THE FINANCIAL SERVICES ROUNDTABLE

Financing America's Economy

VIA Federal eRulemaking Portal http://www.regulations.gov

August 1, 2011

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RE: Credit Risk Retention

Messieurs and Mesdames:

I have attached the comments of The Financial Services Roundtable (the "Roundtable") on the joint proposal[1] by the Securities and Exchange Commission, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, and the Department of Housing and Urban Development to require retention of a material portion of the credit risk of assets used in securitizations as mandated under Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the

[1] Credit Risk Retention, OCC Docket No. 2011-0002; Federal Reserve Docket No. R-1411; FDIC RIN 3064—AD74; Securities and Exchange Commission File No. S7-14-11; and FHFA RIN 2590—AA43; 76 FR 24090 (Apr. 29, 2011) (the "Proposing Release").

"Dodd-Frank Act").[2] The Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $ 92.7 trillion in managed assets, $ 1.2 trillion in revenue, and 2.3 million jobs.

The Roundtable's comments on the Proposal address solely the non-residential mortgage asset classes. The Roundtable's Housing Policy Council's comment letter dated July 29, 2011, addresses the residential mortgage asset class.[3] We endorse the Housing Policy Council's comment letter.

In brief, the Roundtable's enumerated comments are:

- The Proposals are too prescriptive to accommodate existing securitization practice, even in well-performing transactions. The Roundtable urges the Agencies to adopt a more principles-based approach that will better facilitate the necessary tailoring that occurs in every transaction.

- The mandated percentage of retained credit risk should <u>not</u> exceed five percent of the credit risk of the assets as contemplated by section 941 of the Dodd-Frank Act.

- An originator should be permitted to retain credit risk associated *solely with respect to the assets it originates*, instead of the aggregate risk of the securitized pool. The parties should be allowed to divest or hedge their economic interest upon expiration of the initial risk retention period.

- Any entity in the consolidated enterprise should be allowed to hold the retained credit risk interest. Sponsors also should be allowed to allocate the retained credit risk interest among themselves, and not be required to designate only one sponsor to hold the entire interest.

- The "vertical slice" option creates a significant alignment of interest with investors in asset-backed securities transactions. However, regulators ought to allow the parties to tailor the form of credit risk retention to address the unique attributes and complexities of particular asset-backed securities structures.

- The proposed "horizontal first loss residual interest" over-allocates credit risk to the sponsor, and contains restrictions that are unnecessary to preserve an alignment of interests with investors.

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2 Pub. Law No. 111-203, § 939A, 124 Stat. 1887 (July 21, 2010).

3 *Comments of Housing Policy Council*, "Credit Risk Retention" (July 29, 2011), *available at* http://www.fsround.org/fsr/policy_issues/regulatory/pdfs/pdfs11/riskretentionletterQRM.pdf.

- The "representative sample" is too cumbersome and restrictive.

- Although the "sellers' interest" as it is used today does not match the proposed definition, we believe it provides robust and comprehensive alignment of interests between the seller and investors.

- The Agencies should withdraw the proposed "premium capture cash reserve account" rules in their entirety. These rules would eliminate some participants' access to the market, because they cannot structure their transactions to meet rules that are inconsistent with the economic viability of the transaction.

- The Roundtable believes a process that requires all six regulators to provide interpretations or guidance in a joint action may create significant uncertainty and difficulty for market participants. Therefore, we believe a sponsor's primary regulator (or the Securities and Exchange Commission, if the sponsor has no primary regulator) should provide interpretative guidance, no-action relief or legal opinions in response to requests for interpretations or guidance.

- The Roundtable endorses its Housing Policy Council's comment letter dated July 29, 2011, which addresses the residential mortgage asset class issues.

- The Roundtable has significant concerns about the Agencies adopting final rules, and respectfully requests that the Agencies re-propose the regulations after taking into account public comments.

* * * * *

The Roundtable and its members appreciate the opportunity to comment to the Agencies on the Proposal to require retention of credit risk in securitizations. If it would be helpful to discuss the Roundtable's specific comments or general views on this issue, please contact me at Rich@fsround.org. Please also feel free to contact the Roundtable's Senior Regulatory Counsel, Brad Ipema, at Brad.Ipema@fsround.org.

Sincerely yours,

Richard M. Whiting

Richard M. Whiting
Executive Director and General Counsel
The Financial Services Roundtable

Attachment: THE FINANCIAL SERVICES ROUNDTABLE, *Comments on Credit Risk Retention under Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Aug. 1, 2011)

With a copy to:

Office of the Comptroller of the Currency
The Honorable John G. Walsh,
Acting Comptroller of the Currency

Board of Governors of the Federal Reserve System
The Honorable Ben S. Bernake,
Chairman

Federal Deposit Insurance Corporation
The Honorable Martin J. Gruenberg,
Acting Chairman

The Securities and Exchange Commission
The Honorable Mary L. Schapiro,
Chairman
The Honorable Kathleen L. Casey,
Commissioner
The Honorable Elisse B. Walter,
Commissioner
The Honorable Luis A. Aguilar,
Commissioner
The Honorable Troy A. Paredes,
Commissioner

Ms. Meredith Cross, Director, Division of Corporation Finance
Ms. Katherine Hsu, Chief of Office of Structured Finance, Division of Corporation Finance

Federal Housing Finance Agency
The Honorable Edward DeMarco,
Acting Director

Department of Housing and Urban Development
The Honorable Shaun S. Donovan,
Secretary

Mr. Robert C. Ryan, Deputy Assistant Secretary for Risk Management and Regulatory Affairs

THE FINANCIAL SERVICES ROUNDTABLE

Financing America's Economy

THE FINANCIAL SERVICES ROUNDTABLE

Comments on Credit Risk Retention

under Section 941 of the

Dodd-Frank Wall Street Reform and Consumer Protection Act

August 1, 2011

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Introduction

We appreciate the opportunity to comment on the joint proposal (the "Proposal")[1] by the Securities and Exchange Commission (the "Commission"), the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, and the Department of Housing and Urban Development (each, an "Agency," and collectively, the "Agencies") to require retention of a material portion of the credit risk of assets used in securitizations as mandated under Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[2] We also appreciate the thoughtful consideration the Agencies have given to those aspects of securitization that distinguish the structures used to securitize different asset classes. In addition, we strongly support the Agencies' proposing varied means for market participants to hold the mandated risk retention position. This type of flexibility will be critical to establish risk retention structures that are consistent with the restoration of a sustainable securitization market. Even within a single asset class, securitizations may have very different structures and critical economic drivers. We are concerned that, notwithstanding the Agencies' efforts in this regard, the Proposals are too prescriptive to accommodate existing securitization practice even in well-performing transactions. We urge the Agencies to adopt a more principles-based approach that will better facilitate the necessary tailoring that takes place in each transaction.

The Representative Sample

One example is the representative sample, which has been made so cumbersome and restrictive that it will have little to no utility unless revised substantially. We offer several suggestions that we believe would make this a workable form of risk retention in Section II.D., below.

The Seller's Interest

Another example is the *seller's interest for revolving securitizations*, which we discuss in Section II.F., below. Although the Agencies have recognized the value of this form of retained interest, the seller's interest has been defined in such a way that it does not capture essential nuances of this interest as it functions in practice, and thus would not encompass any existing *master trust* seller's interest of which we are aware. Although the seller's interest as it is used today does not match the proposed definition, we believe it *does* in practice provide robust and comprehensive alignment of interests between the seller and investors. We have therefore focused our comments on revising

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[1] Credit Risk Retention, OCC Docket No. 2011-0002; Federal Reserve Docket No. R-1411; FDIC RIN 3064—AD74; Securities and Exchange Commission File No. S7-14-11; and FHFA RIN 2590—AA43; 76 FR 24090 (Apr. 29, 2011) (the "Proposing Release").

[2] Pub. Law No. 111-203, § 939A, 124 Stat. 1887 (July 21, 2010).

the definition to conform with current practice.[3]

Premium Capture Cash Reserve Account

In many ways, the proposed rules seem to have been crafted particularly narrowly to avoid evasion of the risk retention requirements. One of the most troubling examples of this is the proposed premium capture cash reserve account, which appears to reflect a misunderstanding of fundamental aspects of mortgage origination, loan pricing, portfolio hedging, and the timing of issuance of the seller's interest in credit card securitizations, among other flaws. By taking this type of approach, the Agencies may well cripple the sectors of the securitization market that already have robust risk retention, and may eliminate market access for market participants who would act conscientiously to satisfy the requirements but cannot structure their transactions to meet rules that are inconsistent with the economic viability of the transaction. Many sectors of the securitization markets, including consumer credit cards, auto loans and leases, collateralized loan obligation transactions and bank-sponsored asset-backed commercial paper programs, had significant alignments of interest between sponsors and investors and performed extremely well during the worst economic downturn since the Great Depression. We believe the Agencies need to craft rules that acknowledge and support the structures that functioned well. There is no reason to believe that market participants who have voluntarily included robust risk retention in their structures for decades will now seek to evade retention requirements.

In the United States, the federal government's role in regulating securities transactions historically focused on how securities are offered, to whom, and with what level of transparency.[4] The current risk retention requirement reflects a significant shift to a "merit-regulation" model that would regulate the fundamental economics of securities offerings across a wide range of products.[5] The Agencies should make every effort to minimize the impact of such a shift, particularly where the core goals of risk retention—to ensure that sponsors have interests that are aligned with their investors—are already met in existing structures but in ways that are difficult for the Agencies to quantify or define. In this letter we have offered our views on revisions that we believe would enhance the effectiveness of the credit risk retention rules as they relate to the non-

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[3] The Roundtable does not believe that structural changes can be made to the seller's interest for existing master trust structures, because that would require significant amendments to existing documentation. These amendments would generally require investors' consent, and would in many instances be adverse to investors. Accordingly, consents of investors may not be obtainable.

[4] Securities Act of 1933, ch. 38, 48 Stat. 74 (codified as amended at 15 U.S.C. § 77a-aa (2010)). The purpose of the Securities Act is to "provide full and fair disclosure of the character of securities sold in interstate and foreign commerce . . . and to prevent frauds in the sale" of securities. *Id.*

[5] The Securities Act's focus on disclosure rather than merit regulation, as was common among the blue-sky laws of many states, applied "sunshine [as] the best of disinfectants; electric light as the most efficient policeman." LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY AND HOW THE BANKERS USE IT 92 (2nd prtg. 1914); H.R. REP. NO. 73-12, at 1 ("There is . . . an obligation upon us to insist that every issue of new securities to be sold in interstate commerce shall be accompanied by full publicity and information, and that no essentially important element attending the issue shall be concealed from the buying public.").

residential mortgage asset classes.[6] The Roundtable has significant concerns about moving directly from the current proposals to a final rule, and respectfully requests that the Agencies re-propose the regulations after taking into account public comments on the Proposal.

I. Credit Risk Retention

A. The percentage of risk retained should not exceed five percent (5%) of the credit risk of the assets.

Under section 941 of the Dodd-Frank Act, securitizers would be required to "retain an economic interest in a material portion of the credit risk for any asset that [they] transfer, sell, or convey to a third party."[7] Securitizers of assets in most classes other than residential mortgage backed securities have historically retained substantial risk, the forms and amounts of which varied based on the type and quality of the assets, market demands, and ratings criteria. Even so, we are not aware of any meaningful statistical studies that definitively show that retention of risk has a positive effect overall on the performance of asset backed securities ("ABS") transactions.

The Roundtable believes that the proposals would have an adverse impact on capital maintenance levels for some ABS originators. For example, the transaction sponsor must have capital to support the risk it retains in ABS transactions, and must consider the effect of committing capital on a long-term basis, the rate of return on that capital, and whether the retained interest is consistent with the sponsor's overall risk management. If the proposed risk retention requirements were adopted, we believe the economics of securitization transactions would change in an adverse manner, because the risk retention requirements would constrain significantly new loan originations, new securitizations, or both.

For asset classes in which formal retention of interests has not been the norm, risk retention is to some degree an experiment being conducted in the real world with hundreds of billions of dollars at stake, and no control group to ensure that observed effects are caused by risk retention rather than unrelated factors. We do not yet fully understand the impacts of retained risk on the availability of consumer credit and the stability of our financial institutions. Accordingly, we ask that the Agencies not mandate a retained risk position of more than five percent (5%) of the aggregate credit risk of the securitized assets.

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6 The Roundtable endorses the Housing Policy Council's comments on the premium capture cash reserve account as it relates to the residential mortgage asset class. *See*, *Comments of Housing Policy Council*, "Credit Risk Retention" at 5-13 (July 29, 2011), *available at* http://www.fsround.org/fsr/policy_issues/regulatory/pdfs/pdfs11/riskretentionletterQRM.pdf.

7 H.R. REP. NO. 111-517, at 872 (2010) (Conf. Rep).

B. The Agencies should use the authority under section 941 of the Dodd-Frank Act to set a minimum risk retention period, and allow parties to divest or hedge their economic interest after the expiration of the initial risk retention period.

The proposed rules appear to contemplate the permanent retention of the credit risk associated with each securitization transaction. In our view, a permanent retention of credit risk is unnecessary for the sponsor to achieve an alignment of risk with ABS investors. Nor is a permanent retention of risk necessary to ensure that the sponsor properly conducts diligence on the assets pooled into the securitization transaction. In our experience, the risks associated with poor quality loan underwriting begin to diminish in the years following origination of the loan. If a borrower who has made several years of timely payments of principal and interest subsequently defaults, it is significantly less likely to reflect poor loan origination practices than it is to reflect the changing economic status of the borrower after origination. The Roundtable believes there is a point at which the need to free up capital to support new loan originations is of far greater significance than the minimal benefit of continuing to require risk retention. We ask the Agencies to allow the risk retention requirement to terminate for amortizing trust structures[8] no later than three years from origination.

C. The Agencies should permit the retained risk to be held by any party in the consolidated group.

Securitization structures often effect a "true sale" of assets through a non-recourse transfer of assets (except for breaches of representations and warranties) from the sponsor to the sponsor's wholly owned subsidiary (the "depositor"). The depositor transfers an interest in the assets (often on a full recourse basis) to a securitization trust, ABCP conduit, or other acquirer of a beneficial interest in the assets.[9] Thus, the depositor is frequently the natural—and often necessary—place for retention of credit risk.

When an existing affiliate is the depositor in a revolving securitization, it may be impossible to transfer the original credit risk retention to the sponsor. Even parties that create new securitization vehicles for each transaction may find it difficult to restructure their programs to cause the retention to occur at the sponsor rather than depositor level. Nor do these distinctions provide any meaningful alignment of interests, because the Agencies have proposed to allow a subsequent transfer of risk retention to an affiliate. Therefore, we ask the Agencies to allow the depositor, or any other consolidated affiliate, to hold the original retention of all forms of risk retention. This would facilitate achievement of sale accounting treatment, while still causing risk to be retained in the affiliated group of the sponsor.

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[8] Revolving master trust structures may not afford an opportunity for reduction of retained risk, because new assets continually are transferred into the pool.

[9] Some structures may have a depositor that is a sister entity (or even parent) to the sponsor. We do not believe such distinctions are meaningful so long as the risk remains in the corporate family.

D. The Agencies should allow sponsors to allocate the risk retention among themselves, rather than requiring that it be held by a single sponsor.

The proposed regulations seem to contemplate that credit risk retention would be held by a single sponsor in a multiple-sponsor transaction. For example, one sponsor would retain the entire five percent (5%) credit risk on the assets, and the other sponsor(s) would monitor the first sponsor's performance of its risk retention obligation. We believe this approach is too restrictive because it disregards the significant investment multiple sponsors have in large-scale projects.

Transactions often have multiple sponsors because they have an unusually large scale. Thus, although the interests may be small based on the percentage of the project risk each sponsor holds, these interests involve a significant investment. Multiple sponsors that hold proportionate risk retention also may add an additional layer of oversight for the transaction. Thus, we ask the Agencies to allow multiple sponsors to allocate the credit risk retention among themselves (*e.g.*, complete allocation to one sponsor, *pro rata* allocation among all sponsors, *etc.*) as long as the total amount retained complies with the requirement.

E. An originator should be permitted to retain credit risk associated solely with the assets it originates, rather than retaining a portion of the aggregate risk of the pool.

An originator's familiarity with the assets in a securitization pool that it originated would be greater than one would expect for assets originated by unaffiliated third parties. This would make an originator's decision to retain a portion of the credit risk easier because the originator would be incurring only the credit risk of its own assets. Thus, if five percent (5%) of the credit risk of each asset were assumed by the originator (or sponsor) of that asset, then the aggregate amount of credit risk retained for the pool would be the same as if the risk retention were structured on an aggregate basis.

While this approach may discourage the originator from conducting due diligence on the loans transferred to the pool by unaffiliated originators, we believe it would be inappropriate to subject any originator to liability for the quality of due diligence—or the failure to conduct due diligence—on assets selected and transferred by unaffiliated originators. In any event, it simply is not the originator's role to conduct due diligence on assets of unaffiliated originators, and we see no basis in the Dodd-Frank Act for extending the originator's role or risk profile. Moreover, we believe any attempt to use the originator risk retention structure to improve the quality of due diligence would not be efficacious.

In addition, several new laws and regulations already address conduct of due diligence. For example, the Commission adopted rules under Section 945 of the Dodd-Frank Act[10] that would require an issuer to review assets and related disclosures in a

[10] Pub. L. No. 111-203, § 945, 124 Stat. 1898 (July 21, 2010).

securitization transaction.[11] Credit ratings agencies also are subject to "enhanced regulation, accountability, and transparency" under section 932 of the Dodd-Frank Act.[12] Finally, the Commission's recent proposals to regulate credit rating agencies also would cover third-party providers of due diligence services for asset-backed securities, and require that issuers and underwriters make available to the public the due diligence report prepared for it by any third-party.[13] These new laws and regulations already provide for extensive efforts to improve the quality of due diligence, and subjecting an originator to due diligence obligations on assets originated by unaffiliated third parties would be inappropriate and unnecessarily burdensome.

Finally, we note that achieving risk retention at the originator level solely with respect to its own assets could be accomplished quite easily by having the originator retain a fractional undivided interest in the pool that it transfers.

II. Forms of Credit Risk Retention

A. The differences among structured finance transactions for various asset classes compel diverse forms of risk retention.

The "securitization industry," though often viewed as a whole by those unfamiliar with it, is really an amalgam of very different assets, structures and securities for which the benefits, risks and costs are equally diverse. Even where the same terminology is used in more than one asset class, it may have a different meaning; for example, "excess spread"[14] means something rather different in credit card securitizations than it means in auto loan securitizations. The ability to tailor the form of credit risk retention to a unique structure, taking advantage of inherent synergies and alignments, will help ensure that these provisions support, rather than harm, the securitization market.

The Roundtable generally supports the Agencies' proposal to allow transaction parties to select the particular form of credit risk retention from a diverse menu of options. However, we encourage the Agencies to address the panoply of complexity raised by various securitization structures and risk retention choices, rather than adopt more restrictive options or more narrow definitions. We also favor allowing transaction parties to combine forms of risk retention in ways that would achieve the five-percent (5%) credit risk requirement for each asset, while allowing the form of interest retained to more closely correspond to the overall structure of the transaction. For the reasons discussed below, we urge the Agencies to allow even greater flexibility of credit risk retention options.

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11 *Issuer Review of Assets in Offerings of Asset-Backed Securities*, Securities Act of 1933, Release No. 9176, 76 FR 4231 (Jan. 25, 2011) ("Adopting Release").

12 Pub. L. No. 111-203, § 932, 124 Stat. 1872-83 (July 21, 2010).

13 *Nationally Recognized Statistical Rating Organizations*, Securities Exchange Act of 1934, Release No. 64514, 76 FR 33420 (June 8, 2011) ("Proposing Release").

14 "Excess spread" is not an inherent aspect of the securitized assets, but instead arises out of the particular structure used, and represents the portion of the cash flows in a transaction that the investors have not purchased. Accordingly, it is wholly defined by the securitization documents.

The Roundtable urges the Agencies to allow transaction parties to tailor the form of credit risk retention to address the unique attributes and complexities of particular ABS program structures. Since many securitization programs already involve substantial retention of credit risk by sponsors and their affiliates, we urge the Agencies to allow the parties to use existing risk retention alternatives—irrespective of whether these alternatives conform to the technical requirements of the proposed risk retention régime. The Roundtable asks the Agencies to allow securitizers to demonstrate to their primary regulators or to the Commission (for entities that do not have a primary regulator) that a particular combination of credit risk retention would achieve similar results as prescribed by the proposed risk retention rules. We also ask the Agencies to adopt a companion set of risk retention options tailored for each asset class that (a) reflects the way risk is currently retained for that asset class, and (b) cannot be used in another asset class without approval by the primary regulator or the Commission (for entities that do not have a primary regulator).

B. The vertical slice option is appropriately defined and would create a significant alignment of interests with investors. The Agencies also should permit an alternate approaches and more varied combinations with other forms of risk retention.

The Vertical Slice Option

The vertical slice option would require the sponsor to retain at least five percent (5%) of each class issued in the ABS transaction, which would be integrated into the capital structure of the ABS transaction. Since the sponsor must retain at least five percent (5%) of the credit risk of each asset in the pool, we believe the vertical slice option would cause the sponsor to consider the effect of its decisions on each class of securities. Moreover, because the vertical slice option represents a proportionate interest in each asset class, it cannot be manipulated by varying the terms of the securities, and thus should not implicate the concerns the Agencies have expressed elsewhere. We believe the vertical slice option is an essential item on the list of available risk retention options.

The Participation Interest Option

The Roundtable asks the Agencies to allow a form of vertical risk retention that would achieve the same economics as the vertical slice option, but would change the form of the interest. The retention of a five-percent (5%) undivided interest in each asset transferred to the collateral pool (the "participation interest option")[15] may offer a number of advantages, including providing greater support for sale accounting treatment on the transferred assets, because the transferor does not take back any interest in the transferred assets.

[15] The participation interest option effectively is a miniature version of the total collateral pool, rather than a slice of the capital structure (as is the case with the vertical slice option).

The participation interest return may differ slightly from the vertical slice return because the funds allocated to the "retained undivided interest in the asset pool" would not have to be held either in permitted investments in trust accounts pending distribution or as credit enhancement for senior classes. However, the retained undivided interest option should be virtually identical to the vertical slice in terms of allocations from and exposure to the risks of the assets.

Alternate Forms of Risk Retention

Sponsors might favor an alternate form of risk retention for the following reasons: First, holding the vertical slice or the participation interest option is capital-intensive and effectively requires holding five percent (5%) of the entire value of the securitization trust. Second, many issuers already retain risk in their structures in other forms, many of which create first-loss exposure and provide essential credit enhancement. These include subordinated notes for which there is no available market; the seller's interest and excess spread in revolving master trust structures; subordinated overcollateralization; letters of credit and guarantees; and subordinated fees in collateralized loan obligation structures that reflect investor demands. Third, our members would like the flexibility to combine the vertical slice options (as well as other vertical options, such as the seller's interest or the representative sample) with other forms of retained interests so that they can count those other interests toward their mandatory risk retention. The L-shaped risk retention options attempt to achieve this outcome, but we believe it should be made more expansive and flexible.

C. The proposed horizontal first loss residual interest over-allocates credit risk to the sponsor and contains restrictions that are unnecessary to preserve alignment of interests.

i. The proposed horizontal loss retention would result in the retention of greater than five percent (5%) of the credit risk of the assets and would adversely affect market participants in a number of asset classes.

The Agencies propose to define the "eligible horizontal residual interest" as a five percent (5%) first loss interest in the par value of all ABS interests issued by the securitization vehicle in the transaction. This retained interest would exceed the five percent (5%) of the credit risk of each securitized asset mandated by section 941 of the Dodd-Frank Act. In general, with this form of risk retention, the Agencies have chosen to approach risk retention by mandating an investment equal to five percent (5%) of the amount of securitized assets, rather than five percent (5%) of the credit risk. This is neither what the statute requires, nor is it necessary to achieve the goals of the risk retention requirements. We urge the Agencies to resolve the issues presented by the horizontal model so that the economics of structures incorporating risk retention work, especially for asset classes in which a vertical slice may not be feasible.

The difference in risk between the vertical option and the horizontal residual interest is easier to see with real numbers. For purposes of this example, we have used a hypothetical leveraged structure. Consider a pool with 100 assets, each of $1,000, and a capital structure with a Class A consisting of 80%, a Class B consisting of 15%, and a Class C consisting of 5%, with projected losses of 2% of the par value of the pool. The Class A and Class B notes each have interest rates that reflect their relative risk, but the Class C notes are an equity tranche that receives excess spread on a monthly basis, subject to various performance-based triggers that may trap cash in the structure or divert it to senior classes. We will also assume, for the sake of simplicity, that when an asset defaults it has no recoveries (even though this degree of loss severity would be extreme for most asset classes).

Vertical Slice Illustration. If the sponsor takes a vertical slice of the transaction and invests $5,000, the sponsor will have 5% of the Class A notes, 5% of the Class B notes and 5% of the Class C notes. If the projected loss of 2% is accurate and two of the assets default, the sponsor will in fact take 5% of the $2,000 credit loss. As this will play out, the losses will be fully allocated to the Class C notes, which will be written down from $5,000 to $3,000. As the holder of 5% of those Class C notes, the sponsor will be allocated 5% of the $2,000 loss, or $100. The sponsor will receive interest on its Class A and B notes equivalent to that received by other investors in those asset classes, and will receive residual allocations to the Class C notes equivalent to those received by other investors in that class. Accordingly, notwithstanding the losses on the portfolio, the sponsor may receive a reasonable return on its investment.

Horizontal Residual Interest Illustration. If the sponsor takes, instead, a horizontal 5% eligible residual interest, the sponsor will have to buy all of the Class C notes. The sponsor will then bear the full $2,000 loss when it is realized, rather than the $100 that is, in fact, 5% of the credit risk of the pool. Although the sponsor should receive a higher return on this investment through residual allocations of interest payments, it also will be at greater risk. Moreover, the horizontal option in this case allows the sponsor to adjust the risk and return of its investment as compared to a vertical slice, but does not allow it to reduce the amount of the investment.

We urge the Agencies to permit the eligible horizontal risk retention to be measured by the credit risk of the asset pool. We realize that the Agencies may have concerns about how to measure the credit risk of an asset pool at the outset of the transaction, since the Agencies' may no longer use credit ratings to measure credit-worthiness of a security.[16] But measurements of credit risk, whether through internal models or proxies established by class of investment, are an essential part of financial industry regulation and a critical aspect of determining everything from required regulatory capital to permitted investments of money market funds and insurance companies.

In securitizations, projected losses are typically stressed—multiplied by a factor determined by the credit rating agencies—to determine a worst-case scenario for extreme but plausible conditions. In our view, so long as the assumptions, projections and stress factor that go into determining the credit risk of the structure are described in the securitization offering document and are represented to reflect a good-faith estimate of

16 *See* Pub. Law No. 111-203, § 939A, 124 Stat. 1887 (July 21, 2010).

that credit risk, the Agencies should be willing to rely on that determination as a measure of whether an investment appropriately reflects five percent (5%) of the credit risk of the pool.

We ask the Agencies to revise the proposed rules to permit the eligible horizontal risk retention to be measured by credit risk (as contemplated by section 941 of the Dodd-Frank Act) rather than principal amount of assets.

ii. The Agencies should permit unscheduled principal payments to be allocated to the horizontal first loss interest.

The Agencies have proposed, as a required aspect of an eligible horizontal first loss interest, that such an interest be permitted to be allocated a proportionate share of scheduled principal payments but not of unscheduled principal payments. In explaining this proposal, the Agencies have stated that "The prohibition of unscheduled payments to the eligible horizontal residual interest is designed to ensure that unscheduled payments would not accelerate the payoff of the eligible horizontal residual interest before other ABS interests."[17] We believe this is inappropriate.

The structure of principal allocations in a securitization generally depends on, among other things, the nature of the assets, their expected average life, and the extent to which prepayment risk is a concern for investors. Restricting principal allocations in the context of credit cards, where there is a mandated minimum payment but no "scheduled" payment *per se* and all principal collections are treated as fungible, would be impossible. Auto deals likewise do not distinguish between scheduled and unscheduled principal payments—frequently, all cash collections enter at the top of the waterfall and flow through it, regardless of characterization.

We do not see how a proportionate allocation of such unscheduled payments to the horizontal residual interest would do anything other than maintain the horizontal residual interest at the same percentage it occupied at the beginning of the transaction. We believe the same should be true of the proceeds of foreclosure sales, so long as any loss on the foreclosure sale is reflected before the proportionate allocation is made. For auto transactions, which have performed extraordinarily well for decades and generally include overcollateralization in some form, allocations may not be "proportionate," but they must be consistent with maintaining required support for the transaction. We believe these structures also should continue to be allowed.

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17 Proposing Release 76 FR at 24102.

iii. The Agencies should clarify that, even though the eligible horizontal residual interest is required to be subordinated in terms of interest allocations, available interest can be paid to it monthly after interest on investors' securities and other expenses that precede it in the waterfall have been paid.

The typical securitization includes monthly distributions of all interest and principal. In some structures there may be a required trapping of collections in a reserve account, subject to various triggers on both the aggregate amount to be retained and the circumstances in which the reserve must be funded. Other structures use other credit enhancements for their transactions and may include no cash trapping mechanisms. For many structures, it is essential to the overall economics that all excess collections flow through the structure to the junior-most interest or the seller's interest on a monthly basis.

The preamble to the Proposing Release states that the eligible horizontal residual interest must be the "most subordinated claim to payments of both principal and interest by the issuing entity." The discussion that follows it, which addresses the allocation of scheduled principal payments to this interest, suggests that the Agencies are familiar with the monthly distribution schedule of securitizations and intend that the "most subordinated claim" to interest payments is intended to be evaluated in the context of the monthly waterfall and not to the final payment on the securities. At the same time, the Agencies have requested comment on whether this interest should be structured as a "Z bond," or zero-coupon bond, receiving interest (or accreted discount) only at maturity.

Even in a zero-coupon bond securitization structure it would be typical to allocate interest collections to that bond on a monthly basis to ensure that the funds to cover accretion are properly allocated. In an amortizing structure, deferring payment of interest allocations to the first-loss interest will, over time, cause the sponsor's at-risk investment to increase even as the investment of the other investors reduces over time. In other words, the eligible horizontal residual interest—which has already been defined in way that makes it reflect significantly more than five percent (5%) of the credit risk—would over time reflect a larger and larger percentage stake in the securitization, further exacerbating this issue. Thus, we urge the Agencies to permit monthly allocations of interest to the first-loss holder, and to revise the definition of "eligible horizontal residual interest" accordingly.

iv. The Agencies should permit the eligible horizontal residual interest to be a portion of a class in which third-party investors may invest.

Section 941 does not require that the retention of five percent (5%) of the credit risk of the assets protect all investors in the structure from the risk of loss. Moreover, the retention of risk in the context of a vertical slice does not have that effect—the interests protected by the sponsor's retention of a five percent (5%) interest in the bottom-most tranche arguably protects the *sponsor's* retained interests in the more senior tranches. Although we agree that the risk retention requirement ought to be satisfied by holding both a tranche senior to the first-loss position and a share of the first-loss position, we see no reason to restrict co-investment by third-party investors in an eligible first-loss piece.

This is a particularly significant issue for CMBS, where the Commission's position appears to preclude the possibility of having multiple B-piece buyers even where that would support the efficiencies of the transaction. Therefore, we request that the Agencies revise the proposed regulations to provide that interests in the first loss position may be held by entities unaffiliated with the sponsor, even if the sponsor's risk retention is in the form of an eligible horizontal residual interest.

D. The proposed mechanics for selecting the representative sample of assets are unduly burdensome, and do not provide a viable option.

Permitting a sponsor to satisfy its risk retention obligation by holding a representative sample of the assets under the FDIC's safe harbor[18] is attractive in principle for many asset classes, including CMBS, CLOs, and autos. For some, the appeal is based on accounting treatment and preserving the ability to achieve sale accounting for the transferred assets. For others, holding a representative sample is more in line with the sponsor's typical functions and more consistent with its overall investment authority. As proposed, however, we do not believe the safe harbor would provide a useful option for any of these asset classes.

The Roundtable's concern is that the requirements for a representative sample appear to be strongly influenced by the possibility that the risk retention requirement could be circumvented. Of course the representative sample should be representative—but that does not mean it has to be identical to the securitized pool. We do not believe that the proposed methodology will produce a better result than a truly random selection from a pool of largely homogeneous assets, or that it will somehow guarantee consistent performance between the representative sample and the securitized pool. It will simply produce a comparable result at greater cost and with an increased administrative burden.

i. The proposed minimum number of assets and rigid selection process eliminate the representative sample as a viable option, particularly for CMBS.

We appreciate that flipping a coin 1,000 times is more likely to yield a ratio of heads to tails that approximates 1:1 than flipping it 10 times. Not that the odds are different for any particular flip—but the cumulative effect of 1000 coin flips should pull the total ratio closer to the actual probability. We assume that the requirement that the representative sample be drawn from a starting pool of 1,000 assets reflected comparable considerations—the larger the pool, the less likely that any individual asset selected (like an individual flipped coin) would skew the results. Unfortunately, for asset classes where a particular transaction typically would include a much smaller number of assets, choosing from a pool of 1,000 assets is unattainable.

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18 Federal Deposit Insurance Corp., *Treatment of financial assets transferred in connection with a securitization or participation*, 12 C.F.R. § 360.6 (2011).

Even where the number of assets is not an obstacle, the requirements to ensure that the representative sample match the securitized pool in all material respects is unwieldy. As the Agencies describe it,

> After the sponsor randomly selects a representative sample from the designated pool, it would be required to assess that sample to ensure that, for each material characteristic of the assets, including the average unpaid principal balance, in the designated pool the mean of any quantitative characteristic, and the proportion of any characteristic that is categorical in nature, of the sample of assets randomly selected from the designated pool is within a 95 percent two-tailed confidence interval of the mean or proportion, respectively, of the same characteristic of all the assets in the designated pool.[19]

If the sample does not meet these criteria, the sponsor would have to try again. The approach here—to create, at once, a randomly selected pool and a pool that has been carefully constructed to ensure equivalency in its material characteristics—has an inherent tension that will make it almost impossible to achieve.

More to the point, we believe it misses the mark. The goals of the risk retention requirement include ensuring that originators will not reduce their underwriting standards based on the assumption that the asset will be securitized and they will not have to bear its credit risk, and ensuring that originators do not cherry pick their assets, keeping the better ones and pushing the rest off to investors. Requiring *equivalency* in the representative sample provisions achieves nothing in relation to these goals that requiring *randomness* does not. Ultimately, it does not matter how the retained representative sample performs compared to the securitized pool—it only matters that the originator not know which assets will be securitized and have no ability to cherry pick them. With respect to the latter point, the better means of structuring the representative sample would be to draw it from all comparable assets available for securitization, and not from a pool selected by the sponsor. From that perspective, it should not matter if the representative sample is drawn from 20 assets or 20,000—all that matters is that it was a random choice from a pool of similar assets.

ii. The restrictions on servicing the securitization pool and the representative sample are neither appropriate nor workable.

The Agencies have proposed that:

> [S]ervicing of the assets included in the representative sample must be conducted by the same entity and under the same contractual standards as the servicing of the securitized assets [and] the individuals responsible for servicing the assets comprising the representative sample or the securitized assets must not be able to determine whether an asset is held by the sponsor or held by the issuing entity.[20]

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19 Proposing Release, 76 FR at 24105.
20 *Id.* at 21460.

Although we appreciate the desire to have comparable servicing standards for securitized and unsecuritized loans, servicing standards are not covered by section 941. Rather, the mandate in Section 941 is to ensure that the sponsor retains a portion of the credit risk of the assets. Nor is servicing related to the originate-to-distribute model at which the risk retention requirements were aimed. We believe the focus on servicing relates to the proposed periodic disclosure requirement and the Agencies' proposal that sponsors provide parallel reporting for the securitized pool and the retained representative sample.[21] However, we do not believe this requirement is appropriate, or feasible as a practical matter.

We find it hard to imagine a scenario in which it would be appropriate to require the servicer of a loan to be unaware of the identity of the loan's owner. The servicer will need to allocate the collections to the appropriate account, to ensure funds are properly segregated, and not commingled, to file all necessary documents to properly perfect and secure relevant interests, and to know on whose behalf it is acting if collection efforts at any time become more formal or move into foreclosure. It is inconceivable that these actions could be undertaken without knowledge of whether or not the loans were securitized.

iii. Mandating disclosures on the representative sample's performance would create administrative burdens, and impose costs for which there would not be any discernable benefit to investors.

As we indicate in Section II.D.(i) above, we do not believe that the performance of the representative sample has any relevance—what matters is whether it was selected randomly. Requiring periodic reporting on those assets that is equivalent to that provided for the securitized pool would create significant costs and administrative burdens while adding nothing in terms of informing investors about the performance of the assets actually supporting their securities. It seems, instead, designed as a proof of equivalency, as if notwithstanding all of the efforts involved in matching up all material characteristics that the Agencies have proposed, it is still necessary to demonstrate to investors that the selection process works and the sample really was representative. The Roundtable does not believe this requirement does anything other than perhaps establish a litigation record for investors to argue that any variance in performance, for any reason, is somehow evidence that the representative sample was incorrectly constructed and the investors were short-changed. We strongly urge the Agencies to remove this condition from the representative sample rules.

iv. The proposed "agreed-upon procedures letter" would not assure meaningful due diligence on the assets or their quality.

We do not see the value in the requirement that a sponsor obtain an agreed-upon procedures letter from its accountants verifying the process it used to select the assets for the representative pool. The requirement would add an additional cost to securitizations, but would not provide meaningful diligence about the assets or their quality. A more

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21 *See* discussion *infra* at II.D.(iii).

cost-efficient alternative would be to require that an officer of the sponsor provide certification to the Agencies as to the process used in selecting the representative sample.

E. The Agencies should modify the "L-shaped option" to allow variation in the lengths of the vertical and horizontal legs.

As we discuss further in Section II.G. of this letter, we believe that the ability to mix and match risk retention options is important, particularly because so many transactions already include retained risk in a variety of forms. The Agencies' proposed "L-shaped" option, allowing a 50/50 mix of vertical and horizontal retention, combines two options but rather narrowly restricts them. We believe the relative proportion of the two legs has little relevance, so long as their cumulative effect is to provide retention of five percent (5%) of the credit risk of each asset. We, therefore, ask that the Agencies allow a broader version of the L-shaped risk retention.

F. The Agencies should revise the "seller's interest option" definition to better correlate to existing market practice.

i. Although the seller's interest in a master trust generally is pari passu with investors' interests, it is a complicated interest that does not precisely match the parameters in the proposed regulation. The relevant definitions should be revised to permit these complexities.

The seller's interest in structures with revolving assets (*i.e.*, credit cards and floor plans receivables), creates a very strong alignment of interest between the transaction sponsor and the investors. The Roundtable supports the Agencies' decision to include it as a permissible form of risk retention. However, the Agencies' proposed definition of "seller's interest" does not match the seller's interest as it currently exists in most structures. We ask that the Agencies revise the definition to better correlate to existing market practice, which we believe to be fully consistent with the goals of Section 941.

Because master trusts have revolving asset pools, they also have principal balances that fluctuate over time. Credit cards are a paradigm example. Every purchase made with a credit card increases the outstanding principal balance of receivables on that credit card, and every payment reduces it, so that it changes on a daily basis. A cardholder may have a $300 balance one day, a $1,300 balance the next, and a $100 balance a week later. And this happens across the securitized portfolio. The variations at the pool level are generally smaller as a percentage of outstanding balances than they are at the level of an individual cardholder, but they occur daily. Credit card balances also have seasonality, so that January balances—which include holiday spending—tend to be significantly greater than those in the fall.

Credit card master trust structures are designed to address those fluctuations, and to ensure that the seller's interest always reflects the actual investment of the issuing bank in the receivables. In the simplest example, assume the seller forms a master trust by transferring $1,000,000,000 in receivables to it, and receives the seller's interest, which at that point represents the entire interest in the master trust. The master trust then issues

$600,000,000 in securities to investors. This is done by converting $600,000,000 of the seller's interest into investors' interest. The seller receives the $600,000,000 in cash proceeds and retains a seller's interest now worth $400,000,000. If, in the next month, there are no new securities issuances, but the amount of purchases on the relevant credit card pool exceed payments by $50,000,000, the seller's interest will increase to $450,000,000 while the investors' interest remains at $600,000,000. If payments exceed purchases by $50,000,000, the seller's interest will decline to $350,000,000. And if the investors are repaid in full, the seller's interest will again represent the entirety of the trust.

Generally, the seller's interest and the investors' interest each represent a fractional, undivided interest in the master trust, and are allocated a proportionate share of all collections and all losses. But what happens to those collections and losses is not the same for the seller's interest and for the investors' interest. The seller's interest is typically a true pass-through interest—allocable losses reduce the seller's interest, and collections are paid to the seller. The investors' interest, on the other hand, may be subdivided into series, classes and tranches, and will have detailed cash flow provisions that describe how its allocations and losses are to be treated. In securitizations that use a note issuance trust as well as a master trust, the investors' interest is issued by the master trust to the note issuance trust and is again essentially a true pass-through interest—but the notes that are supported by it have differing levels of seniority, such as Class A, Class B and Class C. Their allocations of finance charge collections, for instance, might be used first to pay Class A interest, then Class B interest, then Class C interest, then servicing fees, then to reimburse losses, and then to fund credit enhancement accounts, with any excess then returned to the seller as excess spread. Principal collections might be used to repay principal owed to investors, but they might also be reinvested in new receivables until needed to pay principal at a specified date. And during any period in which principal on the investor interests is being repaid, the investors might be allocated principal collections that include those which would otherwise have gone to the seller to facilitate larger, level payments and a more orderly repayment.

The Agencies have proposed the following definition for the seller's interest:

> Seller's interest means an ABS interest:
>
> > (1) In all of the assets that:
> >
> > > (i) Are owned or held by the issuing entity; and
> > >
> > > (ii) Do not collateralize any other ABS interests issued by the issuing entity;
> >
> > (2) That is *pari passu* with all other ABS interests issued by the issuing entity with respect to the allocation of all payments and losses prior to an early amortization event (as defined in the transaction documents); and

(3) That adjusts for fluctuations in the outstanding principal balances of the securitized assets.

This proposed definition is not an accurate description of the seller's interest, and must be revised in order for the seller's interest option to provide a meaningful option for existing master trust issuances.

First, clause (1) would require that the assets not collateralize any other ABS interests issued by the issuing entity. Where the seller's interest is a beneficial ownership interest in a trust, it represents a fractional, undivided interest in all receivables the trust. In other words, it is a proportionate interest in the entire pool, and the requirement that the assets not "collateralize" any other ABS interests may not fully capture that relationship.

Second, clause (2) also is not accurate in a number of respects. There is a difference between allocating to the seller's interest a share of collections and losses that is proportionate to that allocated to the investors' interest, and having the seller's interest be *pari passu* with all other ABS interests issued by the issuing entity. Even setting aside the added complication of a master trust with a related note issuance trust structure, the master trust itself may issue series of securities with senior and subordinate tranches. In that circumstance, the allocation to the series and the allocation to the seller's interest would be *pari passu*, but the allocation to "all other ABS interests" would not be *pari passu* with the seller's interest.

Putting this in numbers from the previous example, let's say that the $600,000,000 investor interest was in the form of a single series with Class A Certificates equal to $550,000,000 and Class B Certificates equal to $50,000,000. Let's say, further, that in a particular month the master trust receives $200,000,000 in principal collections and $10,000,000 in finance charge collections, and suffers losses of $5,000,000.[22] In a typical master trust, what might happen in the revolving period (when the master trust is not repaying principal on the investor interests) is that the series would be allocated $120,000,000 in principal collections, $6,000,000 in finance charge collections, and $3,000,000 in losses, and the seller's interest would be allocated $80,000,000 in principal collections, $4,000,000 in finance charge collections and $2,000,000 in losses. If the series had a weighted average interest rate of 3% per annum,[23] the monthly weighted average interest payment to the investors would be $1,500,000. The $6,000,000 in finance charge collections would be allocated to pay interest on both classes, sequentially by seniority of class, to reimburse the charge-offs, again sequentially by seniority of class, to pay servicing fees, and to pay any applicable credit enhancement fees or fund reserve accounts, if applicable. Funds remaining after all that—let's say $300,000—

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[22] Note that losses—receivables charged-off as uncollectible—*always* occur for credit card master trusts, and the investors are provided disclosures about historical charge-off percentages, as well as historical yield and payment rate information. In other words, the $5,000,000 in losses (charge-offs) in this example would have been an ordinary, expected occurrence.

[23] Note that the Class A certificates would have a lower interest rate than the Class B certificates, because the Class B investors would be compensated for their subordinated position. We have used a weighted average interest rate to simplify the example.

would be paid to the seller's interest. The $120,000,000 in principal collections originally allocable to the investors and the $3,000,000 of finance charge collections used to reimburse charge-offs would also be paid to the seller for reinvestment in new receivables (otherwise the investor interest would be $477,000,000 in receivables and $123,000,000), and the investors would start the next month in the same position they started the last, with a $600,000,000 investor interest in receivables and no losses. (They would also have received the full interest payment they expected.)

If the master trust were instead in a period in which it was repaying principal to its investors, and their outstanding principal had declined to $300,000,000 through repayments but the trust size remained the same, in a true *pro rata* allocation the investors would be allocated only $60,000,000 in principal collections in the next month (30% of $200,000,000). But that generally is not what happens. In that circumstance, it is typical to "lock" the investor interest at a higher level for purposes of the principal allocation to allow a larger, more level principal repayment. Thus, even though the investors had already been paid $300,000,000 of their investment, they might still be allocated $120,000,000 in principal collections to allow the next month's payment to remain at $100,000,000, effectively reducing the share of principal collections allocated to the seller's interest. Losses, however, would "float" with the reduction in the investor interest, declining to $1,500,000 for the investors and increasing to $3,500,000 for the seller's interest. Finance charges might also "lock" if there were an early amortization event, to provide extra credit enhancement to investors during the unwinding of the transaction.

We believe the following characteristics are common to all sellers' interests:

- They fluctuate in value based on fluctuations in the size of the receivables pool and the amount of investors' interests then outstanding;

- They represent a fractional, undivided interest in the pool, rather than an interest in any particular receivables; and

- They are allocated at least their *pro rata* share of all charge-offs, relative to the share allocated to the investors in the aggregate.

Any definition of the seller's interest that requires additional conditions may exclude seller's interests that do in fact function as a vertical interest in the pool. Therefore, the Roundtable asks the Agencies to revise the definition of "seller's interest" to reflect these core characteristics, and only these core characteristics.

ii. To determine the restrictions on hedging the interest, the retained seller's interest should be based on a percentage of the investors' interests in the master trust, and not a percentage of the assets.

Trust documents may describe the minimum seller's interest as a percentage of the total receivables in the trust or as a percentage of the investors' interest in receivables. The Roundtable believes that the minimum retained seller's interest for purposes of the risk retention requirements should be tied to the investors' interest. Of course, where the total amount of the receivables in the trust is larger than the investors' interest, the excess will constitute seller's interest. However, if there is a large seller's interest in a master trust, we believe that the restrictions on hedging should apply only to the portion of the interest that is required to be maintained, rather than to the entire interest. We therefore believe that the minimum risk retention should include only a percentage of the investors' interest, rather than a percentage of the total assets.

> *iii. It would be more meaningful to investors if the disclosure stated that the seller's interest must be at least five percent (5%) of the aggregate outstanding investors' interests in lieu of disclosing the dollar amount of the seller's interest.*

Dollar-based disclosures are largely irrelevant in a master trust structure, where the amount of outstanding investor interests and the amount of outstanding receivables both change with some frequency. Rather, a statement that the mandatory risk retention will be held in the form of a seller's interest in a minimum amount of 5% of the aggregate investor interest then outstanding will have far more meaning to investors than a dollar-based number. The Roundtable also believes that sponsors that decrease the use of their master trusts over time should not be locked into maintaining a retained interest that reflected higher utilization and included risk retained against interests that have matured. We, therefore, believe disclosure only of the percentage interest that must be maintained is more appropriate.

> *iv. A temporary reduction in the seller's interest due to dilution should be permitted if the securitization documents either require the seller to add additional receivables or cause the transaction to amortize.*

The transaction documents for a revolving securitization typically specify a minimum seller's interest that must be maintained. If the seller's interest falls below that level, principal collections otherwise allocable to the seller's interest will be trapped in the master trust, and the seller will be required to add new receivables by designating additional accounts to the trust. If the seller is unable to add new receivables within a specified time period, the investors' interests will amortize.

As noted previously, the seller's interest can decline as a result of a mismatch between payments of existing receivables and creation of new receivables. The seller's interest also may decline as it absorbs losses from charged-off receivables, and in the context of credit card receivables, from returns, frauds, and other adjustments (such as merchant error). If such declines are sufficiently large, they may cause the seller's interest to fall below the required minimum. Historically, one of the reasons for that required minimum has been to ensure that there was a cushion to absorb these declines without reducing the amount of receivables supporting the investors' interests.

We do not believe that temporary reductions in the seller's interest below the required level should be considered a violation of the obligation to retain risk, as long as the seller is required to restore the interest by transferring new receivables, or the deal will amortize. Once the transaction begins amortizing, if new receivables are not generated, the amount of the seller's interest will increase as the investors' interests decrease, quickly restoring the minimum risk retention level. To the extent mechanisms exist within the structure for addressing these issues, the Roundtable believes that a temporary decline should not cause the sponsor to be out of compliance, and we ask that the Agencies revise their proposals accordingly.

v. The proposed "premium capture reserve account" will not appropriately take into account the seller's interest and must be revised to correct the calculation.

The calculations proposed by the Agencies for a revolving asset master trust are as follows:

> [The] proposal would require that a sponsor retaining credit risk under the vertical, horizontal, L-shaped, or revolving asset master trust options of the proposed rules establish and fund (in cash) at closing a premium capture cash reserve account in an amount equal to the difference (if a positive amount) between (i) the gross proceeds received by the issuing entity from the sale of ABS interests in the issuing entity to persons other than the sponsor (net of closing costs paid by a sponsor or the issuing entity to unaffiliated parties); and (ii) 95 percent of the par value of all ABS interests in the issuing entity issued as part of the transaction.

The problem with this formulation is that the seller's interest is not issued as part of the transaction; in fact, it is reduced as part of the transaction. As with the example in Section II.F., above, if the master trust issues $600,000,000 of investors' interests, it will then have to compare the $600,000,000 purchase price to 95% of the par value of the ABS interests issued as part of the transaction—so 95% of $600,000,000, or $570,000,000—requiring the funding of a premium capture cash reserve account for $30,000,000. But there isn't a premium, and the seller's interest, at $400,000,000, reflects a substantial retained interest that strongly aligns the interests of the seller and the investors. The proposed calculation simply does not work, and if it were applied to the securitization it would potentially change the economics so significantly that the transaction would not be done. In general, the Roundtable believes the premium capture cash reserve account provisions should be removed; but here, in particular, they are destructive and without purpose. Accordingly, we urge the Agencies to remove (or modify) these provisions to preserve the viability of revolving master trust securitizations.

vi. Securitizers should be permitted to satisfy the risk retention requirement by using alternative forms of risk retention even if they use master trust structures.

Although seller's interests are a common feature of master trust structures, a number of our members have indicated that they would not be the risk retention form of choice in all securitizations using master trusts. Auto floor plan receivables master trusts may use a very small or no seller's interest, but nonetheless have significant retained interests in other forms, including subordinated interests and reserve accounts. The rules should clearly permit alternative forms of risk retention to be used in place of, or in addition to, the seller's interest.

G. The Agencies should allow credit for interests in excess spread, at-risk servicing or management fees, or other retained interests that effectively align interests. We urge the Agencies to allow a broader range of combinations of credit risk retention (*e.g.*, seller's interest plus horizontal first loss piece, or cash collateral account plus subordinated certificates), where any combination would count toward the required percentage.

There are a number of types of securitization interests that have significant value to their holders but that are at risk if the assets in the transaction perform poorly. Many of these do not fit neatly within the parameters of the Agencies' proposed rules. Some of these interests include excess spread, which is the true first loss interest in credit card securitizations; subordinated management fees in CLOs; servicing rights that decline significantly in value if the pool underperforms; reserve accounts or subordinated securities that protect a particular tranche, class or series but that do not support all interests in the securitization vehicle; letters of credit; guarantees; overcollateralization; and discount receivables.

These types of interests all currently exist in securitization transactions, even without a mandatory risk retention requirement. Some of them are fundamental to the structure of the transaction; some are included to meet credit enhancement levels required by the rating agencies; some have been demanded by investors; and some may have been of particular significance to one market participant but have over time become market convention. The extent to which these interests provide risk retention depends on the circumstances under which they can be drawn, the cash flows of the transaction, and whether they are tied to credit risk or another kind of risk, such as interest rate risk. There are structures in which the sponsors have retained virtually all of the credit risk—and where they would not receive credit for a single element of their risk retention obligations under the rules as proposed.

We believe it is essential that the Agencies' rules capture more of these forms of retained risk and better reflect the ways in which different pieces of risk retention work together. In some transactions, for instance, it may be impossible to structure an eligible horizontal residual interest because first losses are absorbed by excess spread (also held by the sponsor), which does not count toward the requirement. We appreciate that the actual amount of risk retained may be difficult to value in some instances, but we believe that difficulties in valuation can be overcome. Securitizers should be given the opportunity to demonstrate—through models, spreadsheets, third-party analyses, or other methods—that the cumulative effect of their various retained interests meets or exceeds the required regulatory levels. The Roundtable requests that the Agencies modify their proposed rules to allow this approach.

H. **The calculation of the retained risk (including the underlying assumptions) is inherently a forward-looking statement,[24] and should not be subject to liability under federal securities laws. This calculation data also is proprietary information. In the rare instance where the retained interest calculation data are required to be provided to governmental authorities, the data should be exempted from public disclosure under the Freedom of Information Act.[25]**

We have significant concerns, particularly in the context of horizontal risk retention, that the determination of the appropriate level of risk retention will be reviewed in hindsight and challenged if the amount of the risk retained turns out to be less than five percent (5%) of the credit risk. Although we believe the amount to be held (whether as a percentage of particular classes or as a dollar amount) and the form in which it is to be held should both be disclosed, we do not support disclosures beyond those. Investors of course will be able to do their own determinations as to whether they believe the retained risk satisfies the regulatory requirement.

At the same time, we appreciate that regulators may have an interest in understanding how the risk retention determinations for a particular transaction were made. We believe that securitizers should be prepared to share their calculations and assumptions with their primary regulators, or if applicable with the Commission. Where such calculations and assumptions involve proprietary models or confidential information, the Roundtable asks the Agencies to adopt rules that would deem this proprietary or confidential information exempt from disclosure under FOIA,[26] or subject to a bank examination privilege,[27] or otherwise exempt from disclosure in circumstances where the relevant regulators would support confidential treatment of such information.

III. Premium Capture Cash Reserve Account

The letter submitted concurrently by the Housing Policy Council includes an extensive discussion of the premium capture cash reserve account and its inherent flaws.[28] The Roundtable concurs with the Housing Policy Council's view that requiring such an account would have severe consequences not only for securitizations but also for the options available to mortgage borrowers. Moreover, we are concerned that the adverse consequences of this proposed requirement would go beyond the residential mortgage loan class and potentially include CMBS, credit card and auto floorplan transactions involving master trusts as discussed in Section II.F., above, and CLOs. The Roundtable believes the premium capture cash reserve account provisions are

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[24] *See* 15 U.S.C. § 77z-2(i)(1) (2010).

[25] 5 U.S.C. § 552(b)(4) (2010).

[26] *Id.*

[27] *See, e.g.*, DEPARTMENT OF JUSTICE GUIDE TO THE FREEDOM OF INFORMATION ACT, Exemption 8.

[28] *Comments of Housing Policy Council*, "Credit Risk Retention" at 5-13 (July 29, 2011), *available at* http://www.fsround.org/fsr/policy_issues/regulatory/pdfs/pdfs11/riskretentionletterQRM.pdf.

fundamentally flawed, and recommends that the Agencies decline to adopt them in any form.

We believe the concern which led to the proposed premium capture cash reserve account is relatively limited. As we note elsewhere in this letter, including in Section II.B, above and in Section V., below, many asset classes have always had significant risk retention as a fundamental part of their structures. Furthermore, the vertical forms of risk retention present virtually no opportunity to "game the system" by somehow extracting sufficient value at the time of the securitization to offset the retained interests. Even with a horizontal first loss position (where the retained interest could potentially be illusory if the projected losses exceed the amount of the retained interest) the premium capture cash reserve account is unlikely to provide the appropriate answer, because the assets are unlikely to trade at a premium.

IV. Restrictions on Hedging

The Roundtable supports the Agencies' efforts to strike an appropriate balance between satisfying the requirements of Section 941, which restrict the ability to hedge retained credit risk, and allowing risks of the investment that fall outside the sponsor's control to be properly hedged consistent with sound risk management policies. We also believe that allowing the retained interests to be pledged on a full recourse basis will help mitigate the potential adverse consequences of tying up assets on a long-term basis, and will not undermine the primary goal of credit risk retention. We appreciate the work that went into crafting a balanced solution.

V. Issues for Specific Asset Classes

A. Collateralized Loan Obligations

Managed collateralized loan obligations ("CLOs") are very different transactions than most ABS transactions. In their asset selection and management, for instance, they are much more similar to a debt mutual fund than they are to a securitization of mortgage loans. The relationship of the asset manager to the investors is much more similar to the relationship between fund manager and investors in a private equity fund than it is to the relationship between either servicer or depositor in a traditional securitization.

The assets held by a CLO are primarily ordinary corporate, senior secured loans.[29] The pool is required to meet diversity tests by industry, there are contractual limits to the concentration of any particular obligor in the pool (typically 2% or less, but the asset managers generally manage interests to well below that threshold), the pool is balanced in terms of permitted risk, assets are sold when they are determined to have increased in

[29] CLOs also have very little in common with the collateralized debt obligations ("CDOs") of asset backed securities that were so problematic during the recent financial crisis. Those CDOs of ABS generally securitized subordinated interests in residential mortgage backed securities, and thus both magnified leverage and concentrated risk. Often, the CDOs of ABS held a static, rather than an actively managed, pool of assets. By contrast, managed CLOs are conservatively structured with diversified pools of senior secured corporate obligations and careful manager oversight.

risk, and the pool is continually tested to ensure adequate coverage of its interest and expense obligations and its principal. If a similar portfolio of loans were assembled and managed by an insured depository institution according to comparable criteria and risk management policies and procedures, the institution would likely be given high marks by its prudential regulators.

CLOs are treated as securitizations, rather than private funds, largely because of some of the structuring techniques they use and the fact that they issue rated debt. They generally have no depositor and also do not have a sponsor that is in the chain of title for the assets. The assets acquired by managed CLOs are generally acquired in secondary-market transactions and thus are not part of the originate-to-distribute model that has been a concern for certain asset classes, such as RMBS. CLO managers conduct extensive asset-level due diligence, have fiduciary duties to their clients, and are compensated with a fee for investment advisory services, rather than through an interest in the proceeds of the sale of the assets.

As with other private funds, alignment of interest between investors and the asset manager has always been considered critically important, and a number of mechanisms to achieve this have developed through negotiations with investors. The fee structure, for instance, is designed to align those interests. A typical CLO will have a senior fee, a subordinated fee, and an incentive fee. The senior fee is generally sufficient only to cover management costs and is included to ensure that the asset manager will be able to cover the expenses of servicing the transaction even if performance-based fees are unlikely to be realized. The subordinated fee is an important part of the asset manager's compensation and is paid after interest on all tranches of securities other than the equity tranche, meaning that it is at significant risk if the transaction performs below expectations. In addition, there may be an incentive fee that is payable only if the equity receives returns that exceed a specified internal rate of return. Investors may also require the asset manager to purchase a portion of the equity, especially if the asset manager has a more limited track record. Finally, excellent fund performance is essential to the ability of the asset manager to raise capital for its next fund.

With respect to CLOs, the Agencies have noted that "the CLO manager generally acts as the sponsor by selecting the commercial loans to be purchased by an agent bank for inclusion in the CLO collateral pool, and then manages the securitized assets once deposited in the CLO structure."[30] This assertion is generally not accurate in that there is no "agent bank" that purchases the assets, which are typically acquired directly by the securitization vehicle from secondary market sellers. Moreover, Section 941 defines the "securitizer"—which the Agencies have used interchangeably with "sponsor"—as follows:

> (3) the term 'securitizer' means—
>
> > (A) an issuer of an asset-backed security; or

[30] Proposing Release, 76 FR at 24098 n. 42.

(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.

The CLO manager does not fulfill this role. It does not sell or transfer assets, either directly or indirectly, to the securitization. Instead, it selects assets and facilitates their purchase by the issuing entity for a fee.

It would be very difficult or impossible for most CLO managers to make the scale of investment that would be required for any of the credit risk retention options as proposed by the Agencies. The difference between the capital available to a CLO manager and the capital available to the sponsor of a securitization who is in the chain of title of the assets is dramatic and reflects the difference in roles between an investment adviser and a principal. While the Agencies may be aware that the CLO manager does not really fit within the definition of "securitizer" in Title IX, the economic significance of this statutory disconnect is more significant than appreciated. The CLO manager simply cannot afford to be treated as a securitization sponsor if the sponsor is required to hold an interest equal to five percent (5%) of the capital structure. We believe it is inappropriate to establish risk retention rules for CLO managers that they cannot meet because they are not the type of entity that Congress contemplated in its definition of "securitizer."

Several commentators and trade organizations have argued that the proposed rules should not include arbitrage CLOs. We agree with the points that The Loan Syndications and Trading Association (LSTA) made in various publications and also in the testimony of Bram Smith, the Executive Director of the LSTA before Congress, specifically that:

(i) CLOs are an important source of financing to U.S. corporate borrowers,

(ii) CLOs are not originate-to-distribute ABS that are the target of the proposed rules,

(iii) CLOs performed very well during the recent credit crisis,

(iv) the risk retention requirements set forth in the proposed rules do not work for CLOs,

(v) the approach taken in the proposed rules is inconsistent with the mandates of the Dodd-Frank Act in ways that are punitive for CLOs,

(vi) the proposed rules do not follow the recommendations of the Board of Governors of the Federal Reserve System in "Report to the Congress on Risk Retention" (October 2010) in ways that are punitive to CLOs, and

(vii) there are other, more effective, ways to align interests in the CLO market.

However, if the Agencies nonetheless impose a risk-retention requirement on the asset manager of managed CLOs, the Roundtable requests that the Agencies establish an exemption from risk retention requirements for certain qualifying managed CLOs that meet the criteria proposed by the LSTA in its comment letter.

B. Student Loans

Proposed rule § __.21(b)(1) fully exempts from the five percent (5%) risk retention requirement any securitization transaction if the ABS issued in the transaction are collateralized solely by assets that are fully insured or guaranteed by the United States or any agency of the United States (excluding cash and cash equivalents). This exemption, however, does not include securitizations of student loans that are *nearly*, but not quite, fully insured or guaranteed by the United States. We believe that the failure to exclude loans originated under Title IV of the Higher Education Act Federal Family Education Loan Program ("FFELP"), which benefit from a federal government guarantee of 97 to 100 percent if the loan is serviced in accordance with Department of Education guidelines, was unintentional. Although the origination of FFELP loans was discontinued in mid-2010, lenders continue to hold substantial unsecuritized portfolios of these loans.

FFELP loans do not raise the underwriting concerns at the heart of the risk retention rules. These loans were subject to strict origination and servicing standards, and given the discontinuation of the program, a risk retention requirement for the securitization of legacy portfolios of such loans will have no capacity to influence the standards for future originations. Given the very significant federal government guaranty of these loans, along with the stringent servicing and origination standards to which the FFELP loans are or were subject, the Roundtable urges the Agencies to exempt them completely from the risk retention requirements. We believe an exemption would be consistent with the authority given to the Agencies to provide complete or partial exemptions, including where the terms, conditions and characteristics of a loan in an asset class indicate that such loan is a low credit risk.

If the Agencies do not entirely exclude FFELP loan securitizations from the risk retention requirement, as we have urged, at a minimum the Agencies should clarify that the 5% risk retention requirement applies only to the portion of the ABS portfolio subject to risk (*i.e.*, the portion of the portfolio attributable to the value of the underlying FFELP loans that are not otherwise guaranteed by the federal government). We do not believe that any of the risk retention options as currently defined would have that effect. For example, if the total risk of a $100,000,000 FFELP loan portfolio after giving effect to the government guarantee is $3 million, the amount of mandatory risk retention should not exceed $150,000, and indeed should be far smaller if it were determined based on a realistic expected portfolio loss.

C. Auto Loans

i. Eligible risk retention options also should include existing risk retention structures in auto loan asset backed securities transactions.

Auto loan asset backed securities ("Auto ABS") have a history of strong performance even through economic downturns, with robust risk retention in the form of reserve accounts, overcollateralization and residual interests. And yet we believe that, aside from the seller's interest for floorplan transactions, virtually none of the risk retention options proposed by the Agencies would encompass the retention of risk in auto ABS as it currently is structured. For example, these transactions often have significant overcollateralization that is effectively a first-loss position but would not meet the requirement of an eligible horizontal residual interest. One of the proposed requirements of that interest, which would restrict the allocation of unscheduled principal, is inconsistent with auto loan waterfalls that do not differentiate between types of principal collections. Another requirement, that it be allocated all losses until the par value of the ABS interests is reduced to zero, may not be true unless all seller-retained loss-absorbing interests, including excess spread and the reserve account in addition to the residual interest, are all considered in that determination.

As discussed below, we believe these are technical distinctions rather than substantive ones. These transactions have robust cash flow structures that preserve credit enhancement before allowing payments to flow out to residual interests, with no erosion of risk retention. Where the proposed definition does not adequately capture this, we ask the Agencies to revise the definitions rather than the structures.

ii. The definition of "eligible horizontal residual interest should be modified to accommodate auto structures.

Securitization structures in the auto sector are often very different from those used for other asset classes. Many of these structures do not distinguish between principal and interest collections, but instead pass all collections through a single waterfall. In addition, there is often no formal allocation of losses, but those are nonetheless allocated to the junior-most class through the operation of the cash flows. Given these different structural features, the definition of "eligible horizontal residual interest" will not include the interests typically held in auto securitizations. Auto securitizations have performed extremely well for decades, including throughout the recent crisis. Thus, the Roundtable believes the appropriate regulatory response is to adapt the definition of "eligible horizontal residual interest" to accommodate autos, or perhaps adopt a variant form of horizontal risk retention.

Auto securitizations generally use retained interests in overcollateralization or excess spread (which allows more rapid repayment of the ABS and thus builds overcollateralization) as an essential aspect of credit enhancement that also serves to align interests with ABS investors. The residual interests receives payment only if the structure meets all requirements for overcollateralization. If losses on the pool assets prevent the vehicle from satisfying its overcollateralization requirements, then payments are not made on the residual interest. Thus, the residual interest bears all losses, even though there is not an explicit write down of the interest. Similarly, there is no need for a specific *pro rata* allocation of principal payments between investors and sponsors, because if payments to the sponsor would reduce the pool balance below the required level, they cannot be made.

These structures thus satisfy the goals of the proposed restrictions on an eligible horizontal residual interest—to prevent the holder of that interest from taking out assets in a way that would leave more senior interests at risk—but do so in a way that does not comport with the text of the proposed definition. The Roundtable believes that a form of eligible horizontal residual interest that receives payments only if the vehicle maintains a contractually required level of pool assets, but does not have other restrictions, would allow the typical auto loan residual interest to count toward credit risk retention without in any way lessening the degree of risk retention relative to the type of horizontal residual interest currently proposed.

iii. The proposed definition of "qualifying auto loan" would capture none or a de minimis number of existing loans, and should be revised to provide a commercially reasonable standard.

In determining a set of criteria for qualifying auto loans, the Agencies have gone far afield from the standards and procedures actually used in originating these loans. The Agencies' proposals would require the use of standards for unsecured installment loans rather than for automobile loans, documentation of income and determinations of debt-to-income ratios drawn from proposed QRM requirements, and a requirement that the borrower make a cash payment equal to all vehicle title, tax and registration costs, all dealer-imposed costs *and* 20% of the purchase price of the automobile that seems to go beyond the QRM proposal. But an automobile loan is neither a unsecured installment loan nor a home mortgage, and the creation of standards of creditworthiness that fail to consider the actual features, performance history and practices of the auto industry provides no value. Moreover, these requirements could lead to the counterintuitive result that the best, most-creditworthy customers—those who *might* be able to qualify for a qualifying auto loan—would be subjected to the most onerous documentation and verification process. As a practical matter that will not happen, and neither will the adoption of the proposed standards, which would not only make the process of obtaining an auto loan more cumbersome but would likely also depress sales at the dealers who adopted them. Unless the criteria are revised to reflect actual lending practice in the automobile industry, this option will never be used.

We believe that the criteria should be tailored to provide a commercially reasonable standard that accounts for the unique practices and conventions of the auto ABS market, that will be accessible to a meaningful subset of the market's participants and that is expanded to include qualifying auto leases. Moreover, given the strong performance of this asset class, especially with respect to prime loans, we do not believe that changes to underwriting practices are either necessary or likely to result from this definition. The Roundtable urges the Agencies to draw their criteria from best practices that are currently in wide use in the auto industry (and not from mortgage practices) and set the bar for a qualifying auto loan at a level that includes a meaningful percentage of all loans originated.

D. Equipment Loans

The Agencies have proposed a definition of "qualifying commercial loan" that, like the definition of "qualifying auto loan," would represent a significant deviation from current practice. Very few companies obtain corporate loans that have a straight-line amortization feature, for instance. However, one significant sector of the commercial loan market—the equipment loan sector—might be able to work within the proposed parameters (or a slightly revised version of them) to be able to securitize without mandatory risk retention.

Our members who make commercial loans for the purchase of equipment, however, are concerned about the proposed exclusion in the definition of "commercial loan" in §__.16 of the proposed rules for "[l]oans for the purpose of financing agricultural production." We believe that loans for the purchase of tractors and other farm equipment are appropriately classified as commercial loans and should not be considered to be "for the purpose of financing agricultural production." We ask that the Agencies clarify that this phrase is not intended to exclude commercial loans for the purchase of agricultural equipment.

The equipment ABS sector is a significant part of the commercial loan ABS market, representing approximately 7.28% of new issuance as of 30 June 2011.[31] This sector has performed remarkably well throughout the credit crisis, as noted by the Board of Governors of the Federal Reserve System in its "Report to the Congress on Risk Retention" (October 2010). According to this Federal Reserve study, the equipment ABS market sector displayed "strong performance throughout the financial crisis."[32] The report credited this strong performance to incentives that were more than just risk retention, including "differences in market practices and conventions, which in many instances exist for sound reasons related to the inherent nature of the type of asset being securitized."[33] Accordingly, the Roundtable endorses the proposed new definition of "Equipment Commercial Loan," as defined by the American Securitization Forum.[34]

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[31] INFORMA GLOBAL MARKETS (June 30, 2011).

[32] BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *Report to the Congress on Risk Retention* at 63 (October 2010).

[33] *Id.* at 83. We also agree with the analysis and conclusion of the Captive Commercial Equipment ABS Issuer Group in its letter, dated March 18, 2011 to the respective heads of the Agencies.

[34] *Comments of American Securitization Forum*, "Equipment Loan ABS" at 128, (June 10, 2011), http://www.sec.gov/comments/s7-14-11/s71411-57.pdf. We also endorse the underwriting standards proposed by the American Securitization Forum. *Id.*, "Exhibit J" at 179.

E. Commercial Mortgage-Backed Securities

i. We support the proposal to allow the B-piece buyer in a commercial mortgage-backed securities ("CMBS") transaction to retain the required credit risk for that transaction, but believe the proposal should be revised to allow (a) multiple B-piece buyers for a single transaction and (b) transfers to another B-piece buyer who re-underwrites the pool.

As the Agencies have noted, one of the key aspects of a CMBS transaction that differentiates it from other ABS transactions is the presence of a "B-piece" buyer who purchases a subordinated, first-loss, non-investment grade security (the "B-piece") after conducting its own extensive due diligence of the underlying portfolio. The B-piece buyer, which usually has special expertise in commercial real estate, may also conduct due diligence on individual loans while the CMBS portfolio is being assembled. Section 941(c)(1)(E) of the Dodd-Frank Act specifically suggests that the proposed rules for CMBS include as a permissible form of risk retention:

> retention of the first-loss position by a third-party purchaser that specifically negotiates for the purchase of such first loss position, holds adequate financial resources to back losses, provides due diligence on all individual assets in the pool before the issuance of the asset-backed securities, and meets the same standards for risk retention as the Federal banking agencies and the Commission require of the securitizer.

Proposed §__.10(a) sets forth the conditions under which such a third-party purchaser in a CMBS transaction can provide a permitted form of risk retention. It would require, among other things, that the B-piece buyer comply with the hedging and other restrictions set forth in proposed rule §__.14 as if it were the retaining sponsor in respect of the eligible horizontal residual interest pursuant to the proposed rules, including provisions that would require that a retaining sponsor may not sell or otherwise transfer any interest or assets that the sponsor is required to retain to any person other than an entity that is and remains a consolidated affiliate. The proposed rules also contemplate only a single entity acting as the B-piece buyer.

We are concerned that this approach will be too restrictive for the entities that would typically act as B-piece buyers. In particular, the inability to transfer the interest is likely to be very problematic. Moreover, it is not necessary. The B-piece buyer is a third-party conducting its own diligence and voluntarily investing in the most subordinate piece of the transaction, providing a critical cross-check to the sponsor in terms of asset selection and the structuring of the transaction. We believe the B-piece buyer should be allowed to subsequently sell its interest as long as the sale is made to someone who has relevant experience and who re-underwrites the loan pool at the time of sale; as with the original B-piece buyer, a subsequent buyer would specifically negotiate for the purchase of its first-loss position, retain adequate financial resources to back any losses, perform due diligence on the portfolio assets, and satisfy the other standards for risk retention outlined by the Agencies. Such a process would ensure that the B-piece buyer bears meaningful risk in connection with both the quality of the due diligence and the subsequent performance of the pool, because the price determined by a subsequent B-piece buyer will decrease if it identifies problems with the pool quality or if the pool has underperformed.

We further believe that CMBS sponsors should be able to sell portions of the residual interest directly to multiple B-piece buyers that each *individually* satisfy all of the standards and perform all of the due diligence that would be required of a single B-piece buyer. This may be particularly important for large transactions, where the size of the required risk retention may exceed the risk management thresholds of a single buyer. At the same time, in order to justify the effort involved in meeting the qualifications for a B-piece buyer, the size of the purchased interest must be commensurate with that effort, and thus we do not believe there is a meaningful risk that the interest would be subdivided into units too small to provide a real alignment of interest.

ii. The provisions of the proposal relating to the operating advisor and its oversight of special servicing would not prevent conflicts of interest but would adversely affect the willingness of the B-piece buyer to assume the risk retention obligations.

CMBS B-piece buyers, as a requirement for taking on the first-loss position, often require that they be designated as the "controlling class" under the documents governing the CMBS transaction and have the ability to assume the role of "special servicer" under the transaction to service delinquent or defaulted loans in the CMBS portfolio. The Agencies have noted that they believe this ability to control certain aspects of the loan portfolio has the potential to create certain conflicts of interest between the B-piece buyer who holds the first-loss residual interest in such CMBS and the more senior classes. The Agencies are primarily concerned that B-piece buyer, in its capacity as special servicer, could manage underlying distressed assets in a manner beneficial to itself but detrimental to the more senior classes (*e.g.*, by delaying recognition of losses in order to avoid the diversion of cash further up the principal or interest waterfall to ensure cash flows to the junior residual piece). The proposing release provides little recognition, however, of the alternative view of that conflict of interest: if the senior interest holders have the ability to control this servicing, they may choose to get a quick recovery that covers their interests but pushes unnecessary losses down to the B-piece, rather than taking a path that maximizes the value of the asset.

To address conflicts of interest, the B-piece buyer retention option as currently drafted is subject to several conditions, including the requirement set forth in proposed rule §__.10(a) that an independent, unaffiliated, operating advisor be appointed (by the terms of the underlying CMBS transaction documents) where a B-piece buyer retains the risk and also has control rights that are not collectively shared with all other classes. Pursuant to the proposed rules, any servicer for the securitized assets that is, or is affiliated with, the B-piece buyer must consult with the operating advisor in connection with, and prior to, any major decision regarding servicing of the securitized assets, including material modifications or waivers, foreclosures or acquisitions. In addition, the operating advisor shall be responsible for reviewing the actions of any servicer that is, or is affiliated with, the B-piece buyer. Perhaps most troubling, the proposed rules provide that the operating advisor shall have the authority to recommend that a servicer that is, or is affiliated with, a B-piece buyer be replaced by a successor servicer if it determines that the servicer is not acting in the best interests of the investors in such CMBS transaction as a whole. Upon such recommendation, only a majority of each class of CMBS interests entitled to vote could vote to retain the servicer.

While we appreciate the Agencies' efforts to attempt to ensure that B-piece buyers acting as servicers will act in the best interest of the CMBS transaction as a whole, we believe the provisions of the proposal relating to the operating advisor and its oversight of special servicing are not necessary (or effective) to prevent conflicts of interest—instead, they may support the interests of the senior investors at the expense of the B-piece buyer, a possible outcome that will adversely affect the willingness of the B-piece buyer to assume the risk retention obligations. B-piece buyers are, by definition, purchasing and holding the first-loss position. As a result, they are highly sensitive to changes to underlying deal structures that may place their capital at additional risk. Further, adding additional layers of administrative burden on an already highly structured CMBS framework may make servicing and workouts for the underlying loans more difficult and expensive, reducing returns. We also believe that this forced oversight is unnecessary while the B-piece buyer continues to have an economic stake in the transaction, because the B-piece buyers are highly incentivized to discharge their servicing duties in a manner that maximizes recoveries. That said, we realize that there may be circumstances in which the interest of the B-piece buyer has essentially been wiped out, and we believe that having a provision that allows the removal of the B-piece buyer and its affiliates as servicer at that point may be an acceptable intermediate approach.

iii. The pricing of the B-piece is competitively sensitive information that should not be required to be disclosed.

The Agencies have proposed that sponsors of CMBS that be required to disclose the pricing of the B-piece to potential investors in other securities in the structure and, if requested, to applicable regulators, as a condition to using the B-piece buyers' investment to satisfy the risk retention requirements. §__.10(a)(5). Such information is highly competitive and sensitive, and required disclosure to the market would act as a significant deterrent to the use of this form of risk retention. Disclosure to the applicable regulatory on request might be acceptable; however, we believe that such disclosure should only be made subject to receipt of confidential treatment under the Freedom of Information Act.

iv. The proposed definition of "qualifying commercial real estate loan" would capture a de minimis number of existing loans, and should be revised to provide a commercially reasonable standard.

Proposed rule §__.19 sets forth the underwriting criteria that must be met for a commercial real estate loan to qualify as a "qualifying commercial real estate loan," such that risk retention would not be required in a securitization of that loan. While the

Agencies have attempted to provide a set of clear requirements to encourage the origination of low risk loans, virtually no CMBS loans would qualify under the definition as currently proposed, effectively eliminating this exemption as a realistic option for the CMBS market. Therefore, we propose that these criteria be revised to provide an attainable, commercially reasonable standard that can be utilized by a number of market participants on economically reasonable terms.

v. CMBS securitizations that involve a single borrower should be exempt from the risk retention requirements if investors have access to appropriate financial and other information about the borrower.

The proposed rules currently do not distinguish between CMBS transactions that include assets from one borrower and CMBS transactions that include assets from multiple borrowers. Where there is a single borrower, we believe that the CMBS investment is virtually indistinguishable from an investment in a secured loan, and investment decisions should be based on an assessment of the financial strength of the obligor and the value of the underlying property. In that circumstance, so long as the appropriate financial information about the borrower and property is disclosed, we do not see a benefit to requiring risk retention. We believe this type of CMBS transaction should not be considered to be an Exchange Act ABS, notwithstanding certain structuring similarities, and should therefore not be subject to a risk retention requirement, and we ask that the Agencies clarify their proposed rules on this point.

vi. The Agencies should clarify that the restriction on financing purchases of the B-piece would not preclude general lending relationships between the parties.

Proposed rule §__.10(a) states that, in order for the risk retention requirement to have been met by the B-piece buyer, such buyer must not have obtained financing, directly or indirectly, for the purchase of the B-piece from any other person that is a party to the securitization transaction (including, but not limited to, the sponsor, depositor or an unaffiliated servicer), other than a person that is a party to the transaction solely by reason of being an investor. While we understand and appreciate the concern the Agencies are trying to address to ensure that the third-party purchaser has sufficient financial resources to fund the purchase of the B-piece and absorb any associated losses, we believe that the language of the condition needs to be clarified. By restricting any direct or indirect financing, the restriction goes beyond its initial intent. This requirement should not require tracing of funds. The restriction on the ability to provide financing to the B-piece buyer should relate solely to financing that is entered into in order to finance the relevant transaction, rather than restricting any general lending relationships between such parties. For example, if a sponsor or its affiliates provide financing to a B-piece buyer in a different context (*e.g.*, a general corporate revolver used for working capital or other general business purposes), then this should not foreclose the B-piece buyer from being eligible to purchase the applicable B-piece with separate funds not provided pursuant to such financing even though money is fungible.

F. We believe the conditions for an eligible asset-backed commercial paper program, which would exclude many existing conduits that conduct conventional asset-backed commercial paper programs, should be revised to better reflect the attributes of these programs.

Asset-backed commercial paper ("ABCP") conduits provide a substantial source of funding for many businesses globally, including manufacturing, health care, service industry, and retail companies that are not part of the financial sector. These entities rely on ABCP conduits for inexpensive funding collateralized by their liquid assets, and rules that are too restrictive may well remove this as an effective alternative for them.

i. The Agencies should provide that sponsor liquidity support would qualify as an eligible form of risk retention.

ABCP conduit programs supported by liquidity programs generally have the benefit of letters of credit, revolving credit commitments or other credit enhancements from their sponsors. To the extent the ABCP conduit is unable to "roll" (*i.e.*, refinance) maturing commercial paper or fund its commitments, the liquidity provider steps in to protect the commercial paper held by investors. We believe that sponsor-provided liquidity obligations that represent at least five percent (5%) of the credit risk of the assets should qualify as permissible risk retention by sponsors of ABCP conduits. This position is consistent with the European risk retention rules that apply to banks, which treat similar liquidity programs as permissible risk retention. A liquidity program provided by the sponsor or an affiliate of an ABCP conduit properly aligns the interests of the sponsor with the commercial paper investors. Since the sponsor or an affiliate retains significant potential risk for losses in the assets held by the ABCP conduit, the sponsor has a strong incentive to ensure the proper underwriting of the securitized assets. As a result, sponsors of ABCP conduit programs generally expend substantial due diligence and underwriting effort in connection with the acquisition of securitized assets.

The proposed rules appear to omit a liquidity facility in the form of a letter of credit. We understand that numerous ABCP conduit programs utilize letter of credit liquidity facilities. We believe that a letter of credit liquidity facility should be permitted as appropriate sponsor risk retention. While a letter of credit backstop for an ABCP conduit may not be fully funded, it should not prevent the letter of credit from constituting permissible risk retention. Strict rules govern draws on a letter of credit. Issuing banks typically honor letter of credit draw requests that comply with the applicable draw conditions. In addition to potential liability, the failure of an issuing bank to honor a properly presented letter of credit draw request would have significant reputational impacts above and beyond the specific transaction. Also, the issuance of an unfunded letter of credit will impact the regulatory capital requirements of the issuing bank. The European risk retention rules permit the use of a letter of credit liquidity facility as appropriate risk retention for ABCP conduit programs.

The Roundtable also believes there is no policy-based reason to restrict the liquidity program of an eligible ABCP to only one liquidity provider so long as all liquidity providers are regulated financial institutions as contemplated by §__.2. The number of liquidity programs supporting an ABCP conduit is irrelevant to accomplish the risk retention goals. Instead, it is important that the combination of liquidity programs fully backstops the possible liability of the ABCP conduit.

ii. The Agencies should allow bank-sponsored ABCP programs to qualify as eligible ABCP programs (even though a portion of the transactions do not satisfy the originator-seller criteria) if all transactions included after the effective date of the regulations have originator risk retention.

Some ABCP programs include assets from long-dated commitments of three to five years. Although we realize that compliance with the proposed rules will not become necessary until two years after they are finalized, legacy assets may continue to be outstanding after the effective date of the risk retention requirements. In those programs, the sponsor may not have the ability to modify the transaction terms to require unhedged originator risk. If ABCP sponsors are unable to satisfy risk retention requirements through liquidity programs, then it is important to modify the proposed rules to accommodate legacy assets and legacy commitments.

We believe that the Agencies should permit otherwise eligible ABCP conduits that own legacy assets to be an eligible ABCP conduit as long as the originator-seller of any asset acquired after the effectiveness of the risk retention rules complies with the risk retention requirement. Originator-sellers of assets originated prior to the effectiveness of the risk retention rules should not be required to comply with the risk retention requirements in order for the ABCP conduit to be eligible under the proposed rules. Retroactive application of the risk retention requirement for originator-sellers would have no impact on the goals of the risk retention rules, nor would it improve the underwriting of assets that have already been originated.

iii. The Agencies should treat additional forms of risk retention by the asset originator-seller as consistent with the requirements of an eligible ABCP conduit.

We appreciate and agree with the proposal of the Agencies to provide a risk retention option for ABCP permitting the allocation of risk retention to the originator-sellers. However, this option is limited to the originator-seller's use of horizontal risk retention and does not include the flexibility to permit other forms of risk retention. We believe that the goal of risk retention can be even furthered if the originator-seller's risk retention options are as varied as contemplated in the proposed rules and dependent on the asset class of the originator-seller.

Given the variety of underlying assets acquired by ABCP conduits, we believe that the options available for originator-seller risk retention should mirror the types of assets that are financed by ABCP conduits. For example, originators of revolving assets, such as credit cards, frequently sell master trust certificates to ABCP conduits to provide a funding source or a source of contingent liquidity. In such cases, these originators should be allowed to continue to do so without compromising the eligibility of the ABCP conduit as long as these originators retain risk through one of the options permitted under the final risk retention rules such as a retained seller's interest. Moreover, it should not be necessary for such an originator to pass assets through a vehicle dedicated to the conduit securitization.

iv. ABCP conduit sponsors should not be required to monitor the originator-seller's compliance with applicable risk retention obligations.

The proposed rules require the sponsor of an eligible ABCP conduit to monitor ongoing compliance by each originator-seller with the risk retention requirement. §__.9(c). We believe that this ongoing monitoring obligation, unless very narrowly defined, is inappropriate. Monthly or more frequent reporting should provide the sponsor information as to the retained interest, but will not reflect compliance with restrictions on hedging.

We believe that the document governing the relationship between the ABCP conduit and each originator-seller could include an undertaking by the originator-seller to comply with the risk retention requirement. Any breach of such undertaking would result in a default, allowing the ABCP conduit (or its sponsor) to exercise the full range of remedies against the originator-seller. Given the drastic consequences to an originator-seller for a breach of this undertaking, we believe that appropriate incentives are built into the transaction to effect a commercially reasonable compliance structure.

v. The ABCP conduit's customer list is competitively sensitive information that should not be required to be disclosed.

Sponsors of ABCP conduits that rely on the originator-seller risk retention option would be required under the proposed rules to disclose the name and form of organization of each originator-seller to potential investors and, if requested, to applicable regulators. §__.9(b). Such required disclosure would be materially detrimental to the business operations of an ABCP sponsor.

The originator-sellers are customers of the ABCP sponsor. As with other industries, customer lists are confidential and proprietary in the ABCP sector, and constitute trade secrets. Disclosure of customer lists could lead to a competitive disadvantage to an ABCP sponsor. Accordingly, if customer lists are required to be disclosed, the originator-seller risk retention option may not be a practical option for ABCP sponsors who wish to protect their trade secrets.

Furthermore, we do not believe that investors would obtain any meaningful information from a disclosure of the proprietary and confidential customer lists of an ABCP sponsor. As noted above, ABCP is a unique class because commercial paper investors do not rely on the cash flow of the securitized assets to repay the commercial paper, and would not receive information about the underlying obligors even by having a list of originator-sellers. Instead, investors in this sector rely on the ability of the ABCP conduit to "roll" the CP (*i.e.*, refinance through new issuances of CP) and draw on its liquidity program, as well as the experience of the sponsor. These investors also focus on the creditworthiness of the regulated liquidity provider. Information relevant to the creditworthiness of a regulated liquidity provider is publicly available through periodic filings with the applicable regulator.

We do not believe that the policy goals of the risk retention rules are furthered by requiring this disclosure given the unique nature of the ABCP market. Given the negative impacts on ABCP sponsors, we do not believe that this disclosure requirement should be included in the final rule. However, if ABCP sponsors were required to disclose their confidential and proprietary customer lists to the applicable regulatory agency, then such information should be treated as exempt confidential information for purposes of the Freedom of Information Act.

vi. The Agencies should allow an ABCP conduit sponsor to satisfy its risk retention requirement by holding a vertical slice of the commercial paper.

In the event that a liquidity program is not considered effective risk retention by an ABCP sponsor and the proposed rules are not modified to accommodate the concerns reflected above, we would like to clarify and confirm that an ABCP sponsor may retain a five percent (5%) vertical risk through the purchase of five percent (5%) of each outstanding issuance of commercial paper of each maturity. Unlike some other ABS, ABCP conduits do not issue tranches of securities with the same maturity. Instead, ABCP conduits have multiple issuances of commercial paper with differing maturities. We believe that a purchase of five percent (5%) of each outstanding issuance of commercial paper of each maturity would be the economic equivalent of vertical risk retention for ABCP conduits. Such a purchase would give the ABCP sponsor a five percent (5%) credit risk of all outstanding commercial paper.

G. The exemption for re-securitizations should include all transactions in which the underlying security either is exempt from risk retention or was issued prior to the effective date of the risk retention rules.

Proposed rule §__.21(a)(5) exempts certain re-securitizations from the risk retention requirement to the extent that

(a) the re-securitization is collateralized solely by existing ABS issued in a securitization transaction (other than cash and cash equivalents),

(b) the underlying ABS was issued in compliance with the risk retention requirement *(i.e.,*(y) credit risk as required by the proposed rules was retained in the original securitization or (z) the underlying ABS was exempted from the risk retention requirements),

(c) the re-securitization involves only one class of ABS interest and

(d) the issued ABS interest provides for a pass-through of all principal and interest payments received on the underlying ABS (net of expenses).

Although we appreciate the Agencies' efforts to provide a specific exemption from the risk retention requirements for re-securitizations, the criteria set forth in §__.21(a)(5) of the proposed rules exclude certain types of re-securitizations that we believe should benefit from an express exemption.

i. *Re-securitizations that utilize a senior-subordinated structure are distinguishable from CDOs of ABS, provide an important source of liquidity for distressed assets, and should be permitted without new risk retention obligations.*

Re-securitizations are an important source of liquidity for the holders of ABS, especially for distressed or underperforming ABS. A typical re-securitization would tranche the original security into a senior piece and a subordinate piece, either to monetize an interest in a downgraded security or to shift risk to another person who is willing to accept it at a cost to the holder. Although re-securitizations may include more than one asset, often they involve only a single security and in any event a static pool. Generally the securities that are being re-securitized in a securitization were highly rated and at or near the top of the capital structure when originated, rather than representing mezzanine or first loss pieces. Re-securitizations of static pools of senior securities are distinguishable from CDOs of ABS, which tend to involve more junior securities or actively managed pools, and should not be restricted because of concerns that they would replicate the issues of CDOs of ABS. Requiring risk retention for re-securitizations as a result of tranching will curtail liquidity for investors without affecting credit quality at loan origination, as these securities do not implicate the originate-to-distribute model. For the same reasons, requiring risk retention for re-securitizations of legacy securities—those that precede the date of the regulations—will do little other than limit liquidity for the holders of those securities.

As stated in the Report to the Congress on Risk Retention by the Board of Governors of the Federal Reserve System, the credit risk retention provisions of the Dodd-Frank Act are intended to influence the quality of assets being securitized, making it more appropriate to focus on primary securitizations as opposed to re-securitizations. To this end, the primary goal of the risk retention requirements is to ensure better origination and more sound underwriting standards by aligning the interests of originators and sponsor with ABS investors. This goal would not be furthered by subjecting re-securitizations of legacy ABS or multi-tranche ABS to the proposed risk retention rules. The underlying ABS in re-securitization transactions have already been originated, and re-securitizations of existing ABS do not involve additional origination. Similarly, imposing risk retention rules would not affect the underwriting standards relating to the underlying ABS or incentivize the sponsor of the underlying ABS to improve its original underwriting standards.

ii. Re-securitizations of securities issued or guaranteed by the United States, or by any instrumentality of the Government of the United States should not be subject to a separate risk retention requirement.

The Roundtable also sees no reason that tranched re-securitizations of bonds issued or guaranteed by the United States or by the Government National Mortgage Association, the Federal National Mortgage Association, or the Federal Home Loan Mortgage Corporation (such as those in a typical collateralized mortgage obligation ("CMO") structure) should not benefit from the exemption that is available to the underlying securities. CMOs are an important source of liquidity for U.S. Government and agency bonds, and may be significantly limited if subject to a separate risk retention requirement. We urge the Agencies to revise the proposed rules to permit the exemption of re-securitizations in these circumstances.

iii. New risk retention should not be required for re-securitizations in which the credit risk is reconfigured but retained within an affiliated corporate group.

In addition, the risk retention requirements should not apply to any re-securitizations of underlying ABS to the extent that the entire credit risk of the underlying ABS is retained within the same affiliated corporate group (regardless of whether or not the underlying ABS originally satisfied the proposed risk retention rules). In this scenario, the credit risk is not shifted to outside third parties, but is simply moved between affiliates of the existing credit risk holder. This permits holders of underlying ABS to more effectively manage their exposure to the credit risk of the ABS within parameters that have no impact on origination and that are unrelated to the goal of ensuring quality underwriting standards and diligence.

VI. Process for Guidance and Interpretation

The Roundtable is very concerned that the process articulated by the Agencies for interpretation and guidance related to the final rules will be at best quite lengthy and at worst will place market participants in the position of being unable to obtain necessary guidance and relief. The Agencies state in the preamble:

> In light of the joint nature of the Agencies' rulemaking authority under section 15G, the appropriate Agencies will jointly approve any written interpretations, written responses to requests for no-action letters and legal opinions, or other written interpretive guidance concerning the scope or terms of section 15G and the final rules issued thereunder that are intended to be relied on by the public generally. Similarly, the appropriate Agencies will jointly approve any exemptions, exceptions, or adjustments to the final rules.[35]

We appreciate that Section 941 envisions joint rulemaking with respect to "exemptions, exceptions or adjustments," as indicated in the second sentence above, but that

[35] Proposing Release, 76 FR at 24097 (footnotes omitted).

requirement appears focused primarily on the initial rulemaking, including the definition of QRM. We do not believe the joint rulemaking requirements necessitate that every interpretation be made on a joint basis, and we believe that such an approach may create significant uncertainty and difficulty for market participants.

As we have indicated throughout this letter, a large number of existing forms of risk retention do not currently fit within the proposed definitions of the available options due to technical issues, even in situations where they create significant alignment of interest and are likely intended to be captured by the rule proposals. Especially if the Agencies do not re-propose these rules, we believe it is highly unlikely that they will get the definitions right in all instances. In addition, securitization structures change over time, and minor variations in the form of retained risk that could well be dispensed with quickly and easily by a single regulator may be incapable of being resolved through a multi-agency process, at least on a time frame consistent with efficient capital formation.

The Roundtable believes a better approach would be to allow a sponsor's primary regulator (or if the sponsor does not have a primary regulator, the Commission) to provide interpretative guidance, no-action relief or legal opinions with respect to inquiries brought by that sponsor. Other alternatives might include forming a small committee with authority to grant relief and an obligation to act within a specified time frame, or delegating interpretative authority for particular provisions to a designated agency or subset of agencies. However this is addressed, it is vital that a process be established that will provide a meaningful way for market participants to obtain interpretations and guidance when needed.

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