November 23, 2010

The Honorable Timothy F. Geithner
Secretary of the Treasury
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue
Washington, DC 20551

John E. Bowman
Acting Director
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552

John G. Walsh
Acting Comptroller of the Currency
250 E Street, SW
Washington, DC 20219-0001

The Honorable Mary L. Schapiro
Chairman
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

The Honorable Sheila C. Bair
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429-9990

Re: Implementing Section 941 (Regulation of Credit Risk Retention) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 for Student Loan ABS

Ladies and Gentlemen:

The American Securitization Forum ("ASF")[1] submits this letter 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 "Act") for asset-backed securities ("ABS") backed by student loans. ASF supports reforms within the securitization market and we commend the regulatory agencies for seeking industry input prior to proposing rules on this critically important issue. Over the past decade, ASF has become the preeminent forum for securitization market participants to express their views and ideas. ASF was founded as a means

[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.

to provide industry consensus on market and regulatory issues, and we have established an extensive track record of providing meaningful comment to various regulators on issues affecting our market. Our views as expressed in this letter are based on feedback received from our broad membership, including our student loan ABS issuer and investor members.

We support 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. This letter will address ASF's views concerning the implementation of Section 941 of the Act as it relates to student loan ABS. We have also submitted, or intend to submit, letters addressing our membership's views relating to asset-backed commercial paper and ABS backed by other assets, including credit and charge card receivables, auto loans and leases and residential mortgages.

Section 941(b) of the Act requires the Federal Deposit Insurance Corporation ("FDIC"), the Federal Reserve Board of Governors ("FRB"), the Office of the Comptroller of the Currency ("OCC") and the Securities and Exchange Commission (the "Commission" 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(a) 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(c), 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(b) must 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 Commission 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(c) specifies that the regulations shall provide for certain exemptions as further described below.

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[2] In a release of proposed rules relating to Section 943 of the Act, the Commission 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.

As noted above, we firmly believe that risk retention requirements should be specifically tailored for each major class of ABS. Securitization practices, including the forms of credit risk retention, differ in important respects across the different asset categories based on a variety of factors, including the nature and characteristics of the assets, the historical development and credit performance of each asset class and the securitization structures themselves. Given this variability, any blanket, one-size-fits-all retention requirement would be arbitrary in its application to any particular asset type, and would not reflect important differences in the expected credit and performance characteristics of each asset type as well as the related securitization structures. Our view is consistent with the Act's directive to implement "separate rules for securitizers of different classes of assets" and reflects the primary recommendation of the Board of Governors of the Federal Reserve System in its recently published 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 Act—namely, to improve the asset-backed securitization process and protect investors from losses associated with poorly underwritten loans. … Given the degree of heterogeneity in all aspects of securitization, a single approach to credit risk retention could curtail credit availability in certain sectors of the securitization market. A single universal approach would also not adequately take into consideration different forms of credit risk retention, which may differ by asset category. Further, such an approach is unlikely to be effective in achieving the stated aims of the statute across a broad spectrum of asset categories where securitization practices differ markedly. … In light of the heterogeneity of asset classes and securitization structures, practices and performance, the Board recommends that rulemakers consider crafting credit risk retention requirements that are tailored to each major class of securitized assets."[3]

ASF strongly supports the intent of Section 941 of the Act to encourage sound underwriting decisions by improving the alignment of interests between sponsors of securitizations and originators of loans on the one hand and investors in ABS on the other. However, in implementing that intent, we encourage the Joint Regulators to consider the existing risk retention mechanisms in the student loan securitization market which we believe provide appropriate alignment of interests among issuers and investors. Additionally, we urge the Joint Regulators to consider the primary asset classes underlying student loan ABS. Specifically, (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 We respectfully submit herein our views concerning (i) FFELP loan pools for which an exemption to the risk retention requirements is appropriate and (ii) "horizontal slice" risk retention, which should be available for private student loan securitizers to comply with the risk retention requirements.

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[3] 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.

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.

On March 30, 2010, the president signed into law the Health Care and Education Reconciliation Act of 2010 (the "Reconciliation Act"), which eliminated (as of July 1, 2010) new originations of federally guaranteed student loans under FFELP. All government-guaranteed loans are now originated directly by the federal government through the Federal Direct Loan Program. Although a good portion of FFELP loans were eventually securitized, a substantial amount of these loans still exist on the balance sheets of financial institutions and numerous state and nonprofit agencies. We believe exempting these outstanding FFELP loans from the risk retention requirements would enable these entities to de-leverage their balance sheets and raise capital through securitization which could promote the extension of private credit to students. With respect to state and nonprofit agencies, programs awarding grants and other forms of financial assistance may receive a boost from this potential source of new capital. In addition to encouraging new issuances of FFELP backed ABS, this exemption would allow for the continued efforts to restructure older, less efficient deals.

An exemption for FFELP loan securitizations from the risk retention requirements would be appropriate under Section 941(c)(1)(G)(ii), which requires that the regulations provide for "a total or partial exemption for the securitization of an asset issued or guaranteed by the United States or any agency of the United States" as the Joint Regulators determine appropriate in the public interest and for the protection of investors. As noted above, FFELP permitted eligible lenders[4] 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[5] so long as the loan was serviced in accordance with Department of Education

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

[5] 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.

guidelines.[6] We believe that this reinsurance by the federal government warrants an exemption for FFELP loan securitizations from the risk retention requirements.

Should the Joint Regulators believe that an exemption for FFELP loans under Section 941(c)(1)(G)(ii) is not warranted, an exemption would also be appropriate under Section 941(c)(1)(B)(ii) due to their negligible credit risk.[7] That section provides for a downward adjustment of the five percent risk retention requirement if prescribed underwriting criteria are met "that specify the terms, conditions, and characteristics of a loan within the asset class that indicate a low credit risk with respect to the loan." While this adjustment provision is meant to prescribe specific underwriting that indicates a low credit risk, we point out that the explicit guaranty of FFELP loans as a result of the federal government's reinsurance substantially insulates the ABS from any 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 the program was terminated under the Reconciliation Act. While 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.

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, invariably tying up significant amounts of capital that could otherwise be extended in the form of private loans or other forms of financial assistance to students . As noted in the Federal Reserve Study, "[M]any financial institutions hold significant legacy portfolios of FFELP loans, and some still sell these loans to each other. Risk retention requirements may damp these whole loan sales if it becomes more costly to finance these loans via securitization."[8]

II. Risk Retention for Private Student Loans

Private student loans are typically taken out by students whose educational expenses exceed the government-guaranteed loan limits. In private student loan securitizations, the securitizer or an affiliate generally retains ownership of the first-loss piece of the transaction, which we refer to herein 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 tranches of issued ABS and represents the right to receive cashflow at the most subordinated level of the flow of funds.

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[6] 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.

[7] 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."

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

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. As explained in the Federal Reserve Study:

> "[A]n originator or securitizer can retain credit risk by retaining a portion of the subordinate piece of the security (a horizontal slice). Credit risk is concentrated in this security, so retaining even a small part of the subordinate piece exposes the seller to a relatively larger share of the deal's total credit risk."[9]

Furthermore, in most private student loan securitizations, the underlying collateral is originated and serviced by the securitizer, which, when combined with retention of the subordinated residual interest, provides additional assurances that there is a significant alignment of interests between the securitizer and investors, as the first-loss exposure is held by the party who will structure and service the deal to minimize those losses. Originators who are also securitizers have a vested interest in the quality and performance of their securitizations both to support their ongoing origination business as well as to maintain continued access to the ABS market in order to fund their operations. A securitizer that originates an asset that it retains an interest in by means of a subordinated residual interest must be concerned with the long-term viability of the asset because it would directly bear losses incurred on that asset.

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. A subordinated residual interest will, at certain times, receive excess cashflow in the transaction, which is the cash that is in excess of what is used to make all other payments to the securities and the servicer. If losses are minimized and the flow of funds is adequate to pay investors and other deal participants and to fund the transaction's credit enhancement, then excess cashflow may be paid to the subordinated residual interest. In the Federal Reserve Study, excess cashflow is described as a "conditional" cashflow which "should, in principle, give the originator and the securitizer the incentive to deliver lower-risk loans to the pool, in hopes of meeting the triggers and, thereby, receiving the conditional cash flows themselves."[10] Student loan securitizers may also prefund a reserve account that is released only if the underlying loans perform well. For these reasons, we believe that a "horizontal slice" risk retention provides an appropriate alignment of interests between student loan securitizers and investors and should be included as an option for student loan securitizers to meet the risk retention requirements.

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[9] *See* Federal Reserve Study at page 47.
[10] *See* Federal Reserve Study at page 42.

ASF very much appreciates the opportunity to provide the foregoing views in connection with the Commission's rulemaking process. Should you have any questions or desire any clarification concerning the matters addressed in this letter, please do not hesitate to contact me at 212.412.7107 or at tdeutsch@americansecuritization.com, Evan Siegert, ASF Associate Director, at 212.412.7109 or at esiegert@americansecuritization.com, or ASF's outside counsel on this matter, Lauris Rall of SNR Denton US LLP, at 212.768.6927 or at lauris.rall@snrdenton.com.

Sincerely,

Tom Deutsch
Executive Director
American Securitization Forum