American Securitization Forum

Statement of:

Tom Deutsch
Executive Director
American Securitization Forum

Testimony before the:

House Financial Services Committee
Subcommittee on Capital Markets and Government Sponsored Enterprises

Public Hearing on:

Understanding the Implications and Consequences of the Proposed Rule on Risk Retention

April 14, 2011

TESTIMONY SUMMARY

The American Securitization Forum ("ASF")[1] has long been supportive of further methods to align the incentives of issuers and investors of mortgage- and asset-backed securities. As such, we very much appreciate the hard work the joint regulators have put in developing the risk retention proposals released two weeks ago. In particular, significant strides were made to account for asset class differences as compared to rules implemented by the FDIC and proposals made by the SEC in 2010.

However, significant work still needs to be done to evolve these proposals into workable solutions. What is at stake is the risk of significant reductions in the availability of car loans, mortgages, student loans, credit cards, and business credit all across America if these rules are not appropriately implemented. 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 large swaths of the securitization markets that haven't seen any losses during an extreme economic downturn and instead are now powering economic revival in some sectors of the economy. Attempts to realign incentives in many types of securitization structures, where those incentives have been demonstrated through strong performance to be well-aligned between issuer and investor, only serves to risk harm to the American economy, American consumer and to investors, rather than to aid them.

[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. 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.

As such, we seek in this testimony and later in our comment letter on these proposed risk retention rules for the regulators to specifically articulate that the new rules would not apply to a number of segments of the securitization market, including prime auto loan pools, government guaranteed student loans and sponsor supported asset-backed commercial paper that have all demonstrated extraordinary structural resilience in the most stressed of economic circumstances. In other areas such as corporate and municipal bond repackagings, the rules simply shouldn't have the legal authority to apply to these transactions, nor is there any evidence of misaligned incentives in these markets.

In other areas of the securitization markets, such as residential mortgages, we are quite concerned that the rules put the private markets at an enormous disadvantage vis-à-vis the government-backed market, which will ultimately keep the private markets on the sidelines, while American taxpayers continue to bear the risk on 95+% of new mortgages made in America. These rules should be encouraging the return of private capital by allowing for a broad enough definition of QRM that would allow for effective competition in the relative near-term between government-backed and privately offered transactions. Private offerings and private actors also have a litany of considerations that government offerings, particularly those in conservatorship, don't confront. These include key issues around accounting consolidation under FAS 166 and 167 that can have extraordinary implications for how depositary institutions allocate their risk-based capital.

Moreover, we would encourage the regulators to adhere to the legislative intent of Dodd-Frank in the final rules, rather than include new concepts such as national servicing standards and the newly proposed premium capture cash reserve account. These initiatives should be undertaken as separate initiatives under their own legislative authority rather than bootstrapped onto a set of unrelated rules.

Finally, cumulative impact and need for coordinated implementation of these rules along with other areas of securitization reforms must be done in a decidedly deliberate manner, rather than in any piecemeal manner. As such, we call upon Congress to pass legislation that would require all government agencies to proceed with uniform implementation of these reforms rather than piecemeal, brash approaches such as the FDIC's securitization safe harbor that was just put into place a few months ago and has materially different provisions for risk retention than what was just proposed by the joint regulators two weeks ago.

TABLE OF CONTENTS

I. INTRODUCTION 1

II. IMPACT OF PROPOSALS ON DIFFERENT ASSET CLASSES 6
A. RMBS 6
i. OVERALL EFFECT ON RMBS 6
ii. CONCERNS WITH "ELIGIBLE HORIZONTAL RESIDUAL INTEREST" DEFINITION FOR RMBS 8
iii. INVESTOR CONCERNS RELATING TO HORIZONTAL RISK RETENTION GENERALLY 11
iv. IMPACT OF "PREMIUM CAPTURE CASH RESERVE" RULES ON RMBS 11
v. IMPRACTICALITY OF "REPRESENTATIVE SAMPLE" RETENTION FOR RMBS; SUGGESTED ALTERNATIVE 15
vi. LIMITATIONS ON L-SHAPED RISK RETENTION 18
vii. LIMITATIONS ON RESECURITIZATION EXEMPTION 19
viii. THE QRM CRITERIA 22
a. CREDIT HISTORY 22
b. PAYMENT TERMS 24
c. ABILITY TO REPAY 25
d. LOAN-TO-VALUE RATIO 27
e. POINTS AND FEES 28
f. VIEWS OF OUR INVESTOR MEMBERS ON THE QRM CRITERIA 29
ix. THE EFFECT OF THE QRM CRITERIA ON AVAILABILITY OF CREDIT; ISSUES RELATING TO THE GSES 30
x. ADDITIONAL "QRM BLEND" EXEMPTION 32
xi. QRM CRITERIA – INCLUSION OF SERVICING STANDARDS 33
xii. THE QRM CRITERIA AND THE "QUALIFIED MORTGAGE" DEFINITION 36
B. AUTO ABS 37
i. PROPOSED FORMS OF RISK RETENTION FOR AUTO ABS 37
a. HORIZONTAL RISK RETENTION 39
b. REPRESENTATIVE SAMPLING 43
c. "BLENDED" RISK RETENTION 45
d. MAINTAINING THE RETAINED EXPOSURES 47
ii. QUALIFYING AUTOMOBILE LOAN ADJUSTMENT 48
a. PRINCIPAL ISSUES WITH THE QUALIFYING AUTOMOBILE LOAN ADJUSTMENT 49

b. ALTERNATIVE EXEMPTION REGIME 50
c. INVESTOR VIEW 52
C. ASSET-BACKED COMMERCIAL PAPER CONDUITS 53
i. INTRODUCTION 53
ii. LACK OF STATUTORY AUTHORITY TO IMPOSE RISK RETENTION REQUIREMENTS ON ABCP AND ABCP CONDUIT SPONSORS 54
iii. UNIQUE FEATURES OF ABCP CONDUITS; INVESTORS RELY ON CREDIT OF SUPPORT PROVIDERS AND QUALITY OF PROGRAM 56
iv. SPONSOR-PROVIDED PROGRAM SUPPORT FACILITIES 57
v. ELIGIBILITY REQUIREMENTS FOR ABCP CONDUITS AND OTHER REQUIREMENTS OF THE PROPOSED REGULATIONS 59
vi. DISCLOSURE 61
D. CREDIT AND CHARGE CARD ABS 63
i. RISK RETENTION FOR CREDIT AND CHARGE CARD ABS GENERALLY 63
ii. SELLER'S INTEREST 65
a. DEFINITION 65
b. WHO RETAINS THE SELLER'S INTEREST 67
iii. ADDITIONAL FORMS OF RISK RETENTION IN CREDIT AND CHARGE CARD ABS 67
iv. PREMIUM CAPTURE CASH RESERVE ACCOUNT 68
E. STUDENT LOAN ABS 68
i. EXEMPTION FOR FFELP ABS 69
ii. RISK RETENTION FOR PRIVATE STUDENT LOANS 72
F. MUNICIPAL BOND REPACKAGINGS 73
G. CORPORATE DEBT REPACKAGINGS 77

III. FDIC'S SECURITIZATION SAFE HARBOR AS COMPELLING EVIDENCE OF THE NEED FOR A COORDINATED APPROACH TO RISK RETENTION 81
A. SUMMARY 81
B. DISCUSSION 83

IV. HEDGING, TRANSFER AND FINANCING RESTRICTIONS 89

V. CONCERNS RELATING TO THE ISSUANCE OF INTERPRETIVE GUIDANCE 91

VI. CONCLUSION 92

ATTACHMENT A: ROLE OF SECURITIZATION WITHIN THE FINANCIAL SYSTEM AND U.S. ECONOMY A-1

I. Introduction

ASF submits this testimony to express our views relating to implementation of Section 941 (Regulation of Credit Risk Retention) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act" or "Dodd-Frank"). 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 where misalignment of incentives have been demonstrated to have caused substantial losses.

Section 941 of the Dodd-Frank Act requires the Federal Deposit Insurance Corporation ("FDIC"), the Federal Reserve Board of Governors (the "Board"), the Office of the Comptroller of the Currency ("OCC") and the Securities and Exchange Commission (the "SEC" and collectively, 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.[2]

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 testimony.

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[3] relating to residential mortgage-backed securities ("RMBS") and the qualified residential mortgage ("QRM")

[2] In a release of proposed rules relating to Section 943 of the Dodd-Frank Act, the SEC indicates its belief that the definition of Exchange Act ABS includes securities that are typically sold in transactions exempt from registration under the Securities Act and that the definition of securitizer is not specifically limited to entities that undertake transactions that are registered under the Securities Act. *See* pages 8 and 10 of Release Nos. 33-9148; 34-63029; File No. S7-24-10.
[3] *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.

exemption (the "ASF RMBS Risk Retention Letter"), (ii) our comment letter[4] relating to auto ABS (the "ASF Auto Risk Retention Letter"), (iii) our comment letter[5] relating to ABCP (the "ASF ABCP Risk Retention Letter"), (iv) our comment letter[6] relating to credit card ABS (the "ASF Credit Card Risk Retention Letter"), (v) our comment letter[7] relating to student loan ABS (the "ASF Student Loan Risk Retention Letter") and (vi) our comment letter[8] relating to corporate debt repackagings (the "ASF Repack Risk Retention Letter" and collectively, the "ASF 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 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

---

[4] *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.

[5] *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.

[6] *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.

[7] *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.

[8] *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.

> 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."[9]

In addition, the Financial Stability Oversight Council ("FSOC"), 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."[10]

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" (RIN 1557-AD40; 7100 AD 70; 3064-AD74; 3235-AK96; 2590-AA43),[11] and requested public comment by June 10, 2011 (the "Proposed Regulations"). 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

---

[9] 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, p. 3, 83-84.

[10] 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, p. 3.

[11] *See* http://www.sec.gov/rules/proposed/2011/34-64148.pdf.

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 and qualifying automobile loans ("Qualifying Automobile 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. ASF applauds these efforts to further tailor proposed rules to each asset class.

Within the context of these Proposed Regulations, we respectfully submit herein our comments regarding risk retention for RMBS, ABS backed by auto loans and leases, credit card receivables, and student loans, ABCP and municipal bond and corporate debt repackagings. 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 for economic growth to resume, and for that growth to continue on a sustained basis into the future.[12]

II. Impact of Proposals on Different Asset Classes

A. RMBS

i. Overall 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")[13], 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 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

---

[12] For more information on the role of securitization within the financial system and U.S. economy, *see* Appendix A.
[13] *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.

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.

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 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 make securitizations of higher interest rate loans more expensive (as compared to lower interest rate loans), and may result in further higher costs to less creditworthy borrowers; and
- 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 non-QRM loans, thus impeding the bipartisan policy goal of winding down the GSEs over an appropriate timeline.

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 go too far in imposing costs and burdens on private securitization stunt the return of the private RMBS market, and would ensure that taxpayers will continue to bear the full exposure to housing finance markets indefinitely.

In November 2010, we submitted the ASF RMBS Risk Retention Letter[14] 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 in this testimony.

ii. 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 on its face too narrow and must be revised to accommodate 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 the creditworthiness of the borrowers in the pool.

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. Such borrowers qualify for the lowest available interest rates, in part because they have a stable and strong financial condition. In a securitization of prime loans, the difference

---

[14] *See* "ASF 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.

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.

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 non-prime 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% (or higher) of the total pool balance. 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.

In a non-prime securitization, 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. 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.

As drafted, the Proposed Regulations do not appear to 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." We would request that this be clarified to permit a class that has either a par value, or a fair value, equal to 5% of the par value of all such ABS interests. Otherwise, even if the sponsor did retain the excess spread first loss class, it would also be required to retain a 5% vertical slice, or 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). We do not believe that this result was intended. We note that in our ASF RMBS Risk Retention Letter to the Joint Regulators expressing our views on the implementation of the risk retention requirements, 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.

iii. Investor Concerns Relating to Horizontal Risk Retention Generally

Our investor members harbor concerns about horizontal risk retention because 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. 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. Impact of "Premium Capture Cash Reserve" Rules on RMBS

The premium capture cash reserve proposals within the Proposed Regulations are not 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.

Unfortunately in the Proposed Regulations as drafted, premium capture was based on proceeds in excess of 95% of the par value of the securities issued. It appeared that premium capture would have gone beyond the mandate and legislative intent of Dodd-Frank, by adding on to the 5% risk retention (in most cases) the entire value of the interests issued in the securitization over par.

We have since heard from representatives of some of the Joint Regulators that the intent of premium capture 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. It is essential that the rules be clarified to make this clear. The intent of the premium capture should be limited to confirming that the value of the risk retention position is what it should be, and these rules must not act to further limit the total proceeds that can be realized from a securitization as may be the case if the Proposed Regulations were read strictly.

In addition, we question the assumption that using profits generated from issuing a securitization to at least partially fund risk retention would result in a sponsor not truly having "skin in the game." While it is possible that utilizing such profits to purchase the interests required to be retained could result in a reduced 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 every reason to ensure that such interests retain their value.

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.

We recommend that clause b) above be revised in substance as follows:

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 aggregate fair 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.

There are several concerns with these proposed rules.

First, it is vitally important that the rules be revised as described above to base premium capture on proceeds in excess of 95% of fair value of all ABS interests issued, and not their par value. This clarification must be made, because "par value" technically means the stated principal amount of a security. There are legal, tax and structuring constraints that generally do not allow for ABS interests to be issued with a total principal amount greater than the aggregate unpaid principal balance of the pooled assets. This is a particularly hard and fast rule when securitizing mortgage loans using a REMIC tax election. This clarification is essential because otherwise:

- The cost of origination could not be recovered in a securitization. This includes out-of-pocket costs such as appraisals and title insurance, as well as the originator's overhead and profit on sale. As a result, originators would be compelled to impose more costs on the borrower in the form of points and fees; and

- It would be perhaps impossible to use interest rate hedges during the period between origination and securitization. If a sponsor used a hedge to protect against interest rate movements prior to securitization, and if interest rates were to go down, the sponsor 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 that must be deposited in the premium capture cash reserve.

Second, 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.

Third, the premium capture cash reserve rules will have the effect of encouraging sponsors to structure transactions so that all excess spread is moved to the bottom of the waterfall and made available as subordination. We are concerned as to how this will affect the economics of issuance. If substantially more excess spread is subordinated than is necessary to support a

5% horizontal slice risk retention, this could result in a less favorable execution, in turn leading to higher costs for consumers. This would be most severe for non-prime borrowers, because securitizations of loans to such borrowers create significant amounts of excess spread and the costs of originating such loans tends to be higher. This would result in credit being less available to, and more expensive for, low to moderate income mortgage borrowers.

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 transaction can result in an issuer having less overall exposure to the securitization transaction than it would have had if the account was required to be funded. However, as currently proposed, the premium capture cash reserve account may result in a constriction of credit and an increased cost of capital. Investors are also concerned that a reduced availability of credit may put negative pressure on home values and, in turn, affect the trillions of dollars of outstanding ABS that investors currently own. Our investor members will continue to review this concept and attempt to provide an alternative solution that alleviates these concerns.

v. Impracticality of "Representative Sample" Retention for RMBS; Suggested Alternative

The proposal for a representative sample is not practical for use with RMBS offerings for the reasons discussed below. We suggest below an alternative, under which a 5% pro rata participation interest is retained by the sponsor and not transferred to the issuer of the securitization.

First and foremost, the representative sample methodology outlined in the Proposed Regulations 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.

We are not suggesting that a representative sample as outlined in the proposal should be available for such a pool. To the contrary, such a 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.

Instead, a better approach for such a pool would be to permit the sponsor to retain a 5% pro rata participation in each asset included in the pool. Such a participation would have to be a pari passu pro rata interest in each asset, meeting 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 believe that this approach can be easily executed. Moreover, for "chunkier" pools consisting of a relatively smaller number of assets with relatively larger balances, this approach 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, 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.[15]

Our investor members oppose the representative sample form of risk retention set forth in the proposed rules because they believe it will be difficult to ensure that the sample of loans selected is in fact random and adequately represents the overall credit risk of the loans that are securitized. Investors believe that the alternative form of representative sample that has been proposed in this testimony is not only easier to employ, but also guarantees that the retained risk is representative of the securitized pool.

vi. 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 will 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, 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

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

securities. We believe these changes will provide needed flexibility to securitization sponsors while still meeting all the goals of the risk retention requirements.

vii. Limitations on the Resecuritization Exemption

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. 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.

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. Our investor members agree that resecuritizations of existing ABS for which risk has already been retained should be exempt from the risk retention requirements, 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 a few.

viii. 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." We discuss below certain of the specific criteria proposed for QRMs that our issuer members believe are overly restrictive and do not significantly further the statutory intent. We also 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. Our members are far less 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."[16] 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

[16] *See* Proposing Release, p. 199.

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 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 as a regulatory criterion, we note that use of credit scores is universally used in underwriting policies and procedures, including by the GSEs. 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.

We note that the Release indicates that the Joint Regulators considered the role played by mortgage insurance in the residential mortgage market but determined that the presence of such insurance should not be a factor in determining the criteria for QRMs, since the existence of such insurance does not in and of itself reduce the potential for borrower default. As the Joint Regulators acknowledge, however, mortgage insurance does protect creditors (including investors in ABS) upon the occurrence of mortgage defaults. For that reason, we believe it is appropriate to allow the maximum loan-to-value ratio for purchase mortgages to be as high as 90% if mortgage insurance is obtained and other compensating factors exist that reduce the risk of borrower default (such as a credit score above a certain threshold).

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.

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 and may change over time.

However, there are a few criteria in the definition that should be expanded. First, 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. Second, 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.

ix. The Effect of the QRM Criteria on Availability of Credit; Issues relating to the GSEs

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.

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. In and of itself, this exemption is not unwarranted, given the fact that the guaranty by the GSEs is backed by capital support from the United States and it is not clear any feasible means would be available to require credit risk to be retained on securities guaranteed by the GSEs. We are concerned, however, 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 appropriate 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 will 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 will 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.

x. Additional "QRM Blend" Exemption

As discussed in the Release,[17] section 15G(c)(2)(B) of the Securities Exchange Act of 1934 contemplates that the 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. However, the Joint Regulators did not propose any such standards for residential mortgage loans. We will urge the Joint Regulators to use this authority to create an additional "QRM blend" partial exemption from the risk retention requirements. Under this proposal, for a securitization backed by residential mortgage loans where at least 25% of the loans meet the QRM criteria, the 5% risk retention requirement would be ratably reduced by the proportion of the total pool that meets the QRM standards.

---

[17] *See* Proposing Release, p. 157.

xi. 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.

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 more 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 all 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.

xii. 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." "Qualified mortgage" is defined by the amendments to TILA, but the definition is subject to revisions by the Board. The Board has not yet weighed in on the definition, but is generally expected to issue significant changes. As a result, there is confusion among market participants over the interplay of these two types of mortgages and the degree to which they will overlap. We believe it would be useful for the Board to issue a release indicating the revisions they propose to make to the "qualified mortgage" definition in order to provide market participants with a more appropriate context in which to provide additional comments on the QRM definition.

B. Auto ABS

i. 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 proposal 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 sampling of unsecuritized assets; or, (v) for revolving master trust securitizations of dealer floorplan receivables, holding a *pari passu* seller's interest. By suggesting a framework where a combination of risk retention options is made available to Auto Sponsors, the proposal follows, 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. As discussed further in this testimony, although our Auto Sponsor and auto ABS investors agree on certain of the points made herein, they do have some differing opinions on other topics.

The Auto Sponsors are concerned that two of the forms of risk retention that could be the most useful for them—horizontal exposures and representative sampling—were not drafted in a way that is consistent with our proposals in that prior letter and will need to be clarified or revised significantly to make them appropriate and workable options for their transactions. Furthermore, they believe that the proposal should be revised to allow them greater flexibility to combine different forms of risk retention in a securitization and to modify the manner in which the exposures are held over time, which would achieve the goals of risk retention while reflecting the current structures of their transactions and investors' preferences. With the following 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 them with 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 would also note that virtually all motor vehicle securitizers already have substantial involvement with the ABS they issue, as they originate and service the collateral that comprises the asset pool and retain risk exposure through a subordinated residual interest.[18] These features, when considered in the context of the excellent historical performance of the motor vehicle ABS market,[19] indicate that motor vehicle securitizers have traditionally maintained strong alignment of interests with their ABS investors and why the motor vehicle ABS market remains the most vibrant portion of the United States ABS market.[20]

We fear, however, that if the risk retention rules do not recognize the current forms of risk alignment that the Auto Sponsors presently maintain and instead demand additional, expensive risk retention then there will be a significant impact on consumers. The Auto Sponsors believe that both individual consumers and businesses would face a more constricted credit market in this circumstance, resulting in fewer motor vehicle financing options and higher costs for purchasing or leasing vehicles. Motor vehicle dealers, which constitute a large number of the nation's small businesses, would also likely face restrained and more expensive credit in

[18] The subordinated residual interests that the Auto Sponsors presently retain in their securitizations do not fit squarely within the proposed definition of an "eligible horizontal residual interest." Given the successful risk alignment that the Auto Sponsors have traditionally achieved with their investors by retaining subordinated residual interests, they believe that the revisions to the proposed form of horizontal risk retention set forth in Section I.a. are appropriate and necessary, at least with regard to motor vehicle securitizations.
[19] The Auto Sponsors are unaware of any principal losses or missed interest payments on their ABS during the past twenty years, including during the recent financial crisis.
[20] For the period from January 1, 2008 through March 31, 2011, ABS backed by prime automobile loans, subprime automobile loans, motorcycle loans, automobile leases and motor vehicle dealer floorplan receivables together accounted for 40.1% of the domestic ABS market.

financing their inventory and assisting their customers with financing choices. In turn, the manufacturers whose sales the Auto Sponsors support may sell fewer vehicles, which will harm job growth, investment and the broader economy. 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

In motor vehicle securitizations, the securitizer or an affiliate[21] generally retains ownership of the 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 flow of funds. To the extent that on any distribution 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 is at the investor-desired levels,[22] the subordinated residual interest is typically allowed to receive any excess payments generated by the asset pool. The Auto Sponsors and most ABS investors strongly believe that retention of this subordinated

[21] 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 to achieve the bankruptcy treatment of the securitization that investors 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 initially be held by those consolidated affiliates as well.

[22] 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 pool assets to pay down the principal on the ABS more quickly than principal is collected on the pool assets.

residual interest as horizontal risk retention is highly effective in aligning incentives between securitizers and investors and that allowing retention of such interests (so long as they are sized appropriately) should be a permissible form of horizontal risk retention for motor vehicle ABS.

In many ways the subordinated residual interests that Auto Sponsors typically retain already largely share two of the three principal characteristics of the proposed "eligible horizontal residual interest."[23] First, the subordinated residual interests are the first ABS interest in the respective securitization to bear the burden of losses on the securitized assets until they have been fully depleted, which corresponds to clause (1) of the "eligible horizontal residual interest" definition. Second, they have the most subordinated claim in the transaction's waterfall to any collections on the pool assets, which corresponds to clause (2) of the "eligible horizontal residual interest" definition. We believe that these characteristics alone are appropriate and sufficient to cause a subordinated residual interest to qualify for horizontal risk retention. However, the third criteria of the proposed definition—that an "eligible horizontal residual interest" is not permitted to receive any principal payments other than a proportionate share of scheduled principal payments collected on the pool—is inconsistent with the way subordinated residual interests currently operate in motor vehicle ABS and is an unnecessary, inappropriate and uneconomical restriction.

---

[23] In our full comment letter on the Proposed Regulations the Auto Sponsors will propose specific revisions to the definition of "eligible horizontal residual interest" so that the term can be more appropriately applied to motor vehicle ABS. For example, motor vehicle loan ABS deals do not have a "loss allocation" mechanism each period (which is envisioned in the Proposed Regulations), but the subordinated residual interest is nonetheless the ABS interest that would be the first to have its distributions reduced or eliminated in a particular period if there are losses on the asset pool or other cashflow disruptions. Appropriate revisions to the definition would preserve its "first loss" intent while not inadvertently excluding horizontal risk retention in traditionally structured motor vehicle loan securitizations. Furthermore, there are different structures and terminologies that are used across the motor vehicle loan, lease and dealer floorplan asset classes that all will need to be properly reflected so that horizontal risk retention can be used in any of these three types of motor vehicle securitizations.

As described above, in motor vehicle ABS the subordinated residual interest may receive distributions on the pool assets in any period, so long as the senior ABS have all received their required principal and interest, all issuing entity fees and expenses have been paid and all credit enhancement that is funded or maintained with cashflow from the pool assets is at its then-required level. Preventing payments on the subordinated residual interest when the deal is fully performing would not serve any purpose other than 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 deal was paying on schedule and generating excess collections. Furthermore, in motor vehicle ABS, collections are not segregated into principal and interest collections and applied in separate waterfalls, as is often the case in RMBS and certain other asset classes. Therefore, preventing excess payments on the subordinated residual interest other than from "scheduled payments of principal" on the pool assets would require that the securitizations separately track and account for interest, "regular" principal and "other" principal collections as they flow through the waterfall in a manner that is inconsistent with reporting and cash application for any motor vehicle ABS that is in the market today.

The Auto Sponsors would instead suggest that the only limitation that should be placed on distributions on the subordinated residual interest is that the value of the interest[24] after giving

[24] 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 the retained horizontal interest could have a number of components at any time, including the current amount of overcollateralization and the discounted present value of any expected excess interest to be received on the interest but will request that a clear statement of this appear the final release. Similarly, the Auto Sponsors believe that cash that is on deposit in a securitization's reserve account and that is available to fund shortfalls in payments on the ABS interests (other than

effect to the distribution should not, as a percentage of the value of all ABS interests in the securitization after distributions on the related date, be decreased below the lower of (1) five percent of the then-current aggregate value of all ABS and (2) the percentage interest represented by the subordinated residual interest immediately prior to the distribution. Allowing payments that are consistent with the securitization's waterfall that maintain the retained interest at or above the required five percent level would preserve the securitization's mandated level of risk retention while preventing the transaction from building or maintaining a surplus of credit enhancement. It is also consistent with the provisions in the rules that would allow transfer of a portion of a residual interest to a third-party so long as the required risk retention is still maintained. Furthermore, allowing payments that maintain a level below five percent would result only if the subordinated residual interest had already absorbed losses that otherwise would have affected the more senior ABS interests in the transaction. If the sponsor were required to maintain excess collections in the deal and effectively fund the subordinated residual interest back up to five percent then it would be at risk for the same loss a second time and ultimately would be forced to have greater than the required five percent exposure to the securitization. If a securitization's investors do not desire these additional cash-capture features then the risk retention rules should not separately mandate them.

For these reasons, the Auto Sponsors will request that the sections of the Proposed Regulations regarding horizontal risk retention be modified as described above to match the horizontal risk that is presently retained as a "subordinated residual interest," at least as the rules are applicable to motor vehicle ABS. The historical performance of motor vehicle

---

any interest retained for horizontal risk retention purposes) should be included as a component of the retained horizontal interest's value and will request that this be clearly stated in the final release.

securitizations illustrates that this current model of horizontal risk retention provides an appropriate alignment of interests between securitizers and investors and imposing further conditions on this method of risk retention would only hinder the issuance of motor vehicle ABS and negatively impact the availability of credit to consumers and businesses.

b. Representative Sampling

An Auto Sponsor selects the pool 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 that the option to maintain risk exposure to their securitizations by holding a representative sampling of receivables (an "Unsecuritized Pool") may be an attractive option in certain instances. However, there are a variety of reasons that the proposed Unsecuritized Pool rules are unnecessarily complex and burdensome and, in their present form, likely would not be utilized in the motor vehicle ABS markets.

The Auto Sponsors believe that complying with a specified pool requirement is impractical and inefficient in their market, where an individual securitizer may maintain a portfolio of hundreds of thousands or even millions of originated and serviced loans. Therefore, the Auto Sponsors expect that the final comment letter will include a proposal that would allow satisfaction of the Unsecuritized Pool requirement by maintaining a revolving pool of unsecuritized assets that is, nonetheless, representative of the corresponding securitized pool and its risk profile.

Alternatively, if Unsecuritized Pool risk retention must be conditioned upon maintaining a specified pool of assets, then achieving the goal of aligning an Auto Sponsor's exposure with its investors' can be achieved through much less burdensome methods than those that are described in the Proposing Release. 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, utilizing the same selection criteria and no adverse selection. 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."[25]

Requiring that an Auto Sponsor identify an Unsecuritized Pool based on these revised criteria, perform the sampling and 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, testing and maintenance procedures at the time of the ABS sale; requiring monthly testing and reporting of the performance of the Unsecuritized Pool for comparison against the ABS pool—

[25] The Auto Sponsors expect to propose a list of asset-specific criteria for which it would be appropriate to perform such an equivalency test, such as APR, outstanding principal balance and remaining term.

are unnecessarily costly and time consuming. These additional criteria would drive Auto Sponsors away from ever using this method because it would essentially require that they hold an Unsecuritized Pool, unhedged and wholly at their own expense, while simultaneously assuming the most onerous ongoing costs of a securitization with respect to those assets.

Our motor vehicle ABS investor members are not supportive of Unsecuritized Pool risk retention in any form due to concerns that it will be difficult to ensure that any sample of pool assets selected is in fact random and adequately represents the overall credit risk of the assets that are securitized. However, the Auto Sponsors believe that if the rules were modified to allow them to hold an Unsecuritized Pool in the manner described in this section that proper risk alignment could be achieved. And, of course, if an Auto Sponsor proposes to hold risk retention in only this form for a particular securitization but investors desire that other forms (e.g., horizontal risk retention) be added to or replace the Unsecuritized Pool retention, then we expect that the Auto Sponsor would have no choice but to respond to those desires by modifying its proposed form of risk retention so as not to risk losing investors or causing an increase in the securitization's pricing.

c. "Blended" Risk Retention

The Auto Sponsors note that the proposal to allow "L-shaped" risk retention (i.e., a combination of a vertical slice and a horizontal slice in a prescribed ratio) acknowledges that it is possible to "mix and match" different forms of risk retention while still ensuring that, in the aggregate, exposures have been retained by the sponsor that equal a full five percent of the ABS interests issued in the securitization. There is no reason that a formula could not be set forth in the final regulations that describes how to value each of a retained "vertical slice," a retained "horizontal slice," a cash-funded reserve account,[26] an Unsecuritized Pool and, for revolving master trust securitizations of dealer floorplan receivables, a seller's interest, when such exposures are held in combination and in order to achieve an aggregate retained risk exposure of at least five percent.

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 Sponsors have, for decades, traditionally retained 100% of the subordinated residual interests in their securitizations, they anticipate that investors will expect that they will continue to hold those interests as horizontal risk retention in almost all cases. If such an Auto Sponsor finds that its subordinated residual interest is only "valued" at approximately 4.5% on a particular transaction, however, then the Auto Sponsor would have to consider transferring additional eligible assets to the asset pool to enhance the value of the ABS interest comprising the horizontal risk retention, despite the fact that those assets are otherwise unnecessary to support the securitization's expected losses and cashflow demands. 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 Regulations would be to also hold approximately 2.5% of the 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 such a sponsor to fund a reserve account, as envisioned by the horizontal slice rules, to make up the approximate 0.5% difference, or to allow it to construct a similarly sized Unsecuritized Pool.

[26] In the provisions relating to horizontal risk retention, the Proposing Release would permit a sponsor to establish a cash-funded reserve account in the same amount as the required "horizontal slice" rather than structuring and holding that subordinated ABS interest.

In this context it is important to note that not all investors would prefer a horizontal slice, so flexibility in the risk retention options is critical to the ongoing viability of this market. For example, some of our investor members would prefer a vertical slice because they believe horizontal retention may create incentives for the servicer to adopt servicing strategies that benefit the first loss interest over the other tranches if the servicer and the sponsor are affiliated. Other investors may desire that the sponsor be exposed to both forms and would prefer a blend of vertical and horizontal retention, such as that described above.

d. Maintaining the Retained Exposures

The Auto Sponsors believe that there is no particular value in mandating that they hold their exposure in the same form throughout the life of a deal.[27] So long as a sponsor (i) discloses in its offering documents the manner in which it is allowed to adjust its risk retention holdings over the life of the securitization, (ii) always maintains a specified minimum level of exposure and (iii) for publicly registered securitizations, reports any material reconfiguration to its risk retention holdings in a Form 8-K filing, it should be allowed to modify its risk retention allocations post-closing. Our investor members believe that disclosure of changes in the retention over time is critical to having a full understanding of a sponsor's interests and risks in the securitization.

Additionally, as is mentioned above in the discussion regarding horizontal risk retention, the Auto Sponsors believe that the risk retention rules are intended to cause a sponsor to maintain a fixed <u>percentage</u> of exposure to a securitization over time rather than a fixed <u>amount</u> of exposure. By way of example, if a sponsor retained $5 of risk against $100 of ABS issued at

[27] For instance, a sponsor might find that the value of the ABS it retained to satisfy horizontal risk retention has increased and that it can therefore securitize the assets that it had been holding on its balance sheet as an Unsecuritized Pool or sell those ABS that it had initially retained for vertical risk retention purposes.

closing, if those ABS had amortized to $50 and no losses had been incurred, the sponsor would be able to hedge, sell or otherwise dispose of half of its retained risk to maintain its five percent level of exposure and would not be required to maintain the full exposure that had come to represent 10% of the ABS interests. In their comments on the Proposing Release the Auto Sponsors intend to request that an explicit acknowledgement of this "step down" mechanism be included in the section relating to transfers and hedging.

ii. Qualifying Automobile Loan Adjustment

The Auto Sponsors had initially hoped that the adjustment that would be proposed for securitizations of Qualifying Automobile Loans would allow for regular securitizations in the prime motor vehicle market. ABS that are backed by prime motor vehicle collateral have historically been collateralized and structured to ensure exceptionally strong performance, as illustrated by the fact that investors in these public securitizations have never suffered missed interest payments or principal losses. Furthermore, there have historically been far more ratings upgrades than downgrades as a result of asset performance and conservative transaction structures in the motor vehicle ABS sector.[28] Unfortunately, the Proposed Regulations are drafted so narrowly and with such a focus on underwriting and loan characteristics that (incorrectly) assume a significant overlap between the motor vehicle and residential mortgage markets that they are presently unusable by all Auto Sponsors.

The Auto Sponsors do not currently originate motor vehicle loans using the criteria set forth in the Proposing Release in many significant respects. Furthermore, they indicated that

[28] For example, during the period from January 1, 2001 through December 31, 2010, Standard & Poor's issued 635 upgrades of classes of retail automobile loan ABS, compared to just 37 downgrades for pool credit related reasons (figures exclude downgrades due to the downgrade of a credit support provider, such as a monoline insurer). In addition, no defaults have occurred on any prime automobile retail loan ABS rated by S&P since they began rating automobile ABS in 1985.

they would not customize their origination standards to allow them to assemble such a pool of Qualifying Automobile Loans because the stricter underwriting procedures described would drive away all but the least creditworthy customers;[29] the criteria regarding loan-to-value, debt-to-income and other numeric standards do not comport with their general business models; and 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 costs would eclipse any possible benefits from lower mandated risk retention.

In short, the Auto Sponsors do not believe that a motor vehicle ABS transaction has ever been executed where the collateral would meet the criteria set forth in the Proposed Regulations or that attempting to originate conforming collateral would be economical for them. Unless the Qualifying Automobile Loan Adjustment is reworked significantly, the Auto Sponsors expect that it will remain wholly unused, despite the clear Congressional intent to foster such an asset class.

a. Principal Issues with the Qualifying Automobile Loan Adjustment

The Auto Sponsors believe that in preparing the Qualifying Automobile Loan Adjustment the drafters 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;[30] and a

[29] More creditworthy borrowers presumably would be able to receive financing from lenders that were following today's standard origination processes and were not attempting to conform to the Qualifying Automobile Loan Adjustment standards by demanding additional documentation.

[30] Motor vehicle loans in the ordinary course also regularly finance taxes, titling fees, ancillary products, service contracts, insurance policies and/or balances refinanced on trade-in vehicles. The Proposed Regulations not only

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. Other features, such as the proposed maximum loan terms of 60 months in a market where 72-month lending has been a normal market feature for many years, on both new and used vehicles, simply illustrate a misunderstanding of what constitutes a "standard" product in the motor vehicle marketplace.

Furthermore, the Auto Sponsors believe that the proposed exemption is underinclusive in that it omits many types of consumer transactions that are made using high-quality underwriting standards and that give rise to assets that would be appropriately securitized without prescribed levels of enhancement. For example, in omitting loans to commercial purchasers and to individuals who will use their vehicles for commercial uses by mandating that all loans be made to individuals to secure vehicles used for personal or family use, failing to include motorcycles in the list of permissible "passenger vehicles" and excluding motor vehicle lease transactions, the Proposed Regulations focus on a particular subset of the motor vehicle sector (i.e., loans to individuals for cars) that omits equally creditworthy and low-risk products that should have equivalent access to the exemption.

b. Alternative Exemption Regime

The Auto Sponsors believe that the only appropriate way in which a Qualifying Auto Loan Adjustment could be implemented is by focusing on a securitization's entire asset pool based upon weighted averages of specified pool characteristics. As the Auto Sponsors indicated in November 2010, in the ASF Auto Risk Retention Letter to the Joint Regulators, this

---

require a minimum 20% down payment but also demand that the consumer pay 100% of the title, tax, registration and dealer-imposed fees.

methodology was previously utilized by the Federal Reserve Bank of New York to determine eligibility for borrowings under the Term Asset-Backed Securities Loan Facility ("TALF") where, for example, weighted average FICO Score was used to distinguish between prime and subprime automobile loans for determining the appropriate haircut levels. Motor vehicle assets are, within their various subclasses (e.g., subprime loan, prime lease), largely homogeneous assets that are short term, not particularly interest rate sensitive, rarely refinanced and collateralized by an asset that is easily and quickly liquidated following repossession. Taken together these characteristics suggest that a focus on loan-by-loan origination characteristics to forecast a securitization asset pool's "creditworthiness" is unnecessary and misguided. We also note that, unlike for the QRM exemption, the mandate in the Dodd-Frank Act to develop a Qualified Automobile Loan Adjustment did not demand that 100% of the assets collateralizing the subject transaction meet particular characteristics, so we believe that our alternative approach is both more appropriate and permissible.

Focusing on pool-wide characteristics would accurately provide an indication of a securitization's overall credit quality. While the Auto Sponsors have not yet formulated specific pool composition criteria, they expect that, after consultation with motor vehicle ABS investors, they will propose that in order to meet the Qualifying Automobile Loan Adjustment the securitizations' underlying asset pool, on a weighted average basis, would be required to meet a variety of criteria, which may include specified loan-to-value, FICO score, original term and new vs. used vehicle standards. They may also conclude after discussions with their investors that it would be appropriate to limit the securitization's exposure to relatively lower quality assets by including maximum pool concentrations at the lower ends of certain of these criteria (for example, a pool where (1) the assets have a weighted average FICO Score of ___ and (2) no more than ___% of the assets have a FICO Score below ____).

If a pool constructed in this manner could satisfy the Qualifying Automobile Loan Adjustment, investors and regulators would be assured that the ABS were of the highest quality and that an exemption from the risk retention requirements would be appropriate.[31] Additionally, this would allow Auto Sponsors to construct conforming securitizations from their regularly originated assets in the same manner as they presently create pools, albeit with a focus on higher quality pool assets.

c. Investor View

At this time, our investor members have not developed views around a particular approach for Qualifying Automobile Loans but they intend to provide detailed comments along with the Auto Sponsors in ASF's forthcoming response letter to the Proposed Regulations. The investors' preliminary belief is that a Qualifying Automobile Loan would be the "gold standard" and very high quality. That being said, they do agree that the current proposed definition is likely too restrictive and incorporates criteria, such as the 20% down payment, that are not typically used in the auto space. They also believe that developing an appropriate set of criteria will require a substantial review of historical data to ensure optimal performance.

[31] It should be noted that while the Auto Sponsors are eager to craft a workable Qualified Auto Loan Exemption, they do not expect that their investors or the rating agencies would generally allow them to conduct securitizations in which they truly retained no risk. For instance, as described in Section I.a. above, "horizontal slice" risk retention has been the norm in motor vehicle securitizations for decades and the Auto Sponsors believe that they would retain those exposures even in an exempted transaction (although that exposure might be at less than a five percent level if that lower level is all that a particular securitization's structure mandates).

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 risk retention rule[32] have functioned well, even through the depths of the financial crisis.

While we support 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 the credit quality of those sponsors, not

---

[32] 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.

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 rely on the credit of the sponsor and not the assets in the conduit, we do not believe that ABCP is an asset-backed security under Dodd-Frank. Moreover, we believe that most ABCP conduit sponsors are not securitizers subject to Dodd-Frank because they don't transfer assets to an issuer of asset-backed securities. In addition, for sponsors that cannot rely on credit support facilities to satisfy risk retention, there are a number of provisions in the rule that are unworkable and inconsistent with market practice, without furthering the purposes of the Proposed Regulations. Finally, 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 welcomed by investors in ABCP and would not serve the purposes of the rule.

ii. Lack of Statutory Authority to Impose Risk Retention Requirements on ABCP and ABCP Conduit Sponsors

At the outset, we note that the Joint Regulators would appear to lack statutory authority to impose risk retention requirements on ABCP and most ABCP conduit sponsors. Section 941(b) of the Dodd-Frank Act only mandates the Joint Regulators to prescribe risk retention requirements to “securitizers” that issue “asset-backed securities” as each such term is defined in the Dodd-Frank Act. Consistent with that mandate, the base risk retention requirement in the Proposed Regulations requires sponsors of transactions “involving the offer and sale of asset-backed securities” to retain an economic interest in the securitized assets.

As we indicated in the ASF ABCP Risk Retention Letter submitted to the Joint Regulators on November 22, 2010,[33] the term "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 risk retention rule 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, "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. As further described below, payments on assets financed by ABCP conduits are not expected to be the source of payments made to ABCP investors. Instead, it is expected that ABCP investors will be paid either from proceeds generated through the issuance of additional ABCP notes or, if ABCP cannot be successfully offered on such day, through draws on the liquidity and credit support facilities provided by regulated financial institutions. ABCP therefore does not meet the definition of "asset-backed security" in the Securities Exchange Act of 1934 and therefore should not be subject to the proposed risk retention rule.[34]

---

33 *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.

34 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 Securities Exchange Act of 1934. 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,

iii. 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 bank or other financial institution. In fact, an overwhelming majority of ABCP conduits are covered 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 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. Instead, ABCP investors focus on (i) the creditworthiness of the financial institution that provides 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

---

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."

the ABCP conduit. Most of these protections are not present in other 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 who already provide Program Support Facilities or on the customers of the ABCP conduits they sponsor. Sponsors of these ABCP conduits already assume 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 crises. We are not aware of any losses by holders of fully supported ABCP, even in the worst U.S. economic downturn since the Great Depression. Unfortunately, the Proposed Regulations don't appear to have accounted for these views, but instead posit misaligned incentives without demonstrating where or how that misalignment exists. If the Proposed Regulations are finalized into rules as currently written, appreciable reductions in ABCP lending volumes would result, ultimately causing the further deterioration of the availability of credit to American businesses. If, notwithstanding these concerns, Congress chooses to include ABCP in the Proposed Regulations by amending the definitions of "asset-backed security" and "securitizer" as currently defined in the Dodd-Frank Act, so as to subject ABCP and ABCP program sponsors to the Proposed Regulations, the following modifications to the Proposed Regulations would be appropriate.

iv. Sponsor-Provided Program Support Facilities

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 by the sponsors of ABCP conduits, however, are not specifically covered by name in any of the categories of permitted risk retention. This is striking for two reasons: first, because of the prevalence of these facilities as a form of sponsor support to ABCP programs, and, second, because the recently adopted European risk retention rules applicable to banks explicitly treat these Program Support Facilities as adequate risk retention.[35] 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 sponsor-provided Program Support Facility 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.

We note that in many instances these facilities take the form of letters of credit or other similar undrawn credit facilities. The fact that these facilities are not initially funded positions should not, in our view, preclude their use as permissible forms of risk retention. The institutions providing these facilities have in the past and fully expect in the future to honor their funding obligations when required 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. We also note that in recognition of the potential risks taken by these facilities, banks that provide them are required to maintain capital against them as if they were funded securitization positions from the date of their issuance.

---

[35] *See* Committee of European Banking Supervisors, *31 December 2010 Guidelines to Article 122a of the Capital Requirement Directive*, paragraph 57.

v. Eligibility Requirements for ABCP Conduits and Other Requirements of the Proposed Regulations

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 rely upon 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 conduit-specific risk retention options. 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 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 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 testimony, 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.

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. For example, the requirement that the interests of an 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 issuer 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. So long as the ABCP conduit separately negotiates the terms of each purchase, we see no reason this long established practice should be prohibited. In addition, the requirement that the interests issued by the intermediate SPV be collateralized solely by assets from a single originator would preclude investment in an SPV backed by assets originated by more than one affiliated originator. We see no useful policy goal in so limiting the investments that eligible conduits can make. We will recommend changes to the final rule to address these and other technical issues in our comment letter to the Joint Regulators.

vi. Disclosure

Consistent with the disclosure requirements for other forms of sponsor-provided risk retention, sponsors using Program Support Facilities as a permissible form of risk retention expect to disclose the pertinent details 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 originator-sellers as would be required by the Proposed Regulations is unnecessary, and may be counterproductive. 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 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 is unnecessary under the terms of the Proposed Regulations. Moreover, the policy goals of the prop Proposed Regulations that such disclosures are intended to promote are satisfied in our view by the proposed disclosure in respect of the sponsor and its liquidity and credit support providers.

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 without regulatory oversight 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.

In connection with proposed changes to Regulation AB, the ASF ABCP Conduit Subforum and ASF ABCP Investor Subcommittee recently worked together to develop a detailed comment letter[36] 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.

---

[36] *See* ASF Comment Letter re ABCP under Regulation AB II: <http://www.americansecuritization.com/uploadedFiles/ASFRegABIIABCPCommentLetter8.2.10.pdf>.

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.

D. Credit and Charge Card ABS

i. Risk Retention for Credit and Charge Card ABS Generally

The first securitization of credit card receivables was completed in 1987. The master trust structure was introduced shortly thereafter to accommodate the revolving nature of credit and charge card receivables. Since that time, the master trust structure has been the primary source of financing for unsecured revolving consumer credit in the United States, and credit and charge card ABS performance has been consistently strong, even during the recent financial crisis.

The master trust structure is equipped with numerous technical features that have allowed issuers to respond to changing market conditions. Long before "skin in the game" became a topic of political debate, credit and charge card issuers were holding seller's interests and retaining other meaningful interests in their master trusts that align the interests of issuers with the interests of investors. Features of the credit and charge card ABS market that have facilitated this alignment include:

1. the seller's (or transferor's) interest;
2. the seller's right to receive finance charge collections that remain after covering payments, losses and other amounts allocated to investors (excess spread);
3. the originator's continued ownership of the account (even though the receivables have been transferred to the master trust);
4. the originator's continuing credit-granting and underwriting responsibilities as the account owner;
5. the retention of servicing responsibilities for the securitized receivables, in most cases by the credit and charge card originator or an affiliate; and
6. the retention of subordinated tranches or other residual interests (such as reserve accounts) in the master trust.

These risk retention mechanisms have produced significant economic exposures to the securitized assets. Excess spread, for example, represents the securitizer's return on its investment in the securitized assets and is the first interest to absorb losses. The consistent performance of credit and charge card ABS, particularly during the recent credit crisis, evidences the effectiveness of these risk retention mechanisms.

In order to preserve securitization as a viable funding option for credit and charge card issuers, it is critical that the risk retention rules be appropriately tailored to reflect the nuanced and technical features of the master trust structure, and that the master trust structure retains the flexibility to evolve to meet changing investor demands. Failure to achieve these results will significantly increase the cost of capital to credit and charge card issuers, thereby restricting access to, and increasing the cost of, credit to consumers.

ii. Seller's Interest

a. Definition

The ASF agrees that a range of risk retention options should be available for credit and charge card securitizations, but 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. The seller's interest is a quintessential form of credit risk retention that operates to align the economic interests of securitizers with the interests of investors. The Proposed Regulations indicates that the definition of seller's interest is intended to be consistent with current market practices. However, this definition and the related provisions are not entirely consistent with current market practices. Many of our comments are intended to align the seller's interest mechanism under the Proposed Regulations with current market practices.

First, while the allocation of collections and losses is pro rata during revolving periods, the program documents for virtually all credit and charge card securitization transactions fix the allocation of collections to investors, or in some cases even subordinate amounts allocable to the seller's interest to the investor interests during other periods. These mechanisms are intended to provide for the orderly and timely payment of the investor interests. As a result, the definition of seller's interest should be modified to provide that the seller's interest may be pari passu with "*or subordinated to*" the other ABS interests issued by the issuing entity.

Second, under the Proposed Regulations, the sponsor is required to retain a seller's interest of not less than 5% of the principal balance of all of the assets in the revolving asset master trust at the closing of the securitization transaction and until all ABS interests in the issuing entity are paid in full. We have the following concerns with this standard:

1. It is not consistent with the standard for meeting the minimum seller's interest requirement for credit and charge card ABS master trust issuers that measure the seller's interest by reference to the outstanding investor interests rather than the total assets of the master trust.

2. Regulatory efforts to align the interests of a securitizer with the interests of investors should require the securitizer to retain the required seller's interest only until the ABS interests held by unaffiliated third parties are paid in full.

3. In a revolving asset master trust, the seller's interest and the investor interests will change over time to reflect the then-current amount of investor interests and receivables outstanding. As a result, the Proposed Regulations should be clarified to specify that the seller's interest is to be measured as of a current point in time (rather than an earlier point in time, such as the date of issuance of an ABS interest).

To achieve these objectives, the Proposed Regulations should be modified to require securitizers to retain a seller's interest, at the closing of the securitization transaction and until all ABS interests *held by unaffiliated third parties* are paid in full, of at least 5% *of the principal balance of all ABS interests held by investors at that time*.

Finally, under current market practice, if the amount of the seller's interest is reduced below a minimum level established under the securitization documents, certain amounts to be paid to the holder of the seller's interest are instead deposited in an excess funding or special funding account that supports the outstanding ABS interests other than the seller's interest (much like the horizontal cash reserve account described in the Proposed Regulations). For purposes of determining the amount of risk retained by the securitizer under the Proposed Regulations, amounts in these excess funding or special funding accounts should be included when measuring the amount of the seller's interest.

b. Who Retains the Seller's Interest

The Proposed Regulations requires that the seller's interest be retained by the sponsor. The sponsor is defined 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." In many credit and charge card securitization transactions, the sponsor sells or transfers receivables to an affiliated depositor that, in turn, transfers the receivables to the master trust. In these cases, the seller's interest is held by the depositor rather than by the sponsor. The Proposed Regulations should be clarified to indicate that the seller's interest (or any other form of risk retention) may be held directly by the depositor initially and at any time thereafter, rather than initially by the sponsor with assignment to the depositor thereafter. This is consistent with Dodd-Frank's definition of "securitizer" that includes both the sponsor and the depositor.

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

Unlike amortizing securitization structures, revolving asset master trusts are structured to issue ABS interests in different series at different times. Credit and charge card securitizers believe that the proposal should be revised to allow greater flexibility to combine different forms of risk retention in a securitization, particularly revolving asset master trust securitizations,[37] and revised to modify the manner in which the exposures are held over time, which would achieve the goals of risk retention while reflecting the current structures of their transactions and investors' preferences.

[37] This is particularly important for a revolving asset master trust, since ABS interests are issued in different series at different times and may be issued with different capital structures.

In addition, in many cases, particularly in the current distressed capital markets, the credit or charge card securitizer or an affiliate retains the most subordinate tranche of the transaction. These subordinate tranches are structured to absorb credit losses before more senior tranches held by third parties are affected and are sized based on the amount of subordination needed to protect more senior tranches from multiples of expected losses. Under the proposed definition of "eligible horizontal residual interest," an ABS interest must have the *most* subordinated claim to payments of both principal and interest. However, there may be additional residual interests (e.g., excess spread or reserve accounts) that should not disqualify other retained subordinated interests from being eligible horizontal residual interests.

iv. Premium Capture Cash Reserve Account

The premium capture cash reserve account mechanism should take into account the unique features of a revolving asset master trust. In particular, Section __.12(a)(2)(i) of the Proposed Regulations measures the positive difference between the gross proceeds received by the sponsor at the closing of the securitization transaction and 95% of the par value of all ABS interests in the issuing entity issued as part of the securitization transaction. In the case of a revolving asset master trust, an ABS interest issued at any particular time may be supported by ABS interests (e.g., seller's interest or eligible horizontal residual interests) that are issued at different times. As a result, the rule should include instructions on how the premium capture cash reserve account operates in the context of a revolving asset master trust.

E. Student Loan ABS

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 (ii) non-government guaranteed private student loans which typically supplement the federal student loan programs.

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; is carrying at least one-half of the normal full-time academic workload for the course of study the student is pursuing; and meets the financial need 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 were administered by state-level guarantee agencies and reinsured by the federal government. FFELP loans were originated by commercial banks, thrifts, nonprofit organizations, independent finance companies, and credit unions, and were 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[38] to originate loans that were reinsured by the federal government. Under FFELP, federally insured loans provided a 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,[39] so long as the loan was serviced in accordance with Department of Education guidelines.[40] We believe that this reinsurance by the federal government, even though it is limited to 97 or 98 percent of the defaulted principal and accrued interest for some loans, warrants an exemption for FFELP loan securitizations from the risk retention requirements. 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."[41] Through the reinsurance program administered by the Department of Education, that is certainly the case.

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 under Section 941(c)(1)(B)(ii) of Dodd-Frank due to their negligible credit risk.[42] 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

---

[38] As defined under the *Higher Education Act of 1965*.

[39] 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.

[40] 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.

[41] See page 188 of the Proposing Release.

[42] 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."

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 reinsurance 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 could be appropriate given these special circumstances.[43]

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

[43] 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 reinsured at 97% of the initially disbursed amount.

costly to finance these loans via securitization."[44] 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. In addition, outstanding FFELP securitizations have recently been subjected to restructurings and new issuances of FFELP backed student loan ABS. 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, is effective in aligning incentives between securitizers and investors, due, in large part, to the amount of credit risk to which such interest is exposed. A securitizer holding a "horizontal slice" in the form of a subordinated residual interest is further motivated to structure and service a securitization properly because doing so maximizes the value of its retained interest. 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

[44] *See* Federal Reserve Study at page 79.

employ other forms of risk retention included in the Proposed Regulations. Thus, we strongly support the proposed menu of risk retention structures that are included in the Proposed Regulations as appropriate for student loan backed ABS.

F. 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 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. 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).

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. 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. 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 Commission's proposed rule with respect to asset-backed securities, including the revision of Regulation AB under the Securities Act and the Exchange Act.[45] The

[45] *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.

Commission 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.

G. Corporate Debt Repackagings

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 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. Therefore, on its face, Section 941 of the Dodd-Frank Act would, in the first instance, require the Joint Regulators to prescribe regulations requiring a securitizer of corporate debt securities to retain an economic interest in a portion of the credit risk for those assets. However, Section 941 of the Dodd-Frank Act 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.

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

i. 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.

ii. 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.[46]

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

[46] Dodd-Frank Wall Street Reform and Consumer Protection 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).

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.

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.[47] 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-

[47] 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.

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.[48] 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.[49] 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

---

[48] Section 15G to the Securities Exchange Act of 1934, as added by Section 941 of Dodd-Frank, generally requires the FRB (the "Board"), the Office of the Comptroller of the Currency, the FDIC, the SEC, the Federal Housing Finance Agency and the Department of Housing and Urban Development to jointly 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.

[49] *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* Report to the Congress on Risk Retention, Board of Governors of the Federal Reserve System (October 2010); *see also* Macroeconomic Effects of Risk Retention Requirements, Chairman of the Financial Stability Oversight Counsel (January 2011).

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 ABCP and in commercial mortgage-backed securitization transactions.[50]

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

[50] 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.

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 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.[51]

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.

---

[51] 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.

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.

IV. 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 number of years has elapsed from the issuance of the ABS. By requiring a sponsor to retain a portion of the credit risk in the underlying assets for a specified number of 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.

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.

Finally, we note that within the section that describes permitted hedging activities, including 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.

V. 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

VI. <u>Conclusion</u>

In conclusion, 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 take the foregoing comments into consideration. 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. The 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.

APPENDIX A

<u>Role of Securitization within the Financial System and U.S. Economy</u>

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.[52] 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.[53] $7.2 billion in equipment ABS was issued during 2009, in contrast with the 2007 issuance of $6.1 billion.[54] In 2009, credit card ABS accounted for $46.6 billion in issuance, down 50.7% from 2007 issuance of $94.5 billion.[55] Meanwhile, the student loan sector issued $20.8 billion in ABS during 2009, down 64.2% from 2007 issuance of $58.1 billion.[56] 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.[57] 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.[58]

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

[52] 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>.
[53] Data are from Asset Backed Alert, see the Proposing Release, pg. 12-13. <http://www.sec.gov/rules/proposed/2011/34-64148.pdf>.
[54] Ibid.
[55] Ibid.
[56] Ibid.
[57] Ibid.
[58] Analysis by 1010data, based on data from FNMA, GNMA and FHLMC.

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 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.[59] Between 1990 and 2006, issuance of MBS grew at an annually compounded rate of

---

[59] 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>.

13%, from $259 billion to $2 trillion a year.[60] 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.[61] Securitization plays a critical role in non-mortgage consumer credit as well. Historically, banks securitized 50-60% of their credit card assets.[62] Meanwhile, in the auto industry, approximately 91% of auto industry sales are financed through auto ABS.[63] Overall, recent data collected by the Board show that securitization has provided over 25% of outstanding U.S. consumer credit.[64] 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:

---

[60] 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")

[61] 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).

[62] Citigroup, "Does the World Need Securitization?" pg. 10 (Dec. 2008). <http://www.americansecuritization.com/uploadedFiles/Citi121208_restart_securitization.pdf>.

[63] Ibid., pg. 10.

[64] Federal Reserve Board of Governors, "G19: Consumer Credit," (Sept. 2009). <http://www.federalreserve.gov/releases/g19/current/g19.htm>.

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.

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.[65]

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.[66]

---

[65] NERA Study, pg. 16. <http://www.americansecuritization.com/uploadedFiles/ASF_NERA_Report.pdf>.

[66] 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.

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…"[67] 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."[68] 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 Street,"[69] 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

[67] 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>.
[68] G-7 Finance Ministers and Central Bank Governors Plan of Action (Oct. 10, 2008). <http://www.treas.gov/press/releases/hp1195.htm>.
[69] U.S. Department of the Treasury, "Road to Stability: Consumer & Business Lending Initiative," (March 2009). <http://www.financialstability.gov/roadtostability/lendinginitiative.html>.

substantially reduces the originator's exposure to interest rate, credit, prepayment, and other risks."[70] 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.[71] 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

[70] 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>.

[71] 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>.

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.

United States House of Representatives
Committee on Financial Services

"TRUTH IN TESTIMONY" DISCLOSURE FORM

Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

1. Name:	2. Organization or organizations you are representing:
Tom Deutsch	American Securitization Forum
3. Business Address and telephone number:	
[redacted]	
4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?	5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?
☐ Yes ☑ No	☐ Yes ☑ No
6. If you answered .yes. to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.	
7. Signature:	
Thomas Deutsch	

Please attach a copy of this form to your written testimony.