



February 13, 2012

VIA ELECTRONIC MAIL (rule-comments@sec.gov)

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Request for Public Comment Regarding Proposed Rule 127B Under the Securities Act of 1933 (File Number S7-38-11)

Dear Ms. Murphy:

Toyota Motor Credit Corporation ("TMCC") welcomes the opportunity to comment on proposed Rule 127B under the Securities Act of 1933, as amended (the "Securities Act"). The proposed rules would implement the requirements of Section 27B of the Securities Act, as added by Section 621 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"), which would prohibit certain conflicts of interest with holders of asset-backed securities ("ABS"), including synthetic ABS.

We appreciate the efforts of the Securities and Exchange Commission (the "Commission") in drafting the proposed rule and the extensive commentary set forth in the proposing release (the "Proposing Release").¹ While the Commission acknowledges that some conflicts of interest that are inherent in securitization transactions would not fall within the scope of the proposed rule, neither the proposed rule nor the commentary specifically addresses transactions designed to protect against unexpected downward movements in the residual values of leased motor vehicles ("Residual Value Hedges"). In particular, we ask that the Commission confirm, either in the final rule or in the official interpretive guidance, that:

- A Residual Value Hedge by a motor vehicle manufacturer or its affiliate with respect to its portfolio of leased motor vehicles, including motor vehicles that have been or which may be securitized, does not create a prohibited conflict of interest between investors and the manufacturer or its affiliate;
- The synthetic Residual Value Hedge transactions described in detail below do not involve the issuance of ABS within the meaning of the rule, and so do not present any prohibited conflict of interest; and

¹ Prohibition Against Conflicts of Interest in Certain Securitizations, SEC Rel. No. 34-65355, 76 Fed. Reg. 60320 (Sept. 28, 2011) (the "Proposing Release").

- A Residual Value Hedge by a securitization vehicle with respect to motor vehicles associated with leases in the securitized pool does not create a prohibited conflict of interest between investors in senior ABS and a sponsor or depositor that holds a residual interest or subordinated ABS.

1. TMCC and its Motor Vehicle Lease Business.

TMCC, a California corporation, is an indirect wholly-owned subsidiary of Toyota Motor Corporation (“TMC”). TMC, headquartered in Toyoda City, Japan, is one of the world’s largest automakers. In 2011, TMC sold over 7 million motor vehicles worldwide. In the United States, TMC operates 10 manufacturing plants and directly employs over 29,000 employees. In 2011, TMC sold 1.64 million motor vehicles in the U.S., 70% of which were manufactured domestically. TMCC’s core business is to support the sales of Toyota and Lexus motor vehicles by providing competitively priced retail loans and leases to U.S. consumers. TMCC also provides wholesale financing and certain other financial products and services to authorized Toyota and Lexus motor vehicle dealers, and to a lesser extent to other domestic and import franchised dealers and their customers in the U.S. TMCC is among the ten largest U.S. finance companies as measured by net receivables, with over \$75 billion in assets managed as of December 31, 2011. TMCC sponsors and services trusts that have issued over \$20 billion of publicly registered securities backed by retail motor vehicle loans and over \$3.5 billion of publicly registered securities backed by retail motor vehicle closed-end leases.

TMCC, directly or through a subsidiary, leases motor vehicles manufactured by TMC and its subsidiaries to consumers. In the year ended December 31, 2011, approximately 15% of the motor vehicles sold by TMC in the United States were leased by consumers.

The residual value of a leased motor vehicle is its value at the end of the lease term. The aggregate book value of TMCC’s leased motor vehicles was \$18.5 billion as of December 31, 2011. The majority of this asset represents the expected value of the vehicles at the end of the lease terms.

2. Residual Value Risk.

Residual value risk is the risk that the value of a leased motor vehicle will be lower than expected. The value of a leased motor vehicle, as with all motor vehicles, varies largely with the vagaries of the used car market, which include:

- local, regional and national economic conditions;
- new motor vehicle production disruptions caused by natural disasters;
- the actual or perceived quality, safety or reliability of motor vehicles;
- competitive actions and behavior;
- the mix of used motor vehicle supply;
- the level of current used motor vehicle values; and

- fuel prices.

The impacts of these factors, which are primarily market driven or otherwise outside of the control of a manufacturer or finance company, are difficult to predict. For example, in the summer of 2008, the price of crude oil hit record highs, in excess of \$140 per barrel. Record high crude oil prices translated into much higher fuel prices for consumers. The demand for less fuel efficient vehicles declined and more of these vehicles were returned to the vehicle manufacturers. A combination of these higher return rates and higher losses per returned vehicle resulted in larger residual value losses for vehicle manufacturers. High residual value losses led some automotive finance companies to discontinue or significantly curtail their leasing operations, which in turn led to a reduction in leasing options available to consumers.

In general, a motor vehicle lessor such as TMCC is subject to residual value risk both at the end of the lease term and when the motor vehicle is repossessed following default. At the end of the lease term, the lessee may either purchase the leased motor vehicle or return it to the lessor. If the lessee turns in the motor vehicle, the lessor may either re-lease the used motor vehicle or sell it. If the lessor sells the leased motor vehicle below its book value because that motor vehicle is worth less than was expected at the time of lease inception, then the lessor suffers a loss. In addition, the lessor may suffer a loss if it repossesses the leased motor vehicle after a default and sells it for less than its book value.

In a motor vehicle lease securitization, TMCC or its affiliate typically would retain, directly or indirectly, the residual interest in the special purpose entity (a "Lease SPE") that issues the lease-backed ABS ("Lease ABS"). TMCC or its affiliate also may retain some of the Lease ABS issued in the transaction. Because the residual interest typically bears first losses on the leases, including losses on the projected residual values of the leased motor vehicles, TMCC and its affiliates retain residual value risk when they securitize TMCC's motor vehicle leases.

TMCC or one of its affiliates may enter into Residual Value Hedges to hedge residual value risk with respect to TMCC's broader portfolio of leased motor vehicles. Those motor vehicles may be associated with leases that are not currently securitized and may never be securitized, with leases that are securitized in the future, or with leases that already have been securitized

Hedging residual value risk associated with its portfolio of leased motor vehicles, in an effort to protect against unexpected downward movements in the residual values of leased motor vehicles, is a normal part of the business of manufacturing and leasing motor vehicles. By entering into a Residual Value Hedge, TMCC (as with any other finance affiliate of a manufacturer of motor vehicles) merely wishes to hedge against unexpected losses upon the ultimate sale of the leased motor vehicles that it owns due to unanticipated (and largely unpredictable) movements in the used car market. It would not be entering into a Residual Value Hedge in order to profit at the expense of a holder of Lease ABS issued in a securitization.

Generally, a Residual Value Hedge will not entail complete protection against the risk of residual value loss. A Residual Value Hedge is likely to require the hedging party to retain the risk of first loss, in addition to sharing some of the risk of loss above that.

3. A Residual Value Hedge of Leased Motor Vehicles by Manufacturer, Including Securitized Leased Motor Vehicles, Should Not Be Prohibited.

As described above, a motor vehicle manufacturer or one of its affiliates may enter into a Residual Value Hedge with respect to some or all of its portfolio of leased motor vehicles (or an index of motor vehicles intended to be representative of that portfolio), including motor vehicles associated with leases that already have been securitized or may be securitized in the future, in an effort to hedge against unexpected losses upon the ultimate sale of the leased motor vehicles that it owns due to unanticipated (and largely unpredictable) movements in the used car market. We do not believe that this type of transaction should constitute a prohibited conflict of interest between the investors in the Lease ABS issued in those securitizations and the manufacturer or its affiliate. We ask the Commission to make this clear, either in the final rule or in official interpretive guidance.

TMC is in the business of manufacturing and selling motor vehicles, and TMCC is in the business of financing these motor vehicles. A manufacturer of motor vehicles such as TMC simply has no business incentive to produce malfunctioning motor vehicles with a view toward profiting on low future residual values by means of Residual Value Hedges. To the contrary, all market incentives are for the manufacturer to produce high quality motor vehicles. Likewise, a Residual Value Hedge is not designed for the sponsor of a securitization to profit from the failure of the securitization of leased vehicles – its purpose is to protect it against an ordinary risk inherent in the business of manufacturing and leasing those motor vehicles. For this reason, we do not believe that a Residual Value Hedge by a motor vehicle manufacturer or one of its affiliates should be deemed to give rise to a prohibited conflict of interest.

Even if a Residual Value Hedge by a motor vehicle manufacturer were considered to technically constitute a conflict of interest with respect to holders of its Lease ABS, we do not believe there is a substantial likelihood that a reasonable investor in those Lease ABS would consider it important to his or her investment decision. Because a motor vehicle manufacturer that hedges residual value risk generally will retain the risk of first loss, as well as a loss-sharing component above that, its incentive to minimize residual value losses will continue to align its interests with those of investors in its Lease ABS. Also, because lease securitization structures will continue to include mechanisms that act as credit support for Lease ABS, including credit risk retention by the sponsor, it is unlikely that residual value losses in the securitized lease portfolio will result in losses to investors in Lease ABS.

For these reasons, we urge the Commission to confirm that a Residual Value Hedge entered into by a motor vehicle manufacturer or one of its affiliates in these circumstances is entirely exempt from the application of the final rule, as it simply does not present the types of risks with which Congress was concerned.

4. Residual Value Hedge Structures.

A variety of products and mechanisms may be used to hedge residual value risk.

One possible Residual Value Hedge structure would be the purchase of a residual value insurance policy from a large insurer. This product is not currently available at economic prices, but may be used in the future.

Other Residual Value Hedge structures may include a synthetic transaction (a "Synthetic Residual Value Hedge Transaction") with a special purpose entity (a "Hedge SPE"). The Hedge SPE would write residual value protection to its counterparty (such as TMCC or its affiliate) through a credit default swap, other derivative agreement, financial guaranty or insurance policy. If the future sale price of specific motor vehicles, or some agreed upon index of motor vehicles, is lower than expected ("Loss Amounts"), the Hedge SPE would pay those Loss Amounts to the counterparty to the extent they exceed an agreed-upon threshold (the "Hurdle Amount"). The Hedge SPE would issue securities ("Hedge Securities") to investors to finance payment of its hedge obligations. The proceeds of the Hedge Securities would be held by the Hedge SPE and invested in high quality eligible investments. Payments on the Hedge Securities would be funded by the swap payment or premium paid by the counterparty to the Hedge SPE, and by payments on the eligible investments. To the extent that Loss Amounts exceed the Hurdle Amount, holders of Hedge Securities would suffer a loss. We expect that TMCC or its affiliate would retain the first loss residual interest in the Hedge SPE in any Synthetic Residual Value Hedge Transaction it sponsors.²

A Residual Value Hedge also may protect against residual value risk with respect to motor vehicles associated with a pool of securitized leases, specifically for the benefit of the securitization. Such a Residual Value Hedge may be entered into between the Lease SPE and an external counterparty (an "External SPE Hedge Transaction") such as a Hedge SPE, or be structured entirely within the special purpose entity that issues Lease ABS (an "Internal SPE Hedge Transaction").

In an External SPE Hedge Transaction, the Lease SPE would pay the swap payment or premium to the hedge counterparty (which is likely to be the Hedge SPE in a Synthetic Residual Value Hedge Transaction), and the counterparty would pay to the Lease SPE all Loss Amounts to the extent that they exceed the Hurdle Amount. These payments, together with collections on the leases and motor vehicles beneficially owned by the Lease SPE, would be used by the Lease SPE to fund payments to investors in the Lease ABS and to the owner of the residual interest in the Lease SPE, in accordance with its payment waterfall.³

An Internal SPE Hedge Transaction would effectively imbed a Synthetic Residual Value Hedge Transaction within the special purpose entity that also issues Lease ABS. This special purpose entity (a "Lease/Hedge SPE") would issue two groups of securities. The first group of securities would be Lease ABS. Payments on the Lease ABS would be based primarily on the cash flows from the securitized lease portfolio. The second group of securities would be Hedge Securities. The Hedge Securities would primarily bear the risk of residual value losses. As with a Synthetic

² A graphic illustration of a Synthetic Residual Value Hedge Transaction appears on [Exhibit A](#) to this letter.

³ A graphic illustration of an External Residual Value Hedge Transaction appears on [Exhibit B](#) to this letter.

Residual Value Hedge Transaction, the proceeds of the Hedge Securities would be held by the Lease/Hedge SPE and invested in high quality eligible investments. Payments on the Lease ABS would be funded by collections on the leases and motor vehicles beneficially owned by the Lease/Hedge SPE, less a swap payment or premium for the protection afforded by the Hedge Securities. Payments on the Hedge Securities would be funded by the swap payment or premium for the hedge protection, and by earnings on the eligible investments. The swap payment or premium would be funded by a portion of the collections on the leases and motor vehicles beneficially owned by the Lease/Hedge SPE. The amount of principal paid to holders of the Hedge Securities would be reduced by the Loss Amounts to the extent that they exceed the Hurdle Amount, and this amount would instead be used to fund payments to investors in the Lease ABS and to the owner of the residual interest in the Lease/Hedge SPE, in accordance with its payment waterfall. As with any lease securitization sponsored by TMCC, we expect that it would directly or indirectly retain the residual interest in the Lease/Hedge SPE, and also may retain some of the Lease ABS issued by the Lease/Hedge SPE.⁴

5. A Synthetic Residual Value Hedge Transaction Would Involve Neither the Issuance of an “Asset-Backed Security” Nor a Prohibited Conflict of Interest.

We do not believe that Hedge Securities would constitute “asset-backed securities” within the meaning of the proposed rule. Therefore, we do not believe that receipt by the sponsor of a Synthetic Residual Value Hedge Transaction of hedge payments made by a Hedge SPE would constitute a prohibited conflict of interest with the holder of any Hedge Securities. We ask the Commission to make this clear, either in the final rule itself or in official interpretive guidance.

The proposed rule would apply to any “asset-backed security (as such term is defined in section 3 of the Securities Exchange Act of 1934 . . . , which for the purposes of [the] rule shall include a synthetic asset-backed security).” Neither the proposed rule nor the commentary defines “synthetic asset-backed security,” because the Commission “understand[s] that this term is commonly used and understood by market participants.”⁵ The Commission specifically requests comment on whether this understanding is correct, or whether a definition should be provided.⁶ Whether or not a specific definition of “synthetic asset-backed security” is provided, we believe that Hedge Securities would not constitute synthetic asset-backed securities.

An “asset-backed security” within the meaning of Section 3(a)(79) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”) is “collateralized by . . . self liquidating financial asset[s] . . . that allows the holder of the security to receive payments that depend primarily on cash flows from the asset. . . .”⁷ The Commission has explicitly recognized that motor vehicles do not constitute self-liquidating financial assets in the asset-backed securities context. For a

⁴ A graphic illustration of an Internal SPE Hedge Transaction appears on [Exhibit C](#) to this letter.

⁵ Proposing Release, 76 Fed. Reg. at 60326.

⁶ *Id.*, 76 Fed. Reg. at 60326-27.

⁷ The definition also includes any other security that the Commission determines by rule to be an asset-backed security, but the Commission has not proposed or adopted any such rule that would apply under the proposed conflict of interest rules.

lease-backed security to constitute an asset-backed security under Item 1101(c) of Regulation AB, the residual values of the leased motor vehicles in the pool are required to constitute less than 65% of the securitized pool balance. As noted by the Commission in the adopting release for Regulation AB, the Commission “expand[ed] the definition [of “asset-backed security”] to include securitizations backed by leases where part of the cash flows backing the securities is to come from the disposal of the residual asset underlying the lease,” thereby permitting ABS to be registered on Form S-3 even though they “are not backed solely by financial assets that ‘by their terms convert into cash.’”⁸

Because motor vehicles are “hard assets” rather than self-liquidating financial assets, a direct securitization of motor vehicles clearly would not involve the issuance of an “asset-backed security” within the meaning of Section 3(a)(79) of the Exchange Act. A Synthetic Residual Value Hedge Transaction would be, in essence, a synthetic securitization of motor vehicles. While the assets of a Hedge SPE in a Synthetic Residual Value Hedge Transaction would be invested in eligible investments, some or all of which may be self-liquidating, payments to investors would be based primarily upon the value of a designated portfolio of motor vehicles (or index of motor vehicles). Just as in a direct securitization of motor vehicles, the material risk to investors in the Hedge Securities would be the value of these “hard assets,” not self-liquidating financial assets.

If securities issued in a direct securitization of motor vehicles cannot constitute “asset-backed securities” for purposes of the rule, then neither should synthetic securities in which the reference assets are motor vehicles. For that reason, we ask the Commission to clarify, either in the final rule or official commentary, that receipt by the sponsor of a Synthetic Residual Value Hedge Transaction of hedge payments made by the Hedge SPE would not constitute a prohibited conflict of interest with the holder of any Hedge Securities.

6. A Residual Value Hedge of Securitized Leased Motor Vehicles by a Lease SPE or Lease/Hedge SPE Should Not Be Prohibited.

As noted above, TMCC or an affiliate is expected to retain the residual interest in any Lease SPE or Lease/Hedge SPE it sponsors, and may also retain subordinated Lease ABS issued by that entity. In a typical lease securitization, the risk of first loss on pool assets, including the residual values of the securitized leased motor vehicles, will be borne first by the residual interest, and then by subordinated Lease ABS. Accordingly, payments made as a result of an External SPE Hedge Transaction or Internal SPE Hedge Transaction will reduce losses on the residual interest or subordinated Lease ABS before they reduce losses on more senior Lease ABS. A sponsor or depositor (or an affiliate) that retains the residual interest or subordinated Lease ABS interest could be considered to benefit more directly from the Residual Value Hedge than outside investors in senior Lease ABS. We do not believe that this should constitute a prohibited

⁸ Asset-Backed Securities; Final Rule, SEC Rel. Nos. 33-8518, 34050905, 70 Fed. Reg. 1506, 1519 (Jan. 7, 2005). Because the values of the vehicles in the asset pool underlying a securitization of motor vehicles would constitute significantly more than 65% of the pool balance, a security issued in such a securitization could not constitute an “asset-backed security” under Regulation AB.

conflict of interest, and we ask the Commission to make this clear, either in the final rule itself or in official interpretive guidance.

As stated by the Commission, “[n]othing in the proposed interpretation would prevent a securitization participant from taking positions in which its economic interest would be aligned with the investors in the ABS . . . – such as by purchasing the ABS,”⁹ and “[c]onflicts of interest arising solely among investors in the ABS offering (where investors could include securitization participants, provided these conflicts arise only from their interests as an investor) would also not be covered by the proposed rule.”¹⁰ Based on this guidance, we believe that a conflict of interest arising between investors in senior Lease ABS and a sponsor, depositor or affiliate that retains the residual interest in the Lease SPE or Lease/Hedge SPE and/or subordinated Lease ABS, should not be prohibited.

Moreover, the proposed rule by its terms would apply only when an “underwriter, placement agent, initial purchaser, or sponsor, or any affiliate or subsidiary of any such entity, . . . engage[s] in [a] transaction” that is prohibited. The proposed rule does not cover transactions engaged in by a special purpose securitization vehicle itself. Therefore, an External SPE Hedge Transaction or Internal SPE Hedge Transaction entered into by a Lease SPE or Lease/Hedge SPE should not give rise to a conflict of interest that is within the scope of the rule.

For all of these reasons, we urge the Commission to clarify that when a Lease SPE enters into an External SPE Hedge Transaction or a Lease/Hedge SPE enters into an Internal SPE Hedge Transaction, there is no prohibited conflict of interest between investors in senior Lease ABS and a sponsor, depositor or affiliate that retains a residual interest and/or subordinated Lease ABS.

⁹ *Id.*, 76 Fed. Reg. at 60330.

¹⁰ *Id.*, 76 Fed. Reg. at 60328.

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7. Conclusion.

We thank you for your consideration. Should you have any questions, please contact Reed D. Auerbach of Bingham McCutchen LLP at (212) 705-7400 (or reed.auerbach@bingham.com), or Charles A. Sweet of Bingham McCutchen LLP at (202) 373-6777 (or charles.sweet@bingham.com).

Sincerely,

TOYOTA MOTOR CREDIT CORPORATION

By:



Chris Ballinger

Group Vice President & Chief Financial Officer

Exhibit A

Synthetic Residual Value Hedge Transaction

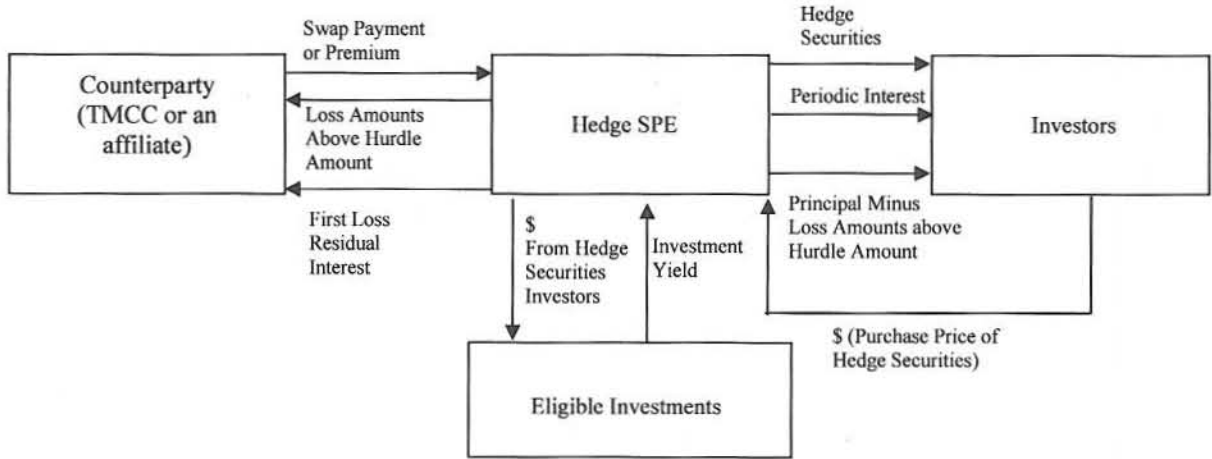


Exhibit B

Internal SPE Hedge Transaction

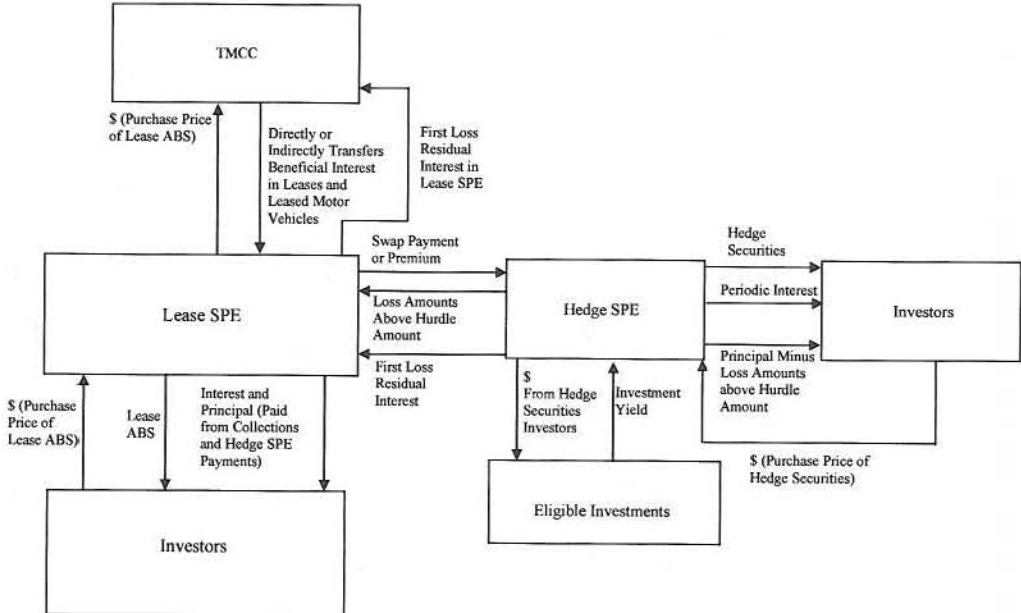


Exhibit C

External SPE Hedge Transaction

