



**Statement of:**

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Subcommittee on Capital Markets and Government Sponsored Enterprises**

**Public Hearing on:**

**The Impact of Dodd-Frank on Customers, Credit, and Job Creators**

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**EXHIBIT A**

## **I. Introduction and Executive Summary**

Chairman Garrett, Ranking Member Waters, and distinguished Members of the Subcommittee, I thank you for this opportunity to testify here before you today on behalf of the 330 member institutions of the American Securitization Forum.<sup>1</sup>

In the testimony that follows, we address in detail the key regulatory initiatives arising out of Dodd-Frank and other legislative and regulatory initiatives that the entire scope of ASF's membership has been focused on, while simultaneously operating to extend credit to consumers and businesses. For each of these initiatives, we provide Internet hyperlinks to the thousands of pages of comment letters that we have submitted to help U.S. and international regulators avoid negative impacts to the credit markets resulting from unintended consequences of the myriad of rulemaking proposals.

But before we address the detailed issues, we focus first on some of the key macro challenges facing the private securitization markets. These markets currently supply hundreds of billions of dollars in Main Street credit to the economy each year for, among other things: consumers to buy houses, cars, motorcycles and college educations; farmers to buy tractors and equipment; and businesses to expand their franchises and physical plants. These securitization markets effectively ship mass quantities of long-term saved capital from pension funds, mutual funds, insurance companies and banks into individually tailored loans to Main Street consumers and businesses. Given the historical shift worldwide of savings patterns, the banking sector simply cannot supply enough capital directly to credit seekers. Instead, securitization in its simplest form links up savers with everyday Americans looking to borrow.

As an outgrowth of the financial crisis though, many have focused on securitization as an ailing patient that needs heavy doses of regulatory medication to recuperate. ASF has strongly agreed that some treatment has been necessary to make appropriate and tailored reforms. First, through ASF's Project RESTART<sup>2</sup>, we have spent considerable effort ramping up transparency for investors by developing model templates for loan and grouped-level standardized disclosure for various asset classes and also to better aligning incentives between issuers and investors by developing model repurchase provisions and representations and warranties. Second, we have supported appropriate regulations for risk retention, rating agency reform, conflicts of interest and regulatory capital standards that would yield beneficial effects on the markets and the broader economy.

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<sup>1</sup> 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. 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](http://www.americansecuritization.com).

<sup>2</sup> Additional details and the key deliverables of ASF Project RESTART may be found on our website at [www.americansecuritization.com/restart](http://www.americansecuritization.com/restart).

But we have passed the point where heavy prescriptions of various regulatory medications have healing effects. Instead, we strongly urge policy makers to examine closely the aggregate and interactive effect of the myriad of ‘treatments’ being administered,<sup>3</sup> as they are becoming poisonous by being injected in aggregated doses, the interactive effects of which have not been thought through. In effect, the poison to the market is in the dosage. While Dodd-Frank may have endeavored to improve the asset-backed securitization process, the layers upon layers of regulation promulgated thereunder will, in the aggregate, result in substantial cost that will ultimately impede securitization and increase the cost of credit for consumers and businesses alike.

The manifestations of these aggregate and interactive effects are as follows:

1. Straight-forward products like auto and equipment-backed securitizations, whose performance was strong across the board through the entirety of the financial crisis, are now facing extraordinary compliance challenges with a complex web of expansive policy initiatives;
2. Unintended interactions of various rules will continue to be discovered for years, which is causing immense costs in reworking various structures or eliminating products all together. The markets would accept these changes if they were constructive and thought-through, but this is occurring without coordination among the rules or analysis of potential interplay;
3. Market participants aren’t investing in building platforms. Rather, they’re putting their skeletal platforms in the deep freeze, particularly for RMBS, because of the tremendous uncertainty of the outcome of proposed rules that could very well make those business lines loss centers. As a result, significant brain drain out of private-label RMBS specialists continues to occur, making the Administration’s<sup>4</sup> and Congress’s<sup>5</sup> desire to bring private capital back into mortgage securitizations more difficult and more protracted. For the mortgage market, the complete absence of direction for Fannie Mae and Freddie Mac has also kept private industry left to question when or if less than 95%<sup>6</sup> of mortgages will be securitized without effectively a 100% taxpayer guarantee behind it;
4. Some rules like the premium capture cash reserve account are so lethal to the RMBS and CMBS markets that those markets are predicted to become relegated to history books for all of those other than a few niche players serving extremely limited segments of the market, if that rule were to be put into place as proposed. The potential impact of such a rule on borrowers would be substantial, with interest rates having to rise multiple percentage points and rate locks effectively being prevented.
5. Non-banks and banks are being subjected to further disparate rules causing competitive advantages and disadvantages to develop that will inevitably cause exiting of business lines based on regulation, rather than on market efficiency or capability;

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<sup>3</sup> Please see Exhibit A for a macro overview of the myriad of key initiatives with which the securitization markets are grappling.

<sup>4</sup> See <http://portal.hud.gov/hudportal/documents/huddoc?id=housingfinmarketreform.pdf>, February 2011.

<sup>5</sup> See <http://www.gpo.gov/fdsys/pkg/BILLS-112hr3644ih/pdf/BILLS-112hr3644ih.pdf> and [http://www.corker.senate.gov/public/?a=Files.Serve&File\\_id=3207ad19-86b6-4444-b436-e016483b67fb](http://www.corker.senate.gov/public/?a=Files.Serve&File_id=3207ad19-86b6-4444-b436-e016483b67fb).

<sup>6</sup> See [http://www.standardandpoors.com/spf/ratings/Positive\\_Housing\\_News3\\_6\\_12.pdf](http://www.standardandpoors.com/spf/ratings/Positive_Housing_News3_6_12.pdf) at p. 4.

6. Although policy initiatives continue to evolve on a country by country basis, the global issuance and purchase of securitizations are forced to comply with new and different standards in each jurisdiction. For example, risk retention standards in Europe require the investor in ABS to police compliance, whereas in the U.S. the issuer is expected to be the compliance monitor with the forthcoming rules; and
7. Many of the rules in Dodd-Frank, such as the Volcker Rule, were not intended to alter the securitization markets, but, in fact, have become the biggest sources of concerns for key segments of the market such as ABCP because of overbroad rules and an absence of appropriate exemptions.

***a. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010  
(Dodd-Frank)***

The reforms set forth in Dodd-Frank are vast, impacting all corners of the financial markets, including retail banking, derivatives, hedge funds, mortgage origination, insurance, capital requirements and securitization, among others. Additionally, there were numerous provisions targeted specifically at securitization, including risk retention requirements, conflicts of interest prohibitions, due diligence standards, and disclosure and reporting requirements. As it turns out, however, there are numerous other provisions throughout Dodd-Frank that, whether intended or not, will have a substantial impact on securitization.

Various regulatory agencies have been tasked with implementing the required rulemakings, but very few of them have actually been completed. A recent report indicates that, as of July 2, 2012, 78.9% of rulemakings with a specified deadline had missed their deadline, and only 29.9% of rulemakings are complete with final rules.<sup>7</sup>

When the rulemakings are ultimately finalized, they will inevitably result in increased cost for the securitization and lending markets, which will be passed on to consumers and businesses in the form of higher borrowing rates. Alternatively, certain parts of the market may disappear entirely, leaving some consumers and businesses without effective access to affordable credit. The rulemakings targeting the mortgage market are a great example of how costs will be aggregated through layers of regulation on both origination and secondary market activities. We review each in turn below.

Dodd-Frank sought to regulate the origination of mortgage loans by requiring lenders to make a determination that borrowers have a reasonable ability to repay the loans and imposing substantial liability on lenders and investors for loans that do not comply. It is this risk of liability that threatens the functioning of the secondary market, which provides the capital necessary to fund mortgages nationwide. Congress recognized this risk, and included the concept of a “qualified mortgage” to promote certainty in the secondary market. A qualified mortgage would be deemed to meet the ability-to-repay requirement, provide a safe harbor from liability for both lenders and investors, and generally promote sound lending. Unfortunately, the CFPB appears to be seriously considering employing a subjective standard for determining what constitutes a qualified mortgage and a rebuttable presumption of compliance that will result in

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<sup>7</sup> See [http://www.davispolk.com/files/Publication/8bc2b1c4-c800-45b1-8324-0381454f6ceb/Presentation/PublicationAttachment/b9462d4e-0be9-4eee-9829-0455bca61e9a/July2012\\_Dodd.Frank.Progress.Report.pdf](http://www.davispolk.com/files/Publication/8bc2b1c4-c800-45b1-8324-0381454f6ceb/Presentation/PublicationAttachment/b9462d4e-0be9-4eee-9829-0455bca61e9a/July2012_Dodd.Frank.Progress.Report.pdf).

frivolous lawsuits, costing anywhere from \$70,000 to \$100,000 to defend.<sup>8</sup> The very real cost associated with this liability risk will cause investors and other secondary market participants to require a premium in order to invest in mortgages, resulting in higher borrowing rates. In addition, many low and moderate income borrowers, indeed the very segment the law intend to protect, will likely be denied access to credit altogether because the resulting risk premium will make mortgages prohibitively expensive for this segment of borrowers.

Dodd-Frank also sought to regulate the capital markets for mortgages, requiring that securitizers hold 5% of the credit risk of each loan securitized. The risk retention rules enacted by Congress will prove to be costly for consumers, but the concept will not be prohibitive if implemented properly. However, the regulators implementing the rules went beyond the mandate in Dodd-Frank and proposed a “premium capture cash reserve account” (PCCRA) that would effectively eliminate incentives to securitize by (i) locking up returns and origination expenses in an account for the life of the securitization, (ii) assuring the accounting consolidation of the securitization onto the balance sheet of the securitizer, and (iii) interfering with an originator’s ability to offer borrowers rate locks. In the aggregate, these effects would have a substantial impact on borrowers. In fact, Mark Zandi of Moody’s Analytics has estimated that mortgage rates would increase by *1 to 4 percentage points* if the rule is implemented as proposed.<sup>9</sup> Combine that amount with costs associated with the ability-to-repay requirement and onerous capital charges nearing 100% of a horizontal risk retention, and the rate originators would have to charge borrowers again becomes prohibitively high.

Congress provided relief from the risk retention requirements for high quality assets called “qualified residential mortgages” (QRMs). However, the QRM definition proposed by the regulators is very tight, and most mortgage loans originated would not meet the definition. In fact, only 19.8% of conventional GSE loans originated from 1997 through 2009 would have met the QRM standards.<sup>10</sup> Even in 2009, during which time credit was very tight, only 30.5% of loans would have been QRMs.<sup>11</sup> Note further that the size of the QRM market will be limited by regulation to, at most, the size of the “qualified mortgage” market, which may itself be narrow depending on final rules put out by the CFPB. What this means is that the bulk of the mortgage market may not meet QRM requirements and that most borrowers would be subject to higher rates due to the premium capture rule. Furthermore, 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, which are exempt from the risk retention requirements. This will have the effect of further entrenching the GSEs in the market when many in Congress, as well as the Administration, are calling for more private capital and less government subsidy.

But this discussion focuses on only two of the mortgage rules arising exclusively out of Dodd-Frank. Each day it seems a new policy maker has a new rule or government program that can ‘fix’ the housing market. But these proposals give rise to thoroughly misguided ideas like using eminent domain to unconstitutionally seize current, underwater mortgages without

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<sup>8</sup> “The Coming Crisis in Credit Availability,” Amherst Mortgage Insight, June 4, 2012, at p. 9.

<sup>9</sup> See <http://www.economy.com/mark-zandi/documents/2011-09-21-Zandi-A-Clarification-on-Risk.pdf> at p. 2.

<sup>10</sup> See [http://www.fhfa.gov/webfiles/20686/QRM\\_FINAL\\_ALL.pdf](http://www.fhfa.gov/webfiles/20686/QRM_FINAL_ALL.pdf) at p. 5.

<sup>11</sup> Id. at p. 6.

providing just compensation that securitization trust owners would be entitled to. Why would new private capital want to invest in products that ultimately can be seized by government fiat all in the name of a purported public purpose?

Consumer and business lending is also impacted by all of the impending regulation, most of which was intended for the RMBS market. Unlike private RMBS, the securitization market for consumer and business assets, such as auto and equipment loans, is currently well-functioning, with some asset classes enjoying issuance at almost pre-crisis levels. Keep in mind, many of these asset classes had absolutely nothing to do with creating the crisis, and performed exactly as intended during the crisis. However, we are concerned that many of the pending rulemakings could eventually derail the recent success by imposing unnecessary costs that will be passed on to consumers and businesses. What follows is a laundry list of other proposed regulations that we believe could have an impact on the securitization market:

- The regulators indicated that the proposed risk retention rules for credit card ABS and asset-backed commercial paper (ABCP) were intended to track current market practices. However, the proposed rules failed to achieve that result and would cause billions of dollars to flee this critical short-term funding market.
- The regulators proposed qualifying auto and commercial loan exemptions from risk retention that fail to embrace traditional loan underwriting practices, and will not be employed by market participants.
- The Volcker Rule is aimed at preventing proprietary trading, but the regulators have proposed rules that would prevent many traditional securitization activities even though Dodd-Frank specifically required that the Volcker Rule not “restrict the ability of a [bank] to sell or securitize loans.”
- The SEC has proposed public style disclosures for asset classes that traditionally issue ABS in the private placement market. Such a requirement could put a stranglehold on many non-traditional asset sectors that employ securitization as an efficient funding mechanism, such as franchise businesses like Domino’s Pizza and Sonic restaurants, and small to medium-sized companies funding timeshares, railcars, containers, cell towers and film receivables.
- Some regulations have yet to be proposed, but are potentially so impactful that they have already caused significant concern in the market. For example, Dodd-Frank granted the FDIC authority to orderly liquidate certain nonbank financial companies, some of which use securitization to fund auto and equipment loans, among other assets. The orderly liquidation authority (OLA) may be used to change or add to the insolvency laws that currently apply to these types of securitizations, potentially exposing investors to insolvency risks that have not existed before. The ABS market briefly grounded to a halt in December 2010 because of investor concerns around OLA, and only resumed due to a near term patch in the form of an FDIC general counsel’s letter. These types of risks will be priced into the ABS, resulting in higher costs for consumers and businesses.
- Finally, special attention should be given to the risk-based and liquidity capital rules that are being enacted in the United States over the next several years. Each of these rulemakings will have a very real impact on the consumer economy, as they will determine the amount of capital a bank needs to hold against specific

investments, including investments in securities that are backed by consumer and business assets such as auto loans, credit cards and equipment loans. If these rules are not appropriately calibrated, consumers and businesses alike will be impacted by the resulting costs.

While each of the rulemakings mentioned in this testimony is significant in its own right, the aggregate effect of all will have profound impacts on the consumer economy. We ask that regulators and Congress work alongside the industry to produce workable and effective rules that do not inhibit securitization or make it prohibitively more expensive, as either result will inevitably be felt by main street consumers and businesses. As demonstrated from the statistics below, our sputtering economy can ill-afford to keep the securitization market on the sidelines.

## **II. The State of the Securitization Market**

Different segments of the asset-backed securities (“ABS”) markets have recovered at varying levels since the end of the recent recession, as noted by the Board of Governors of the Federal Reserve System (“FRB”) in its October 2010 report on risk retention.<sup>12</sup> Although auto loan and lease ABS rebounded to \$59.4 billion in issuance in 2011, this level remains down from the \$79.7 billion in issuance in 2006.<sup>13</sup> Another area of strong performance has been in equipment ABS, where issuance in 2011 moved up to \$8.6 billion, surpassing the \$8.4 billion of 2006 issuance.<sup>14</sup> These asset classes, however, remain exceptions. Between 2006 and 2011, credit card ABS issuance dropped 77.1% from \$72.5 billion to \$16.4 billion,<sup>15</sup> in large part due to banking regulators linking capital requirements directly to accounting consolidation standards under FAS 166 and 167. During those same four years, student loan issuance has fallen nearly 73.4% from \$65.7 billion to \$17.5 billion.<sup>16</sup> By comparison, on the residential mortgage-backed security (“RMBS”) side, only \$22.2 billion of private-label RMBS were issued in 2011, down **96.9%** from the \$723.3 billion issued in 2006.<sup>17</sup> In addition to the overall reduction of issuance in the RMBS market, we further note that 98% of RMBS were federally-backed in 2011, as compared with only 56% in 2006 when private credit accounted for a much larger share of RMBS issuance.<sup>18</sup>

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.

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<sup>12</sup> Board of Governors of the Federal Reserve System, “Report to the Congress on Risk Retention” (Oct. 2010), p. 2, available at <http://federalreserve.gov/boarddocs/rptcongress/securitization/riskretention.pdf>.

<sup>13</sup> Data are from *Asset Backed Alert*; see also the ASF presentation to the Financial Stability Board of April 10, 2012, available at [http://www.americansecuritization.com/uploadedFiles/ASF\\_FSB\\_Presentation\\_4-10-12.pdf](http://www.americansecuritization.com/uploadedFiles/ASF_FSB_Presentation_4-10-12.pdf).

<sup>14</sup> *Id.*

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

### **III. Risk Retention**

ASF continues to support better alignment of incentives of issuers and originators with investors of ABS and we believe these incentives should encourage the application of sound underwriting standards. Despite the appreciable efforts of the FRB, Department of Housing and Urban Development, Federal Deposit Insurance Corporation, Federal Housing Finance Agency, Office of the Comptroller of the Currency, and Securities and Exchange Commission (collectively, the “Risk Retention Regulators”), significant work still needs to be done to evolve the proposed risk retention regulations into workable solutions. Outlined below are a few key issues with respect to risk retention.<sup>19</sup>

#### ***a. Premium Capture***

ASF strongly opposes the proposed premium capture rule, as it 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 premium capture rule also does not take into account the cost of origination of loans, including out-of-pocket costs such as appraisals, title insurance, and overhead, and interferes with an originator’s ability to use interest rate hedges and thus offer rate locks to borrowers. The rule as drafted will have pervasive effects on securitization and borrowers, including virtually assuring the accounting consolidation of the securitization onto the balance sheet of the securitizer regardless of the risk retention form employed. For financial institutions with regulatory capital requirements, consolidation effectively takes securitization off of the table as a viable funding mechanism.

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. We view the premium capture rule as the most dangerous proposed rule in that it would effectively sideline banks from engaging in RMBS and CMBS in the future.

#### ***b. Failure to Incorporate Market Practices***

The commentary in the risk retention proposing release specifically indicates that the proposed risk retention regulations for asset-backed commercial paper (“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. Through our comment letter process, ASF has identified these inconsistencies and recommended specific regulatory changes to resolve them.<sup>20</sup>

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<sup>19</sup> For more exhaustive coverage of our views on the proposed risk retention regulations, *see* our Risk Retention Comment Letter, *available at*

[http://www.americansecuritization.com/uploadedFiles/ASF\\_Risk\\_Retention\\_Comment\\_Letter.pdf](http://www.americansecuritization.com/uploadedFiles/ASF_Risk_Retention_Comment_Letter.pdf).

<sup>20</sup> *See, e.g.,*

[http://www.americansecuritization.com/uploadedFiles/ASF\\_ABCP\\_Risk\\_Retention\\_Follow\\_Up\\_2\\_23\\_12.pdf](http://www.americansecuritization.com/uploadedFiles/ASF_ABCP_Risk_Retention_Follow_Up_2_23_12.pdf).

### *c. Competing Regimes*

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.<sup>21</sup> 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 that is not weighed down by duplicative requirements and unnecessary costs.

### *d. The QRM Definition and Leveling the Playing Field*

An exemption is provided from the risk retention requirement for high quality assets called "qualified residential mortgages" ("QRMs"). 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 Risk Retention Regulators' proposing release indicates that approximately 19.79% of all loans purchased or securitized by the government sponsored enterprises ("GSEs") during the period of 1997-2009, and approximately 30.52% of loans in 2009 alone, would have met the QRM criteria.

We note again that the proposed risk retention 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 ("FHFA"). 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. 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 Risk Retention Regulators to consider adjusting the criteria for QRMs, such that the vast majority of loans to prime borrowers will qualify as QRMs. Furthermore, 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 prime mortgage market. If the QRM definition ultimately is a narrower definition than what qualifies as a conforming loan for the GSEs, because of the GSE exemption from risk retention, the private markets will be so price disadvantaged that every non-QRM loan that is GSE eligible will continue to flow to the GSEs, unless or until they are radically restructured.

## **IV. QM and Ability-to-Repay**

The "qualified mortgage" ("QM"), to be defined by the Bureau of Consumer Financial Protection ("CFPB"), is related to the QRM, in that the QRM's standards can be no broader than

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<sup>21</sup> See CRD Directive 2006/48/EC, p. 78, available at

<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2006L0048:20100330:EN:PDF>.

the QM's standards. This means that the size of the QRM market will be limited to, at most, the size of the QM market. The QM comes by statute from Sections 1411 and 1412 of the Dodd-Frank Act, which establish a new ability-to-repay requirement for certain residential mortgage loans and establish that a QM shall be deemed to meet this requirement.

Under the ability-to-repay requirement, a lender may not make a covered mortgage loan unless the lender makes a reasonable and good faith determination, based on verified and documented information, that the borrower will have a reasonable ability to repay the loan. While the proposed ability-to-repay requirement applies to lenders, the legal consequences of noncompliance essentially rest with the secondary market, as Section 1413 of Dodd-Frank imputes liability on investors and other assignees of mortgage loans that do not meet the requirement. Because the requirement is subjective, investors will not be able to make bright-line judgments as to whether a loan complies, making it difficult to invest in loans that are measured solely by that standard.<sup>22</sup>

Dodd-Frank provides that with respect to any residential mortgage loan, a lender, and any investor assignee of that loan, may presume that the loan has met the ability-to-repay requirement if the loan is a QM. However, there are aspects of the QM definition proposed by the FRB that will make it difficult or even impossible to determine whether the loan qualifies, especially in the case of investor assignees, which are far removed from the origination process. The final regulation must be clear and objective. Additionally, the CFPB is determining whether the protection afforded by a QM should be a "safe harbor" or a "rebuttable presumption." These two options would provide starkly different levels of protection for investors in QMs. If investors are not appropriately insulated from liability through a true safe harbor, they will need a significant risk premium to offset the potential liability. Such a premium will undoubtedly be passed on to borrowers in the form of higher interest rates. Our comment letter to the CFPB provides additional detail on the subject.<sup>23</sup>

## **V. Role of the GSEs Going Forward**

Dodd-Frank did not address the question of what to do with Fannie Mae and Freddie Mac (the "GSEs") on a going forward basis, and that debate lingers on. Ultimately, Congress and the Administration must address this issue head-on, but until that time comes, which many commentators believe may be years or even a decade away, there is potential for meaningful change in the near term to fix certain inefficiencies that exist in the agency market.

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<sup>22</sup> The regulation of "high cost" loans under the Home Ownership Equity Protection Act ("HOEPA"), including the availability of significant enhanced damages for HOEPA violations and assignee liability, led to the ultimate demise of the market for HOEPA loans, with many investors, including both Fannie Mae and Freddie Mac, refusing to purchase them. If non-QM loans suffer the same fate as HOEPA loans, credit availability would ultimately be constrained for many borrowers (with the amount of impacted borrowers being dependent upon the size of the QM market).

<sup>23</sup> See [http://www.americansecuritization.com/uploadedFiles/ASF\\_Comments\\_on\\_QM\\_NPR\\_7\\_22\\_11.pdf](http://www.americansecuritization.com/uploadedFiles/ASF_Comments_on_QM_NPR_7_22_11.pdf).

***a. Current GSE Market Inefficiencies and a Potential Single Security***

On February 21, 2012, FHFA released its Strategic Plan<sup>24</sup> that proposes to build a new infrastructure for Fannie Mae and Freddie Mac, including the development of a single securitization platform that would “allow for a single mortgage-backed security.” ASF believes that secondary mortgage market participants must play an integral role in the implementation of any such security and began holding member meetings to discuss its implications. On July 2, 2012, in response to the Strategic Plan, ASF produced a White Paper outlining the various views of our members on the creation of a single agency security.<sup>25</sup> The White Paper does not address broader legislative GSE reform, but instead, the deficiencies in the plumbing of the current GSE finance system that can be acted upon in the near-term.

Despite unlimited support by the U.S. government for both GSEs, securities issued by Freddie Mac trade at a substantial discount to comparable securities issued by Fannie Mae. Freddie Mac traditionally has made up for this discount by providing loan sellers a lower guarantee fee or other concessions. For example, Freddie Mac often will offer a “market adjustment payment” to lenders to normalize the pricing differential. Because these incentives decrease revenue to Freddie Mac relative to Fannie Mae, they effectively act as a further government subsidy under the conservatorship. Moving to a single security should minimize, and potentially even eliminate, this differential and save the U.S. taxpayers the very real losses associated with this discount. A single security, whether originally issued by Fannie or Freddie, must be fungible, or of equal value in the market. In order to accomplish this, perceptions about and differences between operations at Fannie and Freddie must be eliminated as described in the White Paper. Implemented correctly, a single agency security could benefit all participants in the mortgage market, including borrowers, originators, investors and the taxpayer. It is critical, however, that policymakers take into account industry perspectives on the development of this security.

**VI. Orderly Liquidation Authority**

In enacting the orderly liquidation authority of Title II of Dodd-Frank (“OLA”), Congress intended to create a new statutory regime for the orderly liquidation of “Covered Financial Companies”, as designated by the Financial Stability Oversight Council (“FSOC”). However, several sources, including the Dodd-Frank Act itself, suggest that Congress also intended for the resulting statutory regime to operate in such a way as to minimize the likelihood of different results to creditors of such potential Covered Financial Companies from those results arising under the Bankruptcy Code. If a creditor faces the possibility of two different insolvency regimes, it will have to structure transactions to comply with both. Doing so will raise transaction costs and ultimately raise the costs and lower the availability of credit. Additionally, two specific issues have emerged since Dodd-Frank was enacted.

The first issue relates to an interpretation of OLA that would give the Federal Deposit Insurance Corporation (“FDIC”), as receiver for a Covered Financial Company, broader powers

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<sup>24</sup> See “A Strategic Plan for Enterprise Conservatorships,” February 21, 2012 (the “Strategic Plan”), at <http://www.fhfa.gov/webfiles/23344/StrategicPlanConservatorshipsFINAL.pdf>, which was incorporated into FHFA’s broader “Strategic Plan: Fiscal Years 2013-2017” on May 14, 2012.

<sup>25</sup> See [http://www.americansecuritization.com/uploadedFiles/ASF\\_Single\\_Agency\\_Security\\_White\\_Paper\\_2012.pdf](http://www.americansecuritization.com/uploadedFiles/ASF_Single_Agency_Security_White_Paper_2012.pdf)

to avoid certain previously perfected security interests than a trustee (a “Bankruptcy Trustee”) under the Bankruptcy Code would have upon a Chapter 7 liquidation of the same Covered Financial Company. To eliminate the ambiguity in a manner consistent with the legislative intent, ASF suggested in a December 13, 2010 letter to the FDIC that these “preference provisions” would benefit from additional rulemaking by the FDIC.<sup>26</sup> The FDIC has since issued a General Counsel’s Letter to ASF,<sup>27</sup> a Notice of Proposed Rulemaking,<sup>28</sup> to which ASF responded with further comments,<sup>29</sup> and, in July of last year, a Final Rule<sup>30</sup> to rectify the ambiguity around the priorities and claims process under OLA.

The second issue relates to various “repudiation” concerns, including (i) whether a transfer of property by the Covered Financial Company or a covered subsidiary thereof would constitute an absolute sale or a secured borrowing and (ii) whether the separate existence of another person or entity would be respected and its assets and liabilities not substantively consolidated with the assets and liabilities of the Covered Financial Company or of any covered subsidiary thereof.

The resolution of this concern, as elaborated in a separate ASF letter to the FDIC,<sup>31</sup> is to harmonize FDIC rules implementing OLA “with the insolvency laws that would otherwise apply to a covered financial company.”<sup>32</sup> In response to ASF’s letter, the FDIC issued a General Counsel’s Letter<sup>33</sup> in January 2011 clarifying that its repudiation power under OLA would be exercised consistent with the Bankruptcy Code or other applicable insolvency laws, including bankruptcy- and State-law principles governing legal isolation, on an interim basis until 90 days after the FDIC Board of Directors adopts a regulation to formally address the matter, an action that the FDIC Board has not yet taken. We anticipate significant market attention to any future rulemaking in this area.

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<sup>26</sup> See “ASF FDIC Request re OLA,” American Securitization Forum (December 13, 2010), *available at* [http://asf.informz.net/ASF/data/images/emailattachments/advocacy/asf\\_orderly\\_liquidation\\_letter\\_to\\_the\\_fdic\\_12\\_13\\_10.pdf](http://asf.informz.net/ASF/data/images/emailattachments/advocacy/asf_orderly_liquidation_letter_to_the_fdic_12_13_10.pdf).

<sup>27</sup> See <http://www.americansecuritization.com/uploadedFiles/FDICGeneralCounselLetterreOLA-12-29-10.pdf>.

<sup>28</sup> See NPR at <http://edocket.access.gpo.gov/2011/pdf/2011-6705.pdf>.

<sup>29</sup> See [http://www.americansecuritization.com/uploadedFiles/ASF\\_OLA\\_Transfers\\_Letter\\_FINAL\\_5\\_23\\_11.pdf](http://www.americansecuritization.com/uploadedFiles/ASF_OLA_Transfers_Letter_FINAL_5_23_11.pdf).

<sup>30</sup> See <http://www.gpo.gov/fdsys/pkg/FR-2011-07-15/pdf/2011-17397.pdf>.

<sup>31</sup> ASF’s letter requested that (a) the FDIC as receiver for a covered financial company shall not, in the exercise of its statutory authority to disaffirm or repudiate contracts, reclaim, recover, or re-characterize as property of the covered financial company or the receivership financial assets transferred by the covered financial company, provided that such transfer satisfies the conditions for a legal true sale as applied in the law defining property of the estate under the Bankruptcy Code, and (b) the Act does not itself contain any provision which would mandate a different approach or analysis regarding the factors or circumstances under which the separate existence of one or more legal entities would properly be disregarded than the existing approach or analysis under the Bankruptcy Code. See [http://www.americansecuritization.com/uploadedFiles/ASF\\_Orderly\\_Liquidation\\_Letter\\_1\\_14\\_11.pdf](http://www.americansecuritization.com/uploadedFiles/ASF_Orderly_Liquidation_Letter_1_14_11.pdf).

<sup>32</sup> See Section 209 of Dodd-Frank.

<sup>33</sup> See [http://www.americansecuritization.com/uploadedFiles/GC\\_Letter\\_to\\_ASF\\_1\\_14\\_2011.pdf](http://www.americansecuritization.com/uploadedFiles/GC_Letter_to_ASF_1_14_2011.pdf).

## **VII. Rating Agency Reform**

### ***a. Franken Amendment Study & Rule 17g-5***

On May 10, 2011, the Securities and Exchange Commission (“SEC”) published a request for comment relating to the study the SEC is required to undertake pursuant to Dodd-Frank Section 939F (the “Franken Amendment”) addressing, among other things, the feasibility of establishing a system in which a public or private utility or a self-regulatory organization assigns nationally recognized statistical rating organizations (“NRSROs”) to determine credit ratings of structured finance products. Because of the structure of Section 939F, the SEC is required to implement the assignment system unless the SEC “determines an alternative system would better serve the public interest and the protection of investors.”

As we elaborated in our comments to the SEC in September 2011,<sup>34</sup> we believe that any proposal to establish such a system would be detrimental to the securitization market in a number of ways. Such a system is premised on the assumption that all “qualified” NRSROs are created equal with respect to rating a particular asset class. However, internal investor guidelines restrict the securities in which they can invest based on the NRSRO that provides the rating and issuers may struggle to market securities that have a rating from a non-approved NRSRO. The Franken Amendment would also cause potential conflicts of interest and moral hazard given that the government would create the initial assignment board. Furthermore, the alleged purpose of Section 939F is to examine and eliminate the perceived conflicts associated with the “issuer-pay” ratings model. The SEC has already attempted to address this conflict with its amended Rule 17g-5, which requires issuers to post information provided to hired NRSROs so that non-hired NRSROs can produce unsolicited ratings. While modifications to Rule 17g-5 are necessary to adequately alleviate any perceived conflicts in rating structured finance products, we believe it is a far better alternative to the counterproductive approach suggested by the Franken Amendment.

### ***b. The Repeal of Rule 436(g)***

Upon the effective date of Dodd-Frank in the summer of 2010, Rule 436(g) under the Securities Act was repealed, which caused the complete shutdown of the U.S. public securitization market. Rule 436(g) had excluded NRSROs from being treated as “experts” when their ratings were included in a registration statement under the Securities Act. Repealing Rule 436(g) required NRSROs to consent to the inclusion of their rating in a prospectus, which attached liability to the institution. ASF immediately began discussions with SEC staff to help alleviate the problem. The market paralysis was partially mitigated through the grant of temporary no-action relief by the staff of the SEC on July 22, 2010.<sup>35</sup> The no-action letter relief was then extended indefinitely on November 23, 2010.<sup>36</sup> ASF applauds the SEC’s decision to issue the no-action letters but believes a permanent, comprehensive solution is needed to ensure the long-term viability of the U.S. public securitization markets. Given the implications of Rule

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<sup>34</sup> See our comment letter for more information on assigned credit ratings and a modified Rule 17g-5, available at [http://www.americansecuritization.com/uploadedFiles/ASF\\_Letter\\_to\\_SEC\\_regarding\\_Franken\\_Amendment\\_\(9-12-11\).pdf](http://www.americansecuritization.com/uploadedFiles/ASF_Letter_to_SEC_regarding_Franken_Amendment_(9-12-11).pdf).

<sup>35</sup> See [http://www.americansecuritization.com/uploadedFiles/SEC\\_NAL\\_July2010.pdf](http://www.americansecuritization.com/uploadedFiles/SEC_NAL_July2010.pdf).

<sup>36</sup> See <http://sec.gov/divisions/corpfin/cf-noaction/2010/ford072210-1120.htm>.

436(g) outlined above, ASF believes that proposed solutions may include amending Regulation AB to permanently eliminate the requirement to include ratings in the prospectus or enacting legislation to repeal the repeal of Rule 436(g).<sup>37</sup>

## **VIII. Volcker, Conflicts of Interest, Derivatives**

### ***a. Volcker Rule***

The Volcker Rule, despite its breadth as written, is intended to address concerns that have nothing to do with the securitization markets: specifically, the concern that banking entities may be exposed to undue risks through proprietary trading and the sponsorship and ownership of hedge funds and private equity funds. However, many securitization vehicles potentially are brought within scope of the proposed regulations simply because they share the same exemptions from the Investment Company Act as traditional hedge funds and private equity funds. In fact, Section 13(g)(2) of the Volcker Rule specifically required that the Volcker Rule not “restrict the ability of a [bank] to sell or securitize loans.”

Anything short of an exclusion for securitization entities from the definition of covered fund will limit the securitization market in a manner prohibited by Section 13(g)(2) of the Volcker Rule. Accordingly, we believe it is appropriate for the regulators charged with finalizing the Volcker Rule to provide for a broad carve out for entities that act as depositors and issuers in securitization transactions in the final Volcker Rule regulations.

### ***b. Conflicts of Interest in Securitization***

Section 621 of Dodd-Frank seeks to address conflicts of interest in securitization and generally provides that an underwriter or sponsor (or any affiliate or subsidiary) of an ABS shall not, for one year after closing, engage in any transaction that would result in any material conflict of interest with respect to any investor. While this general statutory mandate is included in Dodd-Frank and in the proposed rules issued by the SEC, there is significant legislative intent that makes clear this provision was meant to eliminate incentives for market participants to intentionally design ABS to fail. While ASF has expressed its full support of the intent behind the legislation, we remain deeply concerned that overly broad rules could have serious unintended consequences on the secondary market. Any rules implemented by the SEC must be crafted so as to prohibit the situations that result in such material conflicts of interest without causing unnecessary adverse impacts on traditional securitization activities.

### ***c. Regulation of Derivatives***

On April 12, 2011, two long-awaited proposed rules on margin and capital requirements for non-cleared swaps were issued, the first jointly by five federal agencies and the second by the Commodity Futures Trading Commission (“CFTC”). In addition, there are numerous other related proposals that may affect securitization, including (i) the SEC’s end-user exception to the mandatory clearing of security-based swaps and swap participant definitions, (ii) the CFTC’s swap participant definitions and the end-user exception and (iii) business conduct standards for

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<sup>37</sup> See our support for the “Asset-Backed Market Stabilization Act” which seeks to reinstate Rule 436(g), available at [http://www.americansecuritization.com/uploadedFiles/ASF\\_Letter\\_Supporting\\_HR\\_1539\\_and\\_HR\\_940.pdf](http://www.americansecuritization.com/uploadedFiles/ASF_Letter_Supporting_HR_1539_and_HR_940.pdf).

“swap dealers” and “major swap participants” relating to ERISA plans. ASF has submitted comment letters on all of these proposals.<sup>38</sup> ASF believes that structured finance participants should not, standing alone, be considered to be included in any of these new rulemakings and that, in particular, the mandatory clearing, margin and capital requirements should not apply to swaps entered into by structured finance participants.

Applying any of these requirements may render many structured financings uneconomic as the special purpose vehicle (“SPV”) would be required to post cash and liquid securities which it does not have. The source of repayment for structured financings is generally the cash flow from the assets or receivables which is generated over time. Applying clearing, margin and capital requirements would affect the cash flow analysis for a structured financing and cause adverse effects on the functioning of this market, including ultimately resulting in a reduction in the available amount of loans or other financing for the assets underlying the structured financing.

## **IX. Capital**

### ***a. Section 939A***

Section 939A of Dodd-Frank requires that the federal regulators remove any reference to or reliance on credit ratings from federal regulations and substitute appropriate standards of creditworthiness in their place. Therefore, it has been necessary in light of Section 939A for the bank regulators to propose and adopt changes to the capital rules that use alternatives to ratings as the methods for determining such capital charges. As a result, our advocacy in this area has been devoted to ensuring that the resulting capital requirements (i) assess capital charges that are appropriate for the risks of securitization positions held by banks, and (ii) can be reasonably determined by banks based on the information available to banks that invest in ABS.

Since the adoption of Dodd-Frank, the uncertainty associated with complying with new and different capital requirements has made many U.S. banks more reluctant to invest in potential securitizations. This has substantially decreased the liquidity of the securitization market, impacting both the availability and cost of the sources of consumer and business credit that would otherwise have been financed through securitizations. More clarity now exists with respect to these issues since last month the bank regulators adopted final rules for determining the capital required for asset-backed securities held in a bank’s trading book and proposed regulations for determining the capital of ABS held in a bank’s banking book. These regulations rely on the use of supervisory formulas for determining the capital of securitization positions in

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<sup>38</sup> See “ASF Margin and Capital Requirements for Covered Swap Entities Letter” (July 11, 2011) at <http://www.americansecuritization.com/uploadedfiles/asfswapmarginletter20110711.pdf>; “ASF Derivatives End-User Exception Comment Letter to SEC,” (February 4, 2011), at [http://asf.informz.net/ASF/data/images/emailattachments/advocacy/asf\\_letter\\_to\\_sec\\_re\\_end-user\\_exception.pdf](http://asf.informz.net/ASF/data/images/emailattachments/advocacy/asf_letter_to_sec_re_end-user_exception.pdf); see “ASF Derivatives Comment Letter to SEC,” (February 14, 2011), at [http://asf.informz.net/ASF/data/images/emailattachments/advocacy/asf\\_letter\\_to\\_sec\\_re\\_derivatives-2-14-11.pdf](http://asf.informz.net/ASF/data/images/emailattachments/advocacy/asf_letter_to_sec_re_derivatives-2-14-11.pdf); see “ASF Derivatives Comment Letter to CFTC,” (February 22, 2011), at [http://www.americansecuritization.com/uploadedFiles/2\\_22\\_11\\_ASF\\_CFTC\\_letter\\_re\\_Derivatives.pdf](http://www.americansecuritization.com/uploadedFiles/2_22_11_ASF_CFTC_letter_re_Derivatives.pdf); and see “ASF Title VII Business Conduct Standards Letter,” (February 22, 2011), at [http://www.americansecuritization.com/uploadedFiles/2\\_22\\_11\\_ASF\\_cftc\\_comment\\_letter\\_re\\_business\\_conduct\\_standards.pdf](http://www.americansecuritization.com/uploadedFiles/2_22_11_ASF_cftc_comment_letter_re_business_conduct_standards.pdf).

lieu of ratings. We have appreciated the willingness of the bank regulators to work with our members to address some of the most significant issues associated with these formulas and their inputs and we believe that the regulators have attempted to address many of these issues in the final market risk regulations and in the proposed banking book regulations. Without these changes, required capital would have been severely overstated for many senior securitization positions and understated for certain riskier, junior securitization positions, improperly providing incentives to banks to invest in the latter.

While ASF members have been very supportive of removing the “government seal of approval” of ratings from regulations, the replacement should at minimum be better than ratings. Even with these changes, however, two things have become clear with respect to the implementation of section 939A. First, the complexity within the system for determining capital has drastically increased the cost and manpower necessary to calculate that capital. Second, it remains very unclear whether this dramatic increase in cost and complexity will actually lead to stronger capital levels throughout the financial system.

***b. Basel 2.5, III***

The global response to recent financial crises has targeted regulatory capital and liquidity standards as well. We support initiatives both here and abroad to ensure that all banking institutions maintain robust capital and liquidity buffers to guard against systemic and idiosyncratic shocks. We also applaud regulatory authorities who have been thoughtfully wrestling with the extraordinarily challenging policy and implementation issues that these initiatives have presented.

Here again, however, businesses and consumers alike are experiencing more costly and less available credit because policymakers opted for a hasty shotgun approach over more targeted and coherent measures. For example, the Basel III liquidity framework published in December 2010 would require banking institutions to prefund all or part of their short-term obligations (including unfunded commitments) with unencumbered, high-quality liquid assets. This means that, if the highest-quality bank in the United States were to provide a \$500 million committed liquidity facility to the highest-quality corporation, the bank would need to acquire and set aside in advance at least \$500 million of unencumbered cash or government securities to guard against even the most improbable risk of that facility being drawn within the next 30 days. Another example is Section 171 of the Dodd-Frank Act, which establishes “generally applicable risk-based capital requirements” as a floor for all U.S. banking institutions. Because the United States and the rest of the G20 have long endorsed a regulatory capital framework that imposes a separate set of standards on internationally active institutions, the second-order effect of Section 171 is that larger U.S. institutions will be forced to adhere to and monitor compliance with two different regulatory capital regimes in parallel. Yet another example is the incongruity between accounting standards that were fundamentally revised in 2009 to discount exposure to risk and U.S. risk-based capital standards that continue to rely on them. This has not only resulted in duplicative capital being held against the same loan to a business or consumer, with associated adverse effects on the cost and availability of that loan, but the door has also been opened to increased regulatory arbitrage and misdirected economic incentives.

## **X. Conclusion**

In this testimony, we have endeavored to give a brief snapshot of key initiatives under Dodd-Frank that will create significant challenges for securitization to deliver low-cost credit availability to consumers and businesses nationwide. But Dodd-Frank is not being implemented in a vacuum. That is, these businesses have to continue to operate and function while also attempting to implement these massive regulatory changes. Additionally, other policy initiatives not mentioned in this testimony (due to length concerns) are also being undertaken and create substantial compliance challenges. These other initiatives should also be considered in this context. They include:

- The SEC's Regulation AB II Proposals;
- The SEC's ANPR and Concept Release on the Investment Company Act;
- The FDIC's NPR on Assessments and Large Bank Pricing;
- The FDIC's Securitization Safe Harbor;
- The FRB's NPR on Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies (Reg YY);
- The CFPB's RFI on Private Education Loans;
- The FHFA's Alternative Servicing Compensation Proposals; and<sup>39</sup>
- Numerous International Proposals.

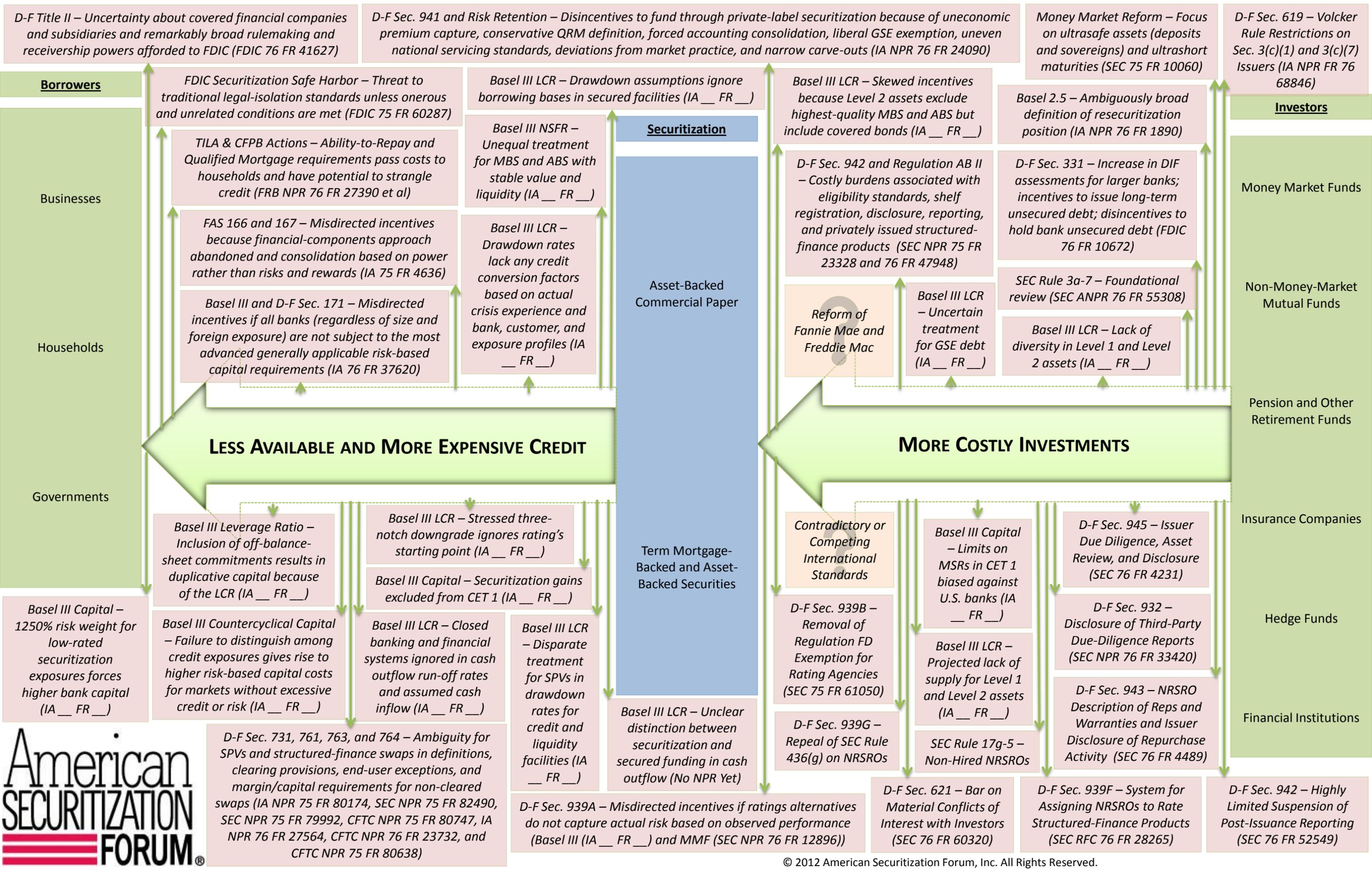
ASF greatly appreciates the invitation to appear before this Subcommittee to share our views related to these current issues. I look forward to answering any questions the Subcommittee may have.

Thank you.

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<sup>39</sup> See ASF's comment letters in response to these rulemakings, at <http://www.americansecuritization.com/uploadedFiles/ASFRegABIICommentLetter8.2.10.pdf>, <http://www.americansecuritization.com/uploadedFiles/ASFRegABIIABCPCCommentLetter8.2.10.pdf>, [http://www.americansecuritization.com/uploadedFiles/ASF\\_Reg\\_AB\\_II\\_Waterfall\\_Comment\\_Letter\\_8.31.10.pdf](http://www.americansecuritization.com/uploadedFiles/ASF_Reg_AB_II_Waterfall_Comment_Letter_8.31.10.pdf), [http://asf.informz.net/ASF/data/images/emailattachments/advocacy/asf\\_reg\\_ab\\_ii\\_auto\\_abs\\_comment\\_letter\\_8.31.10.pdf](http://asf.informz.net/ASF/data/images/emailattachments/advocacy/asf_reg_ab_ii_auto_abs_comment_letter_8.31.10.pdf), [http://www.americansecuritization.com/uploadedFiles/ASF\\_Comment\\_Letter\\_on\\_SEC\\_Reg\\_AB\\_II\\_Re-Proposal\\_10-4-11.pdf](http://www.americansecuritization.com/uploadedFiles/ASF_Comment_Letter_on_SEC_Reg_AB_II_Re-Proposal_10-4-11.pdf), [http://www.americansecuritization.com/uploadedFiles/ASF\\_Equipment\\_ABS\\_Letter\\_\(11-2-11\).pdf](http://www.americansecuritization.com/uploadedFiles/ASF_Equipment_ABS_Letter_(11-2-11).pdf), [http://www.americansecuritization.com/uploadedFiles/ASF\\_Rule\\_3a-7\\_Comment\\_Letter\\_11\\_7\\_11.pdf](http://www.americansecuritization.com/uploadedFiles/ASF_Rule_3a-7_Comment_Letter_11_7_11.pdf), [http://www.americansecuritization.com/uploadedFiles/ASF\\_3\(c\)\(5\)\(C\)\\_Comment\\_Letter\\_11\\_7\\_11.pdf](http://www.americansecuritization.com/uploadedFiles/ASF_3(c)(5)(C)_Comment_Letter_11_7_11.pdf), [http://www.americansecuritization.com/uploadedFiles/Associations\\_Response\\_to\\_Revised\\_Higher-Risk\\_Asset\\_Definitions\\_120529.pdf](http://www.americansecuritization.com/uploadedFiles/Associations_Response_to_Revised_Higher-Risk_Asset_Definitions_120529.pdf), <http://www.americansecuritization.com/uploadedFiles/ASF-FDIC-NPR-Response-Letter-7.1.10.pdf>, [http://www.americansecuritization.com/uploadedFiles/ASF\\_Comment\\_Letter\\_on\\_Reg\\_YY\\_NPR\\_4\\_29\\_12.pdf](http://www.americansecuritization.com/uploadedFiles/ASF_Comment_Letter_on_Reg_YY_NPR_4_29_12.pdf), [http://www.americansecuritization.com/uploadedFiles/ASF\\_Letter\\_to\\_CFPB\\_re\\_Private\\_Education\\_Lending\\_1\\_17\\_12.pdf](http://www.americansecuritization.com/uploadedFiles/ASF_Letter_to_CFPB_re_Private_Education_Lending_1_17_12.pdf), and [http://www.americansecuritization.com/uploadedFiles/ASF\\_Alternative\\_Servicing\\_Comp\\_Letter\\_\(12-21-11\).pdf](http://www.americansecuritization.com/uploadedFiles/ASF_Alternative_Servicing_Comp_Letter_(12-21-11).pdf).

**Exhibit A**



D-F Title II – Uncertainty about covered financial companies and subsidiaries and remarkably broad rulemaking and receivership powers afforded to FDIC (FDIC 76 FR 41627)

D-F Sec. 941 and Risk Retention – Disincentives to fund through private-label securitization because of uneconomic premium capture, conservative QRM definition, forced accounting consolidation, liberal GSE exemption, uneven national servicing standards, deviations from market practice, and narrow carve-outs (IA NPR 76 FR 24090)

Money Market Reform – Focus on ultrasafe assets (deposits and sovereigns) and ultrashort maturities (SEC 75 FR 10060)

D-F Sec. 619 – Volcker Rule Restrictions on Sec. 3(c)(1) and 3(c)(7) Issuers (IA NPR FR 76 68846)

**Borrowers**

Businesses

Households

Governments

FDIC Securitization Safe Harbor – Threat to traditional legal-isolation standards unless onerous and unrelated conditions are met (FDIC 75 FR 60287)

TILA & CFPB Actions – Ability-to-Repay and Qualified Mortgage requirements pass costs to households and have potential to strangle credit (FRB NPR 76 FR 27390 et al)

FAS 166 and 167 – Misdirected incentives because financial-components approach abandoned and consolidation based on power rather than risks and rewards (IA 75 FR 4636)

Basel III and D-F Sec. 171 – Misdirected incentives if all banks (regardless of size and foreign exposure) are not subject to the most advanced generally applicable risk-based capital requirements (IA 76 FR 37620)

Basel III LCR – Drawdown assumptions ignore borrowing bases in secured facilities (IA \_\_ FR \_\_)

Basel III NSFR – Unequal treatment for MBS and ABS with stable value and liquidity (IA \_\_ FR \_\_)

Basel III LCR – Drawdown rates lack any credit conversion factors based on actual crisis experience and bank, customer, and exposure profiles (IA \_\_ FR \_\_)

**Securitization**

Asset-Backed Commercial Paper

Term Mortgage-Backed and Asset-Backed Securities

Basel III LCR – Skewed incentives because Level 2 assets exclude highest-quality MBS and ABS but include covered bonds (IA \_\_ FR \_\_)

D-F Sec. 942 and Regulation AB II – Costly burdens associated with eligibility standards, shelf registration, disclosure, reporting, and privately issued structured-finance products (SEC NPR 75 FR 23328 and 76 FR 47948)

Reform of Fannie Mae and Freddie Mac

Basel 2.5 – Ambiguously broad definition of resecuritization position (IA NPR 76 FR 1890)

D-F Sec. 331 – Increase in DIF assessments for larger banks; incentives to issue long-term unsecured debt; disincentives to hold bank unsecured debt (FDIC 76 FR 10672)

SEC Rule 3a-7 – Foundational review (SEC ANPR 76 FR 55308)

Basel III LCR – Lack of diversity in Level 1 and Level 2 assets (IA \_\_ FR \_\_)

**Investors**

Money Market Funds

Non-Money-Market Mutual Funds

Pension and Other Retirement Funds

Insurance Companies

Hedge Funds

Financial Institutions

**LESS AVAILABLE AND MORE EXPENSIVE CREDIT**

**MORE COSTLY INVESTMENTS**

Basel III Leverage Ratio – Inclusion of off-balance-sheet commitments results in duplicative capital because of the LCR (IA \_\_ FR \_\_)

Basel III Countercyclical Capital – Failure to distinguish among credit exposures gives rise to higher risk-based capital costs for markets without excessive credit or risk (IA \_\_ FR \_\_)

Basel III LCR – Stressed three-notch downgrade ignores rating's starting point (IA \_\_ FR \_\_)

Basel III Capital – Securitization gains excluded from CET 1 (IA \_\_ FR \_\_)

Basel III LCR – Closed banking and financial systems ignored in cash outflow run-off rates and assumed cash inflow (IA \_\_ FR \_\_)

Basel III LCR – Unclear distinction between securitization and secured funding in cash outflow (No NPR Yet)

Contradictory or Competing International Standards

D-F Sec. 939B – Removal of Regulation FD Exemption for Rating Agencies (SEC 75 FR 61050)

D-F Sec. 939G – Repeal of SEC Rule 436(g) on NRSROs

Basel III Capital – Limits on MSR in CET 1 biased against U.S. banks (IA \_\_ FR \_\_)

Basel III LCR – Projected lack of supply for Level 1 and Level 2 assets (IA \_\_ FR \_\_)

SEC Rule 17g-5 – Non-Hired NRSROs

D-F Sec. 945 – Issuer Due Diligence, Asset Review, and Disclosure (SEC 76 FR 4231)

D-F Sec. 932 – Disclosure of Third-Party Due-Diligence Reports (SEC NPR 76 FR 33420)

D-F Sec. 943 – NRSRO Description of Reps and Warranties and Issuer Disclosure of Repurchase Activity (SEC 76 FR 4489)



D-F Sec. 731, 761, 763, and 764 – Ambiguity for SPVs and structured-finance swaps in definitions, clearing provisions, end-user exceptions, and margin/capital requirements for non-cleared swaps (IA NPR 75 FR 80174, SEC NPR 75 FR 82490, SEC NPR 75 FR 79992, CFTC NPR 75 FR 80747, IA NPR 76 FR 27564, CFTC NPR 76 FR 23732, and CFTC NPR 75 FR 80638)

D-F Sec. 939A – Misdirected incentives if ratings alternatives do not capture actual risk based on observed performance (Basel III (IA \_\_ FR \_\_) and MMF (SEC NPR 76 FR 12896))

D-F Sec. 621 – Bar on Material Conflicts of Interest with Investors (SEC 76 FR 60320)

D-F Sec. 939F – System for Assigning NRSROs to Rate Structured-Finance Products (SEC RFC 76 FR 28265)

D-F Sec. 942 – Highly Limited Suspension of Post-Issuance Reporting (SEC 76 FR 52549)