JEB HENSARLING, TX , CHAIRMAN

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

MAXINE WATERS, CA, RANKING MEMBER

M E M O R A N D U M

To: Members of the Committee on Financial Services

From: FSC Majority Committee Staff

Date: February 21, 2014

Subject: February 26, 2014, Subcommittee on Capital Markets and Government Sponsored Enterprises Hearing entitled "The Dodd-Frank Act's Impact on Asset-Backed Securities"

The Subcommittee on Capital Markets and Government Sponsored Enterprises will hold a hearing entitled "The Dodd-Frank Act's Impact on Asset-Backed Securities" at 2:00 p.m. on Wednesday, February 26, 2014, in room 2128 of the Rayburn House Office Building. This will be a one-panel hearing and will include the following witnesses:

- Meredith Coffey, Senior Vice President for Research & Analysis, Loan Syndications and Trading Association
- Adam Levitin, Professor of Law, Georgetown University Law Center
- Tom Quaadman, Vice President, U.S. Chamber of Commerce Center for Capital Markets Competitiveness
- Paul Vanderslice, Managing Director, Citigroup, on behalf of the CRE Finance Council
- Neil Weidner, Partner, Cadwalader, Wickersham & Taft, on behalf of the Structured Finance Industry Group

Background

Several provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") significantly changed the regulatory landscape of the asset-backed securitization markets. These provisions, which will be the focus of this hearing, include:

Section 619 – Prohibition on proprietary trading and certain relationships with hedge funds and private equity funds

Section 619, popularly known as the "Volcker Rule" after its chief proponent, former Federal Reserve Chairman Paul Volcker, prohibits U.S. bank holding companies and their affiliates from engaging in "proprietary trading" and from sponsoring hedge funds and private equity funds.

The Dodd-Frank Act defines hedge funds and private equity funds jointly as "an issuer that would be an investment company, as defined in the Investment Company Act of 1940, but for section 3(c)(1) or 3(c)(7) of that Act, or such similar funds as the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission may determine"(collectively, the "Agencies"). In December 2013, the Agencies promulgated a final rule construing the meaning of "such similar funds."

With respect to asset-backed securities, the Agencies provided an exemption from the definition of "covered fund" if the underlying assets or holdings are comprised solely of certain specified assets. In addition, the Agencies provided exclusions from the rule for certain vehicles that issue short term asset-backed securities and for pools of assets that are part of covered bond transactions.

While there are several exemptions provided in the statute, including language in section 619 that states that "[n]othing in [section 619] shall be construed to limit or restrict the ability of a banking entity or nonbank financial company supervised by the Board to sell or securitize loans in a manner otherwise permitted by law," certain asset-backed securities thought to be exempt from the Volcker Rule are now subject to the covered fund definition.

In response, Rep. Andy Barr has circulated a discussion draft of legislation to amend Section 13(g) of the Bank Holding Company Act, which will be discussed at this hearing. The discussion draft would clarify that nothing in Section 13(g) shall be construed to require the divestiture of any debt securities of collateralized loan obligations, if such collateralized loan obligations were issued before December 31, 2013. The discussion draft would also clarify that a banking entity shall not be considered to have an ownership interest in a collateralized loan obligation if there is no indicia of ownership other than the right of the banking entity to fire or remove for cause, or to participate in the selection or removal of, a general partner, managing member, member of the board of directors or trustees, investment manager, investment adviser, or commodity trading advisor of the fund, provided that the collateralized loan obligation is predominantly backed by loans.

Section 941 – Regulation of Credit Risk Retention

Section 941 of the Dodd-Frank Act requires the Securities and Exchange Commission (SEC), the federal banking agencies, the Secretary of Housing and Urban Development, and the Federal Housing Finance Agency to prescribe rules to require a

securitizer to retain an economic interest in a material portion of the credit risk for any asset that it transfers, sells, or conveys to a third party.

On March 30, 2011, these agencies issued their initial notice of proposed rulemaking to implement section 941 of the Dodd-Frank Act. Following an initial 70-day comment period, the agencies re-proposed their joint rulemaking in August 2013. The comment period for the re-proposal ended October 30, 2013. The re-proposed rule differs from the initial proposal by:

(i) aligning the definition of a qualified residential mortgage (QRM) with the qualified mortgage (QM) standards;

(ii) easing the prohibition on sale and hedging of the required risk retention after a specified time period;

(iii) providing greater flexibility for sponsors to hold first loss interests;

(iii) allowing for the blending of qualifying and non-qualifying loans in asset pools, which would be eligible for a reduced risk-retention; and

(iv) eliminating the premium capture cash reserve account (PCCRA), a provision requiring securitizers to set aside the profits from sales of securities in an account that must be maintained over the life of the security.

Section 942 – Disclosure and Reporting for Asset-Backed Securities

Section 942 of the Dodd-Frank Act grants the SEC the authority to issue rules relating to asset-backed security offering and reporting data requirements, as well as regulations relating to certain threshold requirements for suspension of duty to file certain reports required by the Securities Exchange Act (the "Exchange Act").

Section 943 – Representations and Warranties in Asset-Backed Offerings

Most public offerings of asset-backed securities ("ABS") are conducted through expedited SEC registration procedures known as "shelf offerings." ABS offerings also are sold as private placements which are exempt from SEC registration. Privately-issued ABS are typically sold to large institutional investors known as qualified institutional buyers ("QIBs").

In April 2010, the SEC proposed certain revisions to the existing rules applicable to ABS transactions. Section 943 of the Dodd-Frank Act, however, requires the SEC to prescribe new rules related to representations and warranties in ABS offerings. As such, in July 2011, the SEC re-proposed for public comment some of the rules from April 2010 release — namely the proposals relating to ABS shelf eligibility.

On January 29, 2014, the SEC published its agenda for its Open Meeting on Wednesday, February 5. At that time, the agenda noted that the SEC "will consider whether to adopt rules revising the disclosure, reporting, and offering process for asset-backed securities. The revisions would require asset-backed issuers to provide enhanced disclosures including information for certain asset classes about each asset in the underlying pool in a standardized, tagged format and revise the shelf offering process and eligibility criteria for asset-backed securities."[1] Prior to the Open Meeting, however, the SEC removed this agenda item without explanation.

Section 945 – Due diligence analysis and disclosure in asset-backed securities issues

The SEC adopted final rules to implement section 945 of the Dodd-Frank Act on January 20, 2011, requiring ABS issuers whose offerings are registered under the Securities Act to conduct a review of the assets underlying those securities and make certain disclosures about those reviews. The SEC also has adopted rules relating to the ongoing reporting of ABS issuers under the Exchange Act.

[1] SEC's Open Meeting Notice. January 29, 2014. Available at: http://www.sec.gov/news/openmeetings/2014/ssamtg020514.htm