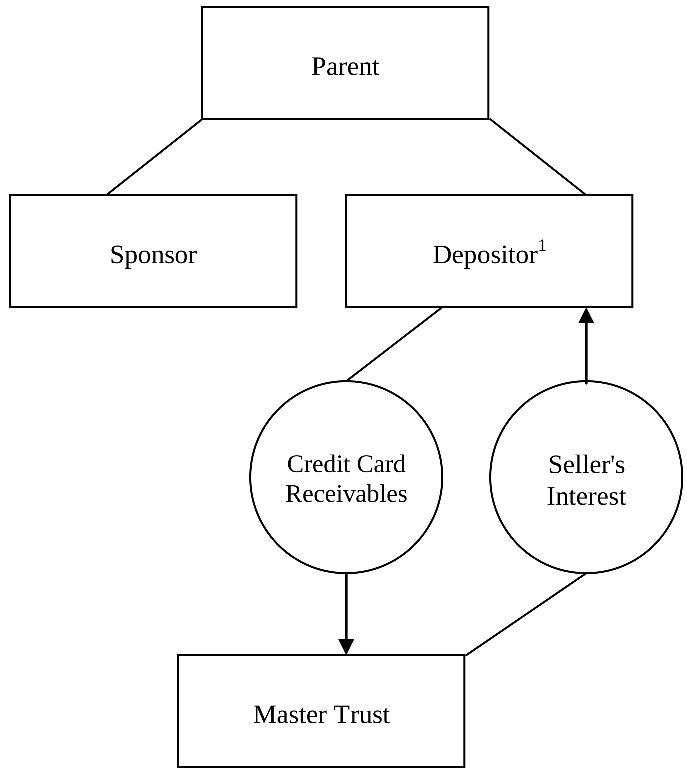


EXHIBIT E

Illustration 1:	Illustration 2:
Depositor is a direct wholly-owned subsidiary of sponsor	**Depositor is an affiliate of sponsor that is under common control with direct parent**





[1] The Depositor receives the Credit Card Receivables either directly or indirectly from the Sponsor.

EXHIBIT F

ILLUSTRATION OF AFFILIATED DEPOSITORS EACH HOLDING A PORTION OF SELLER'S INTEREST

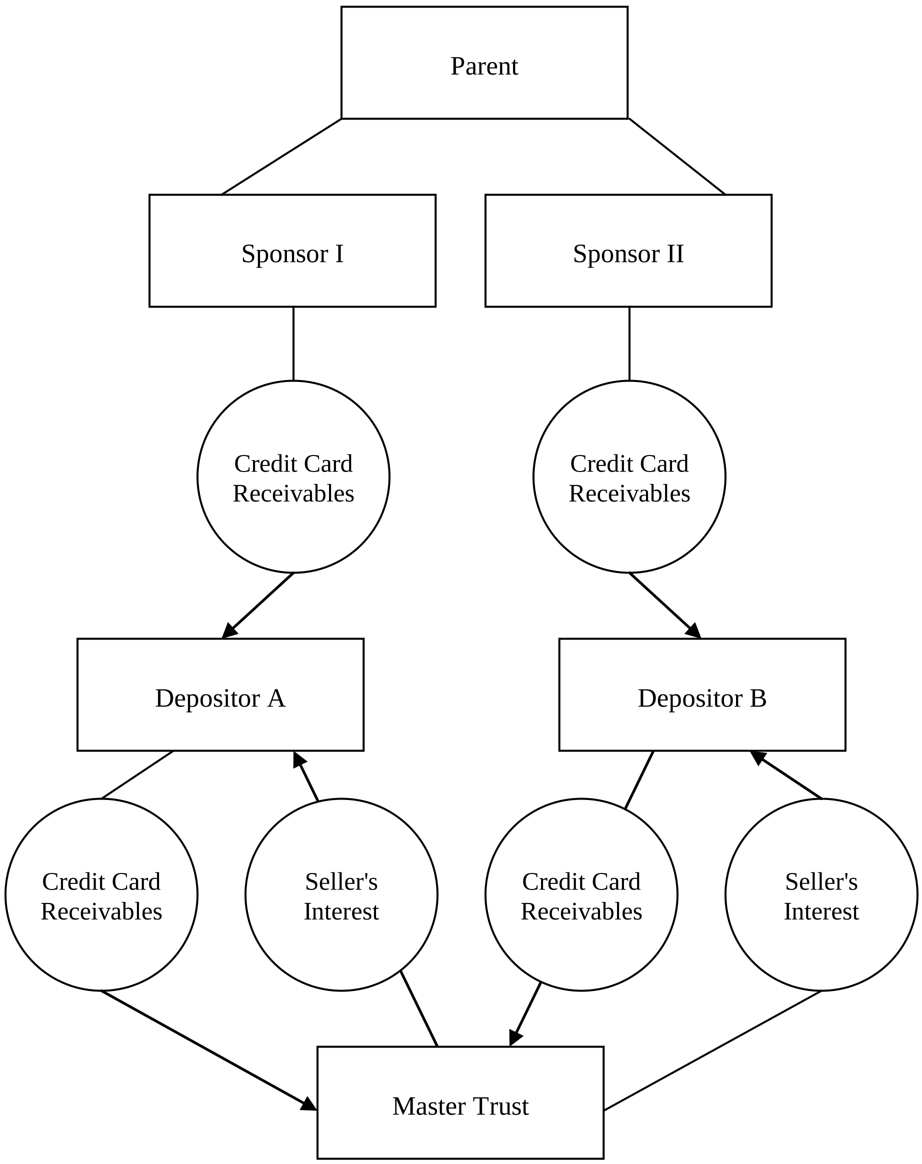
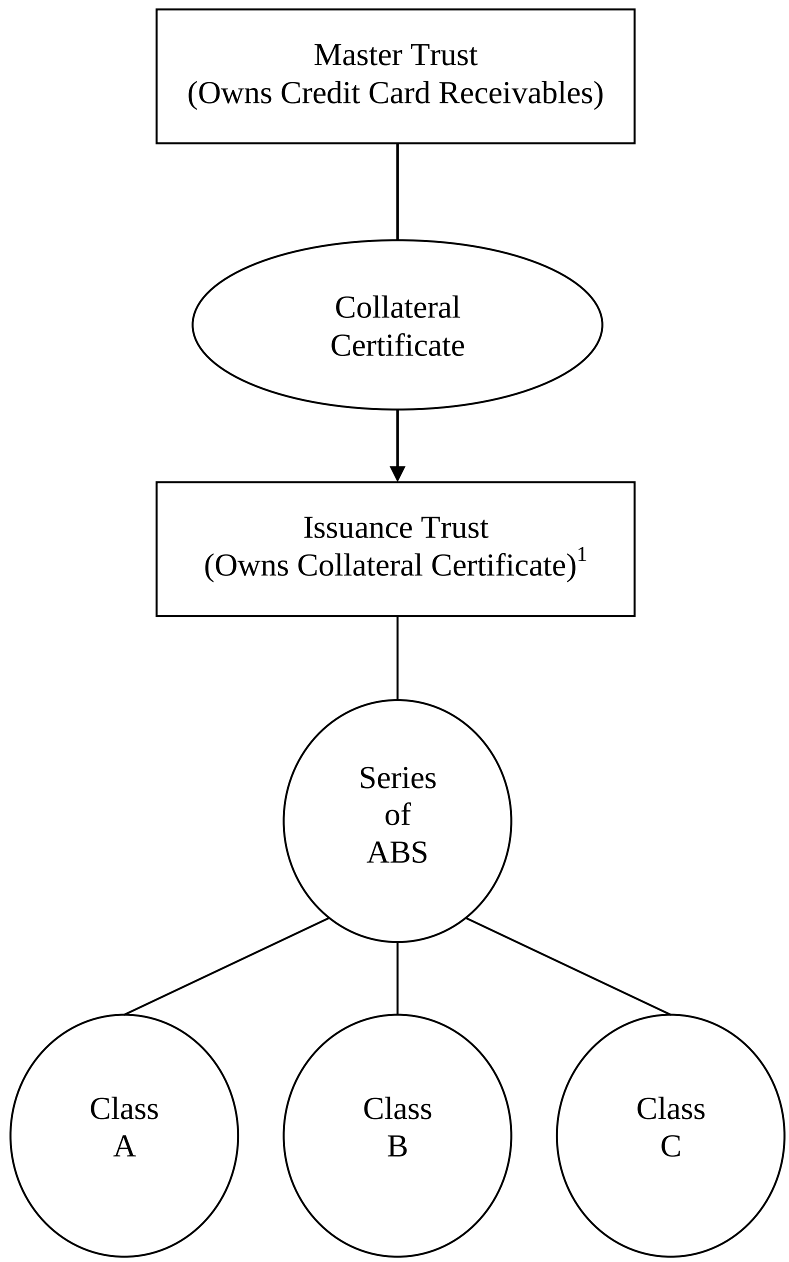


EXHIBIT G

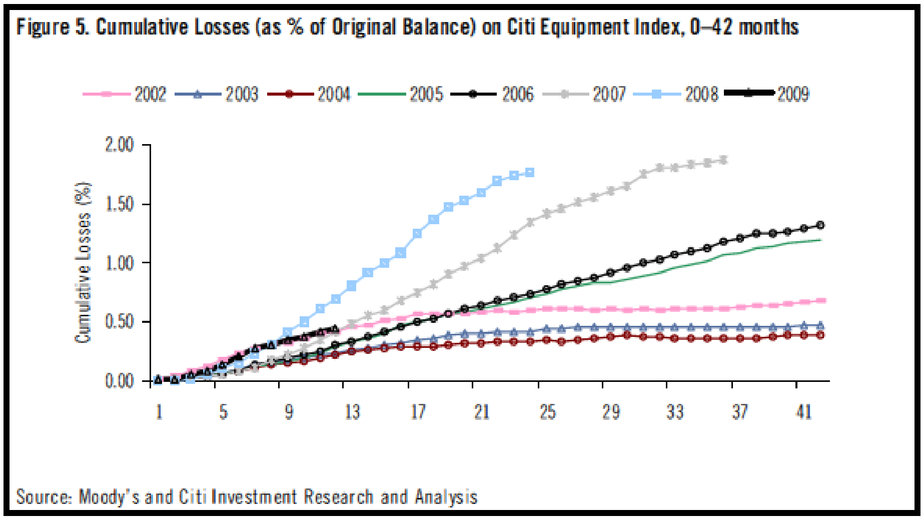
ILLUSTRATION OF AN ISSUANCE TRUST STRUCTURE



[1] In some instances, the Issuance Trust may own some Credit Card Receivables in addition to the Collateral Certificate.

EXHIBIT H

EQUIPMENT ABS CUMULATIVE LOSS CHART



Source: Citi Consumer ABS Weekly, Sept. 30, 2010 (the "Citi Equipment Index") at 4. Most of the trusts included in the "Citi Equipment Index" contain "mixed collateral, with obligors in service, transportation, manufacturing, agricultural and construction industries." Ibid. at 3.

EXHIBIT I

Percentage of Equipment Asset-Backed Securities with Ratings Changes in the Year Indicated from 2006 to 2010:Q3

Year	Total Number of Issues Rated at the Beginning of Year	Rating Change Direction	Ratings Changes over Year				
			AAA to/from IG	AAA to/from Speculative	IG to/from Speculative	IG to/from Likely to Default	Speculative to/from Likely to Default
2006	141	Downgrades	0.0	0.0	0.0	0.0	0.0
		Upgrades	0.0	0.0	0.0	0.0	0.0
2007	175	Downgrades	0.0	0.0	0.0	0.0	0.0
		Upgrades	25.9	0.0	0.0	0.0	0.0
2008	135	Downgrades	1.0	0.0	0.0	0.0	0.0
		Upgrades	5.9	0.0	0.0	0.0	0.0
2009	85	Downgrades	0.0	0.0	3.6	0.0	0.0
		Upgrades	7.1	0.0	0.0	0.0	0.0
2010	61	Downgrades	0.0	0.0	0.0	0.0	100.0*
		Upgrades	4.8	0.0	0.0	0.0	0.0

Note: Upgrades and downgrades are expressed as a percentage of all rated securitizations in a specified year. "Investment Grade" (IG) are ratings from AA+ to BBB-, "Speculative" are from BB+ to B-, and "Likely to Default" are CCC+ and below.

*The 100% reflects the downgrade of the single security in this category.

Source: Standard & Poor's.

Source: Board of Governors of the Federal Reserve System, Report to the Congress on Risk Retention (October 2010), Table 11 at 65.

EXHIBIT J

PROPOSED REGULATION LANGUAGE FOR EQUIPMENT ABS

****

§ __.18(A) Underwriting standards for qualifying equipment commercial loans.

(a) *General.* The securitization transaction—

(1) Is collateralized solely (excluding cash and cash equivalents) by one or more equipment commercial loans (and may also be collateralized by any other related collateral that is customarily included in equipment securitizations),[1] and such equipment commercial loans (A) satisfy all of the requirements of paragraph (b) of this section and (B) have been transferred, directly or indirectly, to the issuing entity from a sponsor that has, or has an affiliate that has, performed underwriting assessments of equipment commercial loans for at least three years; and
(2) Does not permit reinvestment periods.

(b) *Underwriting, product and other standards.*

(1) With respect to each equipment commercial loan, the sponsor or its affiliate:
(i) Considering factors relevant due to its experience had, on a date prior to the cut-off date, reached a conclusion as to the likelihood of the amounts due under the equipment commercial loan being repaid, based on:

(A) the obligor/lessee's expected ability to repay;
(B) the obligor/lessee's credit history;
(C) the terms of the equipment commercial loan;
(D) the value of the equipment; and
(E) the anticipated use of the equipment

and concluded that the likelihood of receiving the amounts due under the equipment commercial loan was high enough that the originator would fund such equipment commercial loan regardless of whether it would securitize the equipment commercial loan; and
(ii) Obtained a security interest in the equipment pledged to collateralize the equipment commercial loan.

(2) As of the cut-off date for the securitization transaction, no payments due on the equipment commercial loan are more than 31 days past due.

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[1] This addition is imperative since all typical ABS transactions include security interests in additional collateral for the benefit of the securityholders, such as, for example, security interests in: the issuing entity's security interest in the related equipment; any equipment that secured an equipment commercial loan and that has been acquired by or on behalf of the issuing entity; proceeds from insurance on equipment or from dealer recourse; rights under certain securitization transaction documents; etc.

(3) Each equipment commercial loan has a remaining term to maturity of not more than 84 months as of the applicable cut-off date or, with respect to equipment commercial loans secured by maritime or construction equipment, each such equipment commercial loan has a remaining term to maturity of not more than 120 months as of the applicable cut-off date.

(4) As of the cut-off date, each equipment commercial loan has a scheduled maturity not later than the date that is six months prior to the latest final scheduled maturity date for any class of the asset-backed securities.

(5) Each equipment commercial loan has a statistical contract value as of the applicable cut-off date that (when combined with the statistical contract value of any other equipment commercial loans with the same obligor) does not exceed 1.5% of the aggregate statistical contract value of all the equipment commercial loans as of the applicable cut-off date. For purposes of the preceding sentence, the statistical contract value for each equipment commercial loan is equal to the current balance of the equipment commercial loan on the servicer's or sponsor's records.

(6) Each equipment commercial loan had an original term not exceeding 96 months or, with respect to equipment commercial loans secured by maritime or construction equipment, each such equipment commercial loan had an original term not exceeding 132 months.

(7) As of the cut-off date, to the knowledge of the sponsor, none of the obligors relating to the equipment commercial loans collateralizing the securitization transaction were in bankruptcy.

(8) The loan/lease documentation for the equipment commercial loan effectively requires the obligor/lessee to:
(i) Obtain and maintain physical damage insurance (which may include self-insurance consistent with practices customary in the obligor's/lessee's industry) with respect to the related equipment;
(ii) Pay taxes, charges, fees, and claims, where non-payment might give rise to an adverse lien on the related equipment;
(iii) Permit the originator or the servicer of the equipment commercial loan to inspect the equipment collateralizing the equipment commercial loan; and
(iv) Maintain the physical condition of the equipment collateralizing the equipment commercial loan.

(9) The asset pool collateralizing the securitization transaction must have a weighted average[2] loan-to-value and/or lease-to-value of not more than 95% and no more than 15% of the equipment commercial loans may have a loan-to-value and/or lease-to-value above 100%. With respect to such calculations:

[2] Weighted by the principal balance of each equipment commercial loan as of the cut-off date.

(i) loan-to-value and lease-to-value shall be calculated in the method disclosed by a sponsor or issuer to investors,[3] and
(ii) the value of the equipment and the amount of the equipment commercial loan related thereto are both as of the date of origination of the related equipment commercial loan.

(10) (i) The depositor of the asset-backed security certifies that it has evaluated the effectiveness of its internal supervisory controls with respect to the process for ensuring that each asset that collateralizes the asset-backed security, or that the pool of assets that collateralize the asset backed security, as applicable, meet all of the requirements set forth in paragraphs (b)(1) through (b)(9) of this section and has concluded that its internal supervisory controls are effective;
(ii) The evaluation of the effectiveness of the depositor's internal supervisory controls referenced in paragraph (b)(10)(i) of this section shall be performed, for each issuance of an asset-backed security, as of a date within 60 days of the cut-off date or similar date for establishing the composition of the asset pool collateralizing such asset-backed security; and
(iii) The sponsor provides, or causes to be provided, a copy of the certification described in paragraph (b)(10)(i) of this section to potential investors a reasonable period of time prior to the sale of asset-backed securities in the issuing entity, and, upon request, to its appropriate Federal banking agency, if any.

(c) *Buy-back requirement.* A sponsor that has relied on the exception provided in paragraph (a) of this section with respect to a securitization transaction shall not lose such exception with respect to such transaction if, after the closing of the securitization transaction, it is determined that one or more of the equipment commercial loans collateralizing the asset-backed securities, or that the asset pool collateralizing the asset-backed securities, as applicable, did not meet all of the requirements set forth in paragraphs (b)(1) through (b)(9) of this section provided that:
(1) The depositor complied with the certification requirement set forth in paragraph (b)(10) of this section;
(2) The sponsor repurchases the equipment commercial loan(s) from the issuing entity at a price at least equal to the remaining principal balance and accrued interest on the equipment commercial loan(s) no later than ninety (90) days after the determination that the equipment commercial loans, or the asset pool, as applicable, do not satisfy all of the requirements of paragraphs (b)(1) through (b)(9) of this section; and
(3) The sponsor promptly notifies, or causes to be notified, the holders of the asset-backed securities issued in the securitization transaction of any equipment commercial loan(s) included in such securitization transaction that is required to be repurchased by the sponsor pursuant to paragraph (c)(2) of this section, including the principal amount of such repurchased equipment commercial loan(s) and the cause for such repurchase. The preceding notification shall be deemed to have been provided promptly to the holders of the asset-backed securities if it is provided in a servicer report or noteholder report that is delivered to or made available to noteholders within 35 days of any such repurchase.

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[3] It is vital that this calculation contain this flexibility in determining loan-to-value and lease-to-value. Equipment Sponsors calculate this information differently and no single method exists that would be useable by Equipment Sponsors generally.

ATTACHMENT I

Role of Securitization within the Financial System and U.S. Economy

The Current State of the Market

As the Board noted in its recent study on risk retention, different segments of the ABS and MBS markets have recovered differently during the 18 months since the recession ended.[1] Auto and auto-related ABS accounted for $53.9 billion in issuance in 2009, which represents 80.7% of the auto and auto-related ABS issuance of $66.8 billion during 2007, just before the downturn.[2] $7.2 billion in equipment ABS was issued during 2009, in contrast with the 2007 issuance of $6.1 billion.[3] In 2009, credit card ABS accounted for $46.6 billion in issuance, down 50.7% from 2007 issuance of $94.5 billion.[4] Meanwhile, the student loan sector issued $20.8 billion in ABS during 2009, down 64.2% from 2007 issuance of $58.1 billion.[5] By comparison, on the RMBS side, $48.1 billion of RMBS were issued in 2009, down 92.5% from 2007 issuance of $641.8 billion.[6] In addition to the overall reduction of issuance in the RMBS market, we further note that 97% of RMBS were issued by the Agencies in 2010, as compared with only 64% in 2007 when the private market accounted for a much larger share of RMBS issuance.[7]

Simply put, the absence of a properly functioning securitization market, and the funding and liquidity this market has historically provided, adversely impacts consumers, businesses, financial markets and the broader economy. The recovery and restoration of confidence in securitization is therefore a necessary ingredient for economic growth to resume, and for that growth to continue on a sustained basis into the future. ASF supports efforts to align the incentives of issuers and originators with securitization investors and believe these incentives should encourage the application of sound underwriting standards by both the originator and securitizer in connection with the assets that are securitized. We believe that risk retention can aid in achieving this goal so long as the requirements are tailored to each class of securitized assets as described in this testimony. We believe that the Joint Regulators must carefully calibrate the risk retention requirements so as to not impede the securitization markets recovery and further constrain the availability of credit.

Why is Securitization Important?

Securitization—generally speaking, the process of pooling and financing consumer and business assets in the capital markets by issuing securities, the payment on which depends primarily on

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[1] Board of Governors of the Federal Reserve System, "Report to the Congress on Risk Retention" (Oct. 2010), pg. 2. < http://federalreserve.gov/boarddocs/rptcongress/securitization/riskretention.pdf>.

[2] Data are from Asset Backed Alert, see the Proposing Release, pg. 12-13. <http://www.sec.gov/rules/proposed/2011/34-64148.pdf>.

[3] Ibid.

[4] Ibid.

[5] Ibid.

[6] Ibid.

[7] Analysis by 1010data, based on data from FNMA, GNMA and FHLMC.

the performance of those underlying assets—plays an essential role in the financial system and the broader U.S. economy. Over the past 40 years, securitization has grown from a relatively small and unknown segment of the financial markets to a mainstream source of credit and financing for individuals and businesses alike.

In recent years, the role that securitization has assumed in providing both consumers and businesses with credit is striking: currently, there is over $11 trillion of outstanding securitized assets, including RMBS, ABS and ABCP. This represents a market substantially larger than the normal size of all outstanding marketable U.S. Treasury securities—bonds, bills, notes, and TIPS combined.[8] Between 1990 and 2006, issuance of MBS grew at an annually compounded rate of 13%, from $259 billion to $2 trillion a year.[9] In the same time period, issuance of ABS secured by auto loans, credit cards, home equity loans, equipment loans, student loans and other assets, grew from $43 billion to $753 billion. In 2006, just before the downturn, nearly $2.9 trillion in RMBS and ABS were issued. As these data demonstrate, securitization is clearly an important sector of today's financial markets.

The importance of securitization becomes more evident by observing the significant proportion of consumer credit it has financed in the U.S. It is estimated that securitization has funded between 30% and 75% of lending in various markets, including an estimated 64% of outstanding home mortgages.[10] Securitization plays a critical role in non-mortgage consumer credit as well. Historically, banks securitized 50-60% of their credit card assets.[11] Meanwhile, in the auto industry, approximately 91% of auto industry sales are financed through auto ABS.[12] Overall, recent data collected by the Board show that securitization has provided over 25% of outstanding U.S. consumer credit.[13] Securitization also provides an important source of commercial mortgage loan financing throughout the U.S., through the issuance of CMBS.

Over the years, securitization has grown in large measure because of the benefits and value it delivers to transaction participants and to the financial system. Among these benefits and value are the following:

A. *Efficiency and Cost of Financing.* By linking financing terms to the performance of a discrete asset or pool of assets, rather than to the future profitability or claims-paying potential of an operating company, securitization often provides a cheaper and more efficient form of financing than other types of equity or debt financing.

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8 U.S. Department of the Treasury, "Monthly Statement of the Public Debt of the United States: January 31, 2011," (January 2011). <http://www.treasurydirect.gov/govt/reports/pd/mspd/2011/opds012011.pdf>.

9 National Economic Research Associates, Inc. ("NERA"), "Study of the Impact of Securitization on Consumers, Investors, Financial Institutions and the Capital Markets," pg. 16 (June 2009). <http://www.americansecuritization.com/uploadedFiles/ASF_NERA_Report.pdf> (the "NERA Study")

10 Fitch Ratings, "U.S. Housing Reform Proposal FAQs: Filling the Void" pg. 1-2 (Feb. 2011). <http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=606315> (free registration required).

11 Citigroup, "Does the World Need Securitization?" pg. 10 (Dec. 2008). <http://www.americansecuritization.com/uploadedFiles/Citi121208_restart_securitization.pdf>.

12 Ibid., pg. 10.

13 Federal Reserve Board of Governors, "G19: Consumer Credit," (Sept. 2009). <http://www.federalreserve.gov/releases/g19/current/g19.htm>.

B. *Incremental Credit Creation.* By enabling capital to be raised via securitization, lenders can obtain additional funding from the capital markets that can be used to support incremental credit creation. In contrast, loans that are made and held in a financial institution's portfolio occupy that capital until the loans are repaid.

C. *Credit Cost Reduction.* The economic efficiencies and increased liquidity available from securitization can serve to lower the cost of credit to consumers and businesses. Several academic studies have demonstrated this result. A recent study by National Economic Research Associates, Inc., concluded that securitization lowers the cost of consumer credit, reducing yield spreads across a range of products including residential mortgages, credit card receivables and automobile loans.[14]

D. *Liquidity Creation.* Securitization often offers issuers an alternative and cheaper form of financing than is available from traditional bank lending, or debt or equity financing. As a result, securitization serves as an alternative and complementary form of liquidity creation within the capital markets and primary lending markets.

E. *Risk Transfer.* Securitization allows entities that originate credit risk to transfer that risk throughout the financial markets to parties willing to assume it, such as institutional investors and hedge funds.[15]

F. *Customized Financing and Investment Products.* Securitization allows for precise and customized creation of financing and investment products tailored to the specific needs of both issuers and investors. For example, issuers can tailor securitization structures to meet their capital needs and preferences and diversify their sources of financing and liquidity. Investors can tailor securitized products to meet their specific credit, duration, diversification and other investment objectives.

Recognizing these and other benefits, policymakers globally have taken steps to help encourage and facilitate the recovery of securitization activity. Discussing the Joint Regulators' risk retention rulemaking, Acting Comptroller of the Currency John Walsh stated, "I think it's vital that we craft a final rule that does not impede the revival of the securitization markets. We will be hard pressed to fund the needs of American consumers, particularly in the area of housing, without securitization…"[16] The G-7 finance ministers, representing the world's largest economies, declared that "the current situation calls for urgent and exceptional action…to restart the secondary markets for mortgages and other securitized assets."[17] The Department of the Treasury stated in March, 2009, that "while the intricacies of secondary markets and securitization…may be complex, these loans account for almost half of the credit going to Main

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14 NERA Study, pg. 16. <http://www.americansecuritization.com/uploadedFiles/ASF_NERA_Report.pdf>.

15 The vast majority of investors in the securitization market are institutional investors, including banks, insurance companies, mutual funds, money market funds, pension funds, hedge funds and other large pools of capital.

16 Walsh, John, "Remarks Before the American Bankers Association Government Relations Summit." *Office of the Comptroller of the Currency* (March 2011). <http://www.occ.treas.gov/news-issuances/speeches/2011/pub-speech-2011-26.pdf>.

17 G-7 Finance Ministers and Central Bank Governors Plan of Action (Oct. 10, 2008). <http://www.treas.gov/press/releases/hp1195.htm>.

Street,"[18] underscoring the critical nature of securitization in today's economy. The Chairman of the Board noted that securitization "provides originators much wider sources of funding than they could obtain through conventional sources, such as retail deposits" and also that "it substantially reduces the originator's exposure to interest rate, credit, prepayment, and other risks."[19] Echoing that statement, the Financial Stability Oversight Council in its recent study on *Macroeconomic Effects of Risk Retention Requirements* stated that, "By providing access to the capital markets, securitization has improved the availability and affordability of credit to a diverse group of businesses, consumers, and homeowners in the United States." There is clear recognition in the official sector of the importance of the securitization process and the access to financing that it provides lenders as well as its importance in providing credit that ultimately flows to consumers, businesses and the real economy.

Restoration of function and confidence to the securitization markets is a particularly urgent need, in light of capital and liquidity constraints currently confronting financial institutions and markets globally. As mentioned above, at present nearly $11 trillion in U.S. assets are funded via securitization. With the process of bank de-leveraging and balance sheet reduction still underway, and with increased bank capital requirements on the horizon, such as those expected in Basel III, the funding capacity provided by securitization cannot be replaced with deposit-based financing alone in the current or foreseeable economic environment. In fact, the IMF estimated that a financing "gap" of $440 billion existed between total U.S. credit capacity available for the nonfinancial sector and U.S. total credit demand from that sector for the year 2009.[20] Moreover, non-bank finance companies, which have played an important role in providing financing to consumers and small businesses, are particularly reliant on securitization to fund their lending activities, because they do not have access to deposit-based funding. Small businesses, which employ approximately 50% of the nation's workforce, depend on securitization to supply credit that is used to pay employees, finance inventory and investment, and fulfill other business purposes. Furthermore, many jobs are made possible by securitization. For example, a lack of financing for mortgages hampers the housing industry; likewise, constriction of trade receivable financing can adversely affect employment opportunities in the manufacturing sector. To jump start the engine of growth and jobs, securitization is needed to help restore credit availability.

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18 U.S. Department of the Treasury, "Road to Stability: Consumer & Business Lending Initiative," (March 2009). <http://www.financialstability.gov/roadtostability/lendinginitiative.html>.

19 Bernanke, Ben S., "Speech at the UC Berkeley/UCLA Symposium: The Mortgage Meltdown, the Economy, and Public Policy, Berkeley, California." *Board of Governors of the Federal Reserve System* (Oct. 2008). <http://www.federalreserve.gov/newsevents/speech/bernanke20081031a.htm>.

20 International Monetary Fund, "The Road to Recovery." *Global Financial Stability Report: Navigating the Financial Challenges Ahead* (Oct. 2009), pg. 29. <http://www.imf.org/external/pubs/ft/gfsr/2009/02/pdf/text.pdf>.