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September 28, 2010

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The Hon. Benjamin Bernanke
Chairman
Board of Governors of the Federal Reserve System
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Washington, DC 20551

The Hon. Mary Schapiro
Chair
Securities and Exchange Commission
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The Hon. John Walsh
Acting Comptroller of the Currency
Office of the Comptroller of the Currency
Independence Square
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RE: DODD-FRANK RISK RETENTION REGULATIONS FOR ABS – EQUIPMENT LEASING AND LENDING

This letter is a response by the Equipment Leasing and Finance Association ("ELFA") to the requirement in P.L. 111-203 (the "Dodd-Frank Act") that the Securities and Exchange Commission and the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation (collectively, the "Agencies") issue rules relating to risk retention in various classes of securitization transactions.

Background on ELFA

ELFA is the trade association that represents financial services companies and manufacturers in the $521 billion U.S. equipment finance sector. Equipment finance provides a significant source of funding for both small and large commercial enterprises in the United States and is a significant contributor to capital formation in the U.S. and abroad. Overall, business investment in equipment and software accounts for 8.0 percent of the U.S. Gross Domestic Product (GDP) and the commercial equipment finance sector contributes about 4.5 percent to the GDP.

ELFA members are the driving force behind the commercial equipment finance market~~,~~ providing credit every business day to nearly every business sector in the country. ELFA members finance the acquisition of all types of capital equipment, including commercial and corporate aircraft, rail cars and rolling stock, trucks and transportation equipment, vessels and containers, construction and off road equipment, medical technology and equipment, IT equipment and software and virtually every other type of equipment.

ELFA has more than 500 members including (i) independent leasing and finance companies, (ii) captive finance companies, (iii) commercial banks, (iv) diversified financial services companies, (v) investment banks and (vi) service providers including law firms, accounting firms, trustees, servicers, custodians and others who assist in the financing of equipment leases and loans. ELFA members include (a) many of the nation's largest financial services companies and manufacturers, (b) regional and community banks and (c) independent medium and small finance companies throughout the country. ELFA members' clients range from Fortune 100 companies to small and medium sized business enterprises to government agencies and non-profits.

ELFA represents virtually all sectors of the equipment finance market and its members see virtually every type of equipment financing transaction conducted in the United States. ELFA members who are service providers to the equipment finance industry (such as lawyers, accountants, trustees and vendors) have a unique vantage point of seeing scores of financial transactions from initial concept to final payout and from the perspective of both the borrower/issuer and lender/investor. ELFA truly is at the heart of equipment finance in the United States.

Summary

The equipment finance sector provides a significant source of funding for small businesses and a valuable alternative source of funding for large businesses in the United States. We are concerned about the potential harm which risk retention regulations could impose upon the capital formation process for equipment finance companies, particularly their access to the securitization market ("Equipment ABS"). Equipment finance providers have already been harmed by the financial crisis in the United States and have suffered reduced access to the capital they need to continue to extend credit to their customers. Many equipment lessors and lenders may not survive additional costs and limitations on funding which would significantly decrease the availability of equipment leasing and loans to operating companies, increase equipment finance costs and harm the United States' economic recovery.

The U.S. capital markets are extremely important to equipment lessors/lenders because they operate a highly-capital intensive business, essentially financing equipment used by operating companies in the production of goods and services in exchange for cash flow (in the form of lease/loan payments) that will repay the lessors/lenders only over a period of several years. In many cases, equipment lessors will not recover their investment or realize a profit until they sell or re-lease the equipment at the end of the lease term, so this economic reality constitutes a valid form of risk by the lessor. Equipment lessors/lenders tend to be relatively highly leveraged with significant bank loans and securities issuances. During the past twenty years, equipment lessors/lenders have been significant users of securitization facilities by offering securities backed by lease/loan cash flow and equipment residual values to investors in equipment asset backed securities Equipment ABS. The securitization market has been a valuable alternative at competitive pricing to the bank loan market and provided access to institutional investors (such as pension plans, insurance companies and investment funds) that provide a meaningful complement to traditional syndicated bank loans The availability of funding at competitive prices provided by the securitization market helps to reduce the total prices paid by the businesses, which are customers of equipment lessors/lenders, for new productive assets and software. Additionally, Equipment ABS has allowed both banks and institutional investors to diversify their portfolios.

No data have indicated any correlation between practices in the equipment finance sector and causes for the U.S. financial crisis. In addition, we are not aware of any significant defaults in securitizations involving Equipment ABS. Although defaults and delinquencies on equipment leases and loans backing Equipment ABS did increase significantly as the U.S. economy deteriorated, unlike collateralized debt obligations (CDOs) and residential mortgage-backed securities (RMBS), this did not translate into a sudden and precipitous drop in the valuation or performance of Equipment ABS.[1] We believe that the relatively stronger performance of Equipment ABS is attributable in large part to the already sound practices followed by issuers in this sector, including (i) historic risk retention that is well in excess of five (5) percent, (ii) stronger underwriting practices for equipment finance contracts as compared to mortgage lending and (iii) more conservative valuations for equipment as compared to housing. Consequently, both the letter and the spirit of regulations mandated by Dodd-Frank Section 941 suggest that mandatory risk retention for Equipment ABS differ from those appropriate for mortgage-backed securities and other financial products.

This letter highlights the consequences of risk retention which would be problematic for the equipment finance industry and suggests alternative approaches for Equipment ABS.

I. Risk retention regulations should recognize the wide variety of types, forms, accounts and duration used for Equipment ABS.

Section 941 of the Dodd-Frank Act requires the SEC and the other Agencies to "prescribe regulations to require any securitizer to retain an economic interest in a portion of the credit risk for any assets that the securitizer, through the issuance of an asset-backed security, transfers, sells, or conveys to a third party" but allows the SEC and the other Agencies to specify "the permissible forms of risk retention for purposes" of the risk retention regulations and "the allocation of risk retention obligations between a securitizer and an originator." For the reasons set forth below, we recommend that such regulations permit Equipment ABS to recognize risk retention in the forms of overcollateralization (which is the inverse of the loan-to-value advance rate used in all Equipment ABS), reserve accounts, subordinated classes of notes or certificates held by the securitizer or its affiliates, equipment residual values, as well as any securitizer obligations to reimburse third party providers of credit enhancement such as guaranties, surety bonds, insurance policies and letters of credit.

Each of these approaches recognizes that investors and rating agencies currently require the protection and safety of credit enhancement on a pool basis, because no one knows which contracts in the pool will default--and when a contract defaults, the loss on that contract most likely will exceed 5% of the original discounted principal balance of that contract. A standard 10% credit enhancement on a $10MM pool typically will result in $1MM available to cover losses, no matter how large and no matter how many contracts, until the $1MM is exhausted. Since the vast majority of contracts will never default, requiring risk retention on other than a poolwide basis would place a securitizer's capital needlessly at risk, while the investors and rating agencies will attribute little value to any 5% credit enhancement on any individual contract.

As mentioned above, all Equipment ABS transactions utilize the concept of the "advance rate" which is applied to calculate the original principal amount of Equipment ABS which will be issued against the discounted balance of each lease contract or the remaining principal balance of each equipment loan in the collateral pool. For instance, a 90% advance rate would mean that $90MM of Equipment ABS would

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1 See, for example, Moody's Investors Service, "Structured Finance Ratings Transitions: 1983-2009" (March 2010, Analyst Contacts: Julia Tung and Nicolas Weill) reporting that during 2008 and 2009, the downgrades in US Home Equity Loans were 54.7% and 47.4%, the downgrades in US RMBS were 37.2% and 74.7%, the downgrades in US CDOs were 48.1% and 66.8% and the downgrades in the US Equipment Leases were 5.6% and 9.3% (Figure 1: "Global Structured Finance 12-Month Downgrade and Upgrade Rates by Sector in 2009, 2008 and Averaged over 2000-2009" at page 2).

be issued against leases and loan contracts with a principal balance aggregating $100MM. The securitizer thus has risk retention of 10% of the value of each asset which has been securitized, since any losses incurred by reason of defaulted contracts would erode the cash flow payable to the securitizer and the investors in the Equipment ABS would not suffer any loss until the entire 10% risk retention had been exhausted. This advance rate is applied against each asset in the collateral pool, so that in the above example if a $1MM contract were added to the securitized pool, then the Equipment ABS would be increased by $900,000 and the securitizer risk retention would rise by another 10%, or $100,000. It is vital that the risk retention regulations recognize that this investor practice constitutes a valid form of risk retention.

Similarly, the most subordinated classes of securities frequently are retained by an affiliate of the seller, and not sold to third party investors, perhaps because of the low rating which such classes would receive. As an economic matter, the subordinated cash flow resulting from overcollateralization (an advance rate less than 100%) is indistinguishable from the subordinated cash flow from the most subordinated classes of securities. And while subordinated cash flow from an advance rate of less than 100% remains as securitizer risk retention for the entire time that the Equipment ABS are outstanding, cash flow from subordinated securities constitutes risk retention only so long as those securities are held by the securitizer or one of its affiliates.

It has been customary for Equipment ABS to include a reserve account. Typically, this account is fully funded at closing, thereby reducing the cash proceeds received by the securitizer. Furthermore, most transactions require the reserve account to be replenished from subordinated cash flow otherwise payable to the securitizer while the Equipment ABS are outstanding; this latter feature emphasizes that the risk retention described in the two foregoing paragraphs exists during the life of the transaction. In any event, the securitizer is not entitled to receive any amounts from the reserve account until all principal and interest on the securities have been paid. We recommend that the Commission and the other Agencies recognize such a reserve account as an acceptable element of risk retention and that (because it is available to cover losses on each asset which has been securitized) it is applicable to each asset.

Another unique feature of Equipment ABS is that the residual value (the fair market resale or re-lease value of the equipment at expiration or earlier termination of the lease contract) of each item of equipment owned by the securitizer also is at risk in these transactions. If there has occurred an event of default under the related lease, then the ABS holders have the right to foreclose on the securitizer’s ownership interest in the equipment as well as that contract and the receivables thereunder. This asset of the securitizer remains at risk until expiration of the lease contract, at which point the proceeds of remarketing the equipment typically would be payable to the securitizer, unless an ABS event of default had occurred and was continuing. Consequently, equipment residual values constitute a measure of risk retained by the securitizer with respect to each lease contract and the present value, at closing of the Equipment ABS transaction, of the residual values should be recognized as an acceptable form of risk retention for the duration of each applicable lease contract.

Third party credit enhancement is no longer used as frequently, for the reason that many of the providers of letters of credit or financial guaranty bonds are no longer engaging in such business. Nevertheless, the reimbursement agreements almost universally used by such companies typically require that any draws on such facilities be repaid from a reserve account dedicated for that purpose and also from subordinated cash flow otherwise payable to the securitizer; there even may be recourse to the securitizer for up to 10% of amounts paid by the credit enhancer. These amounts remain at risk for the entire duration of the external credit enhancement, are available to cover losses on each asset which has been securitized, and hence should be recognized as such. However, in meeting the 5% or other applicable risk retention threshold, there should not be double counting, i.e., subordinated cash flow dedicated to repayment of letter of credit draws should not be included in securitizer risk retention if it is already accounted for under the advance rate/overcollateralization formula detailed above. All of the foregoing reimbursement mechanisms constitute securitizer risk retention on each asset in the securitized pool, since such mechanisms cover losses on the entire pool.

In recognizing that the foregoing kinds of risk retention apply to each asset which has been securitized, it is important to keep in mind that all securitization transactions require a “true sale” opinion, to the effect that the conveyed assets would not constitute “property of the estate” of the operating entity which sells to the special purpose issuer. It is important that risk retention regulations recognize that all of the foregoing risk retention mechanisms apply to each equipment lease or loan. Otherwise, investors might insist upon supplemental credit enhancement/risk retention, and to the extent that the sum of the traditional, and any supplemental, securitizer risk retention were to exceed 10% (the standard limit on credit enhancement in “true sale” transactions) of the value of the assets being securitized, then the ability to render the required legal isolation opinions of counsel would be jeopardized. It is important that mandatory risk retention coincide with industry standard credit enhancement rather than being additive thereto, so that the level of risk retention is consistent with “true sale” opinions required by investors, rating agencies and originators’ accountants.

II. <u>Risk Retention for Originators should be limited to circumstances which indicate that the transfer to the Securitizer was intended as a first step in a securitization.</u>

As is the case with many other kinds of financial assets, equipment leases and loans are originated by a wide variety of large and small organizations and are transferred for numerous reasons. There often is a disconnect between organizations with the marketing capability for particular equipment and those which possess the resources to finance the equipment via a lease or lending arrangement. The industry includes companies which specialize in arranging leasing or secured loans for one manufacturer or one kind of equipment (such as off-road construction equipment). Other companies concentrate on equipment users within a certain region of the United States. Except for those companies which are affiliated with a bank or substantial manufacturer, most equipment finance companies depend upon their relationships with third party institutions to purchase equipment leases or loans, or to make nonrecourse loans to the arranger, collateralized by those contracts and the related equipment.

Even within the latter category of institutional lessors and lenders, as well as among affiliates of banks or manufacturers, many of those companies are motivated to transfer portions of their equipment finance portfolio to third parties. One incentive could be the need to reduce concentration of risk to a certain obligor or equipment type, in order to comply with legal limits or internal risk management guidelines. Another could be the desire to match fund assets on its balance sheet with advantageous long-term funding. Yet another could be the opportunity to realize a profit through sale of a portion of the portfolio which has appreciated in value. And many well-heeled equipment finance companies establish revolving lines of credit which enable them to grow their business through availability of committed future funding.

Securitization can play a role in all of these options but is not necessarily implicated in asset sales to another institution. Either vendor financing or syndication of leases and loans may simply be a means for the seller to raise working capital, or realize a profit, or reduce its exposure to particular obligors or market segments. Many of these transactions are structured so that the purchaser will assume the billing and collection duties and the seller will have no ongoing contact with the contracts which have been sold.

Even where the billing and collection "servicing" of the contracts is retained by the seller, and the obligors continue to make payments to the same lockbox account as before, the buyer typically enters into a joinder agreement with the lockbox bank so that payments from the contracts which have been sold will be remitted to the buyer or its designee, and hence the seller may have no knowledge of whether subsequent transfers of the receivables ever occur.

Many subprime mortgage loans were "originated for securitization"; an affiliate of the securitizer ostensibly would make the loan but in reality intended from the outset to sell the financial assets to a securitizer which would issue mortgage-backed securities ("MBS"), the proceeds of which would be used to purchase the loans at a profit to the originator. Many observers concluded that this arrangement may have led to a weakening of credit and other origination standards, and hence that originators should have "some skin in the game" to guard against reckless lending practices. ELFA does not contest that this may have occurred in the MBS arena, and that under certain circumstances it may be appropriate for originators to share in the risk retention imposed upon securitizers of certain asset categories. However, for the reasons set forth below, we believe that risk retention regulations for originators of equipment leases and loans should be restricted to identified circumstances where the facts clearly demonstrate that the origination was the first step in a securitization.

We recommend that originator risk retention guidelines for equipment leases and loans be considered (albeit not automatically imposed) only where either (a) the securitizer is an affiliate of the originator or (b) the equipment leases or loans are included in a securitization which closes within [30] days after the sale to the securitizer. This approach not only will spotlight situations where it is likely that the assets were "originated for the ABS market", but also will avoid potentially damaging consequences for asset sales as to which the originator has no knowledge or intent that it be the initial leg of a securitization.

Requiring the two alternatives in the preceding paragraph would prevent a number of unintended scenarios. For instance, if the Seller were to sell $20 million of equipment finance contracts to the Buyer in a so-called "whole loan, servicing released" transaction, Seller understandably would have the reasonable expectation that its contact with the assets had been terminated, except for any recourse for which the Buyer might have bargained. If the Buyer were to include some or all of those assets in a securitization several months later, then it would have no legal obligation to so advise the Seller, and the Seller's economic expectations would be undermined if it were to learn (perhaps in a subsequent fiscal year, after its accounting books had closed for the year of the sale) that a portion of the mandated risk retention had been imposed upon it. The mere possibility of this unfair result would have a chilling effect on sales and syndications of this asset category.

Practices in the equipment finance syndication market (the "Market") already embrace arm's-length negotiated protections that are time-tested, tailored to specific concerns and provide the precise recourse and other contractual protections required by investors. Imposing risk allocation in the Market would be fixing something that is not broken, and by attempting to do so, the financial institutions in the Market and, more importantly, their customers would suffer unintended and unwanted consequences.

The majority of the financial institutions participating in this Market both buy and sell financing transactions. Buyers are able to evaluate each syndication opportunity on its own merits, conduct extensive due diligence and impose their own underwriting standards. Typical syndication documents include negotiated representations, warranties, covenants and conditions, and any buyer holdback, retained subordinated interests or recourse to the Seller is addressed by tailored remedies.

The extent to which the Seller retains recourse liability for an unrecovered investment is one of many business terms/heavily negotiated between the parties. For reasons relating to the relationship between the Buyer and Seller, or specific to the syndicated transaction, the parties might agree that the Seller retains no recourse, incurs conditional or limited recourse, or provides full (100%) recourse. Retention of recourse in the Market is often related to the Buyer's opportunity to evaluate the collection risk in the context of the other business considerations related to the syndication. Transaction-specific factors considered when allocating collection risks include price, customer relationships, market segment of the customer or the desire of the Seller or Buyer to enter into or exit a transaction or market segment. There are many factors considered by the parties in determining the level of recourse.

A Seller's willingness to retain collection risk is also related to its ability to mitigate this risk. The Seller's opportunity to mitigate its collection risk is largely impacted by the manner in which the sold loan or lease will be serviced and administered after it is sold. In the majority of cases, the Buyer is responsible for all aspects of servicing and contractual enforcement after it acquires the transaction. Thus, the Buyer (not the Seller) bills and collects all payments, monitors contractual compliance, declares defaults and pursues remedies. It is the Buyer's competence with respect to such servicing matters that often dictates the extent of any collection loss. Other matters that might exacerbate the collection risk include a decline in collateral value, and further dispositions by the Buyer. It would be extraordinary (and certainly an inefficient allocation of risk and related reserve capital) for participants in the Market to allocate any collection risk to the Seller if that risk related to these or other circumstances outside of the Seller's control. Furthermore, any "forced" allocation of credit risk would also lead to a purchase price failing to reflect a true "market" price as determined by two sophisticated institutions based on their negotiated allocation of risk taking into account all the facts and circumstances.

There is no meaningful bargaining or sophistication imbalance among the buyers and sellers in the Market, and they have successfully relied on their freedom of contract to negotiate a specific allocation of risks with respect to collection and other future contractual performance by borrowers and lessees. The free buying, selling and trading of transactions in the Market has been its hallmark for decades. The resulting liquidity enables Market participants to provide billions of dollars in additional credit to small and large businesses in the U.S. acquiring capital equipment and consumable raw materials, as well as to U.S. equipment manufacturers, vendors and other customers.

Mandating originator risk retention would diminish availability of credit to equipment lessees and borrowers. If as a condition to syndicating its financing transactions a financing party must retain a credit exposure without an opportunity to avoid or mitigate that risk by accepted Market practices, far fewer transactions will be sold. As a consequence, less credit capacity will be available to enter into additional transactions with customers, or to provide credit to new customers, the overall credit markets will tighten even further than they are today and general economic activity will most certainly suffer. One would be very hard-pressed to cite any examples of abuses in the Market that have led to our recent economic turmoil, nor any that would at all merit legislative or regulatory protection of buyers of lease and loan financing transactions.

One further clarification is in order with regard to originator risk retention. Some observers have inquired whether the Dodd-Frank definition of securitizer would apply to two different entities: the issuer of the ABS and the entity which meets the requirements of definition clause (B) ("a person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuer.") These observers have suggested that "securitizer" risk retention could be imposed upon *both* the special purpose entity which issues the ABS *and* the operating company which sells the assets to the SPE issuer. We believe that this would be an unreasonable interpretation and that clause (B) was included so that an entity would be an “originator” (and hence subject to potential sharing of mandatory risk retention) if it sold assets either to the ABS issuer or to an entity which qualified under clause (B) as the sponsor of the securitization. ELFA respectfully requests that the Agencies confirm that this latter view is correct, and not the possible interpretation which has been described earlier in this paragraph.

Conclusion

The ELFA appreciates the efforts of the SEC and the other Agencies to implement the Dodd-Frank Act and appropriately regulate the asset backed securities market to increase investor confidence in the securitization marketplace and minimize the likelihood of future financial crises that affect the capital markets. As described above, we believe that there are reasonable approaches to securitizer risk retention which would utilize current Equipment ABS investor practices, and to originator risk retention which would reflect the intent of Congress. The risk retention regulations should recognize the variety of risk retention devices used in Equipment ABS and in particular validate that they comply with the guidelines of the Dodd-Frank Act. However, there is the distinct possibility that originator risk retention may impose a substantial burden on vendor financing and syndication of equipment leases and loans. Failure to address these concerns likely would decrease the overall capital available to equipment lessors/lenders (already diminished in the aftermath of the financial crisis) and result in higher aggregate financing costs -- which would be passed on to operating companies in the form of higher equipment finance costs and then to their customers through higher prices. We would welcome the opportunity to meet with you and discuss our suggestions and any questions which you may have.

Respectfully submitted,

EQUIPMENT LEASING AND FINANCE
ASSOCIATION (ELFA)

By: ________________________________

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President

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