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Regulators Propose "Skin in the Game" Rule

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Introduction

Proposed "Skin in the Game" Rule

Section 941(b) of the Dodd-Frank Act, codified as new Section 15G to the Securities Exchange Act of 1934, requires six Federal agencies—the U.S. Department of the Treasury, Federal Reserve Board, Federal Deposit Insurance Corporation, U.S. Securities and Exchange Commission, Federal Housing Finance Agency, and Department of Housing and Urban Development (collectively, the "Agencies")—jointly to prescribe regulations requiring increased credit risk retention for securitizers of asset-backed securities and limiting the hedging or transferring of securitizers' retained risk.[1] Section 15G generally requires securitizers of asset-backed securities ("ABS")[2] to retain an unhedged five percent economic interest in the credit risk of securitized assets, but authorizes several exemptions from the general risk retention requirement. These include an exemption for securities collateralized by "qualified residential mortgages," which must be underwritten pursuant to specific standards established by regulation, as well as exemptions for certain other asset classes.

To implement section 941, the Agencies recently issued a proposed rulemaking on Credit Risk Retention, seeking public comment by **June 10, 2011.** While the Agencies satisfied the section 941 requirement for issuing regulations within 270 days of enactment, the effective date of any rule will not occur until one year after publication of a final rule in the *Federal Register* for securitizers and originators of asset-backed securities backed by residential mortgages and two years after publication of a final rule for securitizers and originators of all other classes of asset-backed securities.

As proposed, the new rules would profoundly impact mortgage origination by insured depository institutions, non-bank lenders and mortgage servicers, by requiring significant changes to long-standing securitization practices. Accordingly, mortgage industry participants should proactively review the proposed rule and provide comments to the Agencies with respect to the impact of the proposal on their operations. Specifically, the proposal seeks public input on 174 individual questions, which are set forth in Appendix A.

Section 941 is based on concerns that during the period leading up to the recent financial crisis, mortgage originators "retain[ed] little or no continuing exposure to loans they originate[d] for securitization." The result was a focus on mortgage origination volume rather than viable underwriting, decreased transparency in the securitization process, and complicated loss mitigation actions.[3] Section 941 and the proposed rule seek to address these perceived abuses by forcibly realigning market incentives and instilling greater discipline in the mortgage origination process by ensuring that participants maintain "skin in the game."[4]

The risk retention rule required by section 941 has the potential to constitute the most sweeping and profound of all reforms required by the Dodd-Frank Act, significantly impacting both the secondary market and mortgage lending in this country for years. It will be critically important for banks, thrifts, mortgage lenders, securitizers, rating agencies, investment banking firms, mutual funds, private equity firms, insurance companies, and pension plans, among others, to carefully review and understand the implications of the Proposed Rule.

General Risk Retention Requirement

Under the proposed rule, securitizers[5] must retain an economic interest in the credit risk of the assets collateralizing the issuance of an ABS. In particular, securitizers are required to retain a base interest of five percent of the aggregate credit risk of assets transferred, sold, or conveyed to a third party in an ABS issuance, unless an exemption from the risk retention requirements is otherwise available. The five percent requirement is a minimum, and a party to a securitization may retain or be required to retain additional exposure to credit risks beyond five percent. A sponsor/securitizer would also be prohibited from hedging or otherwise transferring this retained interest.

For transactions in which an originator contributed at least 20 percent of the assets, a securitizer can allocate a portion of the credit risk it is required to retain to the originator of the securitized assets. Additionally, to limit the practice of securitizers receiving "excess spread,"[6] a sponsor may be required to fund an additional "premium capture cash reserve account"[7] in connection with a securitization transaction. Securitizers would also be required to disclose to investors material information concerning their retained interests in a securitization transaction.

Under the proposal, the risk retention requirements can be satisfied through one of several options, including but not limited to:

- a "vertical" slice of the ABS interest, whereby the securitizer retains a specified pro rata piece of every class of interests issued in the transaction;
- a "horizontal" first-loss position, whereby the entity retains a subordinate interest in the issuing entity that bears losses on the assets before any other classes of interests;
- an "L-shaped" interest, which would allow an entity, subject to certain conditions, to use an equal combination of vertical and horizontal risk retention;
- a "seller's interest" in securitizations structured using a master trust collateralized by revolving assets whereby an entity holds a separate interest that is *pari passu* with the investors' interest in the pool of receivables, unless and until the occurrence of an early amortization event; or
- retention of a representative sample of the assets to be securitized that exposes the securitizer to credit risk equivalent to that of the securitized assets.

While these risk retention options apply to residential mortgages, the proposal also sets forth risk retention options specifically designed for structures involving asset-backed commercial paper and commercial mortgage-backed securities. Certain credit risk retention requirements also apply to Fannie Mae and Freddie Mac, although the requirements are deemed satisfied while these entities are operating under conservatorship or receivership of the Federal Housing Finance Agency with capital support from the United States.

Exemption for Qualified Residential Mortgages

Notwithstanding the general requirements, the heart of the proposed rule centers on its exemptions, primary among these being the Qualified Residential Mortgage ("QRM") exemption. The proposal provides a complete exemption from the risk retention requirements for securitizations solely involving QRMs. Because a sponsor will not be required to retain any portion of the credit risk associated with a QRM securitization, the underwriting standards are designed to ensure that the underlying mortgages are of very high credit quality. This is accomplished by the rule's restrictive definition of a QRM, which is limited to:

- a closed-end first-lien mortgage;
- used to purchase or refinance a one-to-four family property;
- at least one unit of which is the principal dwelling of a borrower; and
- the property is perfected in accordance with applicable law.

QRMs exclude bridge loans, loans used to purchase time-share properties, and reverse mortgages, in part to limit the complexity of underwriting the QRMs.

Eligibility Requirements for QRMs

The proposed rule imposes additional eligibility requirements for QRMs, including:

- a loan-to-value ("LTV") ratio of 80 percent for purchase mortgage transactions and a combined LTV ratio cap of 75 percent on rate and term refinance loans and 70 percent for cash-out refinance loans;
- borrowers must provide a cash down payment;[8]
- a qualifying appraisal that conforms to generally accepted appraisal standards;
- a front-end debt-to-income ("DTI") ratio limit of 28 percent and a back-end limit of 36 percent, as calculated using the borrower's monthly gross income and as verified and documented by the originator; and
- total points and fees payable by the borrower of not more than three percent of the total loan amount, calculated in the same manner as in Regulation Z.

QRMs would be restricted from payment terms allowing for interest-only payments, negative amortization, balloon payments, or any prepayment penalty. While fixed- and adjustable-rate mortgages ("ARMs") could both qualify as QRMs, interest rate adjustments on ARMs would be limited to avoid the potential for consumer payment shock following the expiration of a "teaser rate" period. An increase could not exceed: (a) 200 basis points in any twelve month period and (b) 600 basis points over the life of the mortgage transaction. Finally, QRMs would not be assumable by any person who was not a borrower under the original mortgage transaction.

While the current challenges facing the mortgage servicing industry were not an impetus for Section 941, the Agencies have boot-strapped mortgage servicing standards to the QRM definition as a means to develop and implement comprehensive national mortgage servicing standards. As a result, the originator of a QRM would be required to incorporate certain servicing policies and procedures for loss mitigation into its mortgage transaction documents. These would require that a servicer promptly initiate loss mitigation activities, such as engaging in loan modifications, within 90 days of a loan becoming delinquent.

QRM Transaction Requirements

Two additional requirements for a securitization to qualify for the QRM exemption relate to performance and verification. First, at closing of the securitization, each QRM must be currently performing (i.e., the borrower is not 30 days or more past due, in whole or in part, on the mortgage). Second, the depositor for the ABS must certify to potential investors prior to sale that it evaluated and determined the effectiveness of its internal supervisory controls for ensuring that all of the assets collateralizing the ABS are QRMs.

A sponsor relying on the QRM exemption in a securitization would not lose the exemption if, after closing, it is determined that one or more of the mortgages collateralizing the ABS do not meet all of the criteria to be a QRM if:

- the depositor provided the required certification regarding the effectiveness of its internal supervisory controls in ensuring that all of the loans collateralizing the ABS are QRMs;
- the sponsor must repurchase from the issuer, within 90 days of the determination that a loan does not qualify as a QRM, at a price at least equal to the remaining principal balance and accrued interest on the loan; and
- the sponsor must promptly notify all investors regarding any loans that are required to be repurchased, including the principal amount of the loans and the cause for repurchase.

QRM Borrower Credit History

The proposal does not include a borrower credit score threshold in the QRM underwriting standards. Instead, the rule defines a set of “derogatory factors” relating to a borrower that would disqualify a borrower’s mortgage from qualifying as a QRM. In particular, an originator would be required to verify with at least two consumer credit rating agencies, and document within 90 days prior to the closing of the mortgage transaction, that a borrower satisfies all of the following requirements:

- currently, borrower is not 30 or more days past due, in whole or in part, on any debt;
- within the preceding 24 months, borrower was not 60 or more days past due, in whole or in part, on any debt; and
- within the preceding 36 months, borrower was not a debtor in a bankruptcy proceeding, did not have property repossessed or foreclosed upon, was not involved in a short sale or deed-in-lieu of foreclosure, and was not subject to a judgment for collection of any unpaid debt.

Reduced Risk Retention for Qualifying Commercial Real Estate, and Commercial and Automobile Loans

Similar to QRMs, the proposed rule does not require a securitizer to retain any portion of the credit risk associated with a securitization of “qualifying” commercial loans, commercial mortgages or automobile loans that meet conservative underwriting standards specified by the Federal banking agencies. For a commercial loan to be considered “qualifying,” the originator must verify and document the borrower’s ability to repay and the transaction documentation must include covenants restricting the borrower’s ability to incur additional debt or transfer or pledge its assets. Similar underwriting standards are imposed on commercial real estate (“CRE”) and automobile loans, which also include an LTV ratio requirement; consideration of the value of, and the originator’s security interest in, the collateral; whether the loan documentation includes the appropriate risk management and monitoring requirements; and a requirement for fixed interest rates for automobile loans.

Similar to the repurchase requirement for QRMs, the proposed rule requires the buy-back of qualifying CRE, commercial and automobile loans that are subsequently determined to be in conflict with the applicable underwriting requirements.

General Exemptions

In addition to the exemptions discussed above, certain other ABS and securitization transactions are completely exempt from the proposed risk retention requirement. These include:

- Federally insured or guaranteed residential, multifamily, and health care mortgage loan assets;
- ABS collateralized solely by obligations issued by the U.S. or an agency of the U.S.;
- ABS collateralized solely by assets that are fully insured or guaranteed by the U.S. or an agency of the U.S.;
- ABS fully guaranteed as to the timely payment of principal and interest by the U.S. or an agency of the U.S.;
- securitizations collateralized solely by loans or other assets made, insured, guaranteed, or purchased by an institution subject to supervision of the Farm Credit Administration, including the Federal Agricultural Mortgage Corporation;
- ABS in which the security is issued or guaranteed by a State, political subdivision, or public instrumentality thereof that is exempt from registration under the Securities Act of 1933;
- ABS in which the security is defined as a qualified scholarship funding bond;[9]
- certain resecuritization transactions;[10] and
- certain foreign-related transactions that fall within a designated safe harbor provision.[11]

The proposed rule provides that the Agencies may jointly adopt or issue additional exemptions, exceptions or adjustments to the credit risk retention requirements.

Request for Comment

Pursuant to the proposal, the Agencies are seeking comment on an unprecedented 174 specific questions. Notwithstanding the comprehensive nature of the proposed rule, the Agencies are seeking through the comment process a better understanding of the industry and the market implications of the proposal consistent with their statutory responsibilities to adopt rules to implement section 941.

The questions set forth by the Agencies include a wide range of inquiry covering all aspects of the proposed standards, ranging from the sufficiency of the defined terms to the appropriateness of the standards posed for varying classes of assets. Notwithstanding the volume, each question raises important issues regarding loan origination and securitization.

Action Plan

Mortgage loan originators and securitizers should solidify an action plan anticipating the implementation of the proposed risk retention changes. We recommend that your action plan include:

- a careful review of the proposed rule and the specific questions posed by the Agencies, which are set forth in Appendix A to this alert;

- review of your current underwriting, sales, and securitization practices and the wide range of regulatory implications in light of the proposed rule;
- providing your views and concerns on the relevant questions posed by submitting a comment letter to the Agencies by the June 10, 2011 deadline.

Paul Hastings attorneys are actively working with clients to identify and address the impact of the Proposed Rule on their operations, and to assist in drafting comments to provide to the Agencies.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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[1] Joint Press Release, Agencies Seek Comment on Risk Retention Proposal (March 31, 2011), *available at* http://fdic.gov/news/board/29Marchno2.pdf.

[2] An asset-backed security is defined as "a fixed-income or other security collateralized by any type of self-liquidating financial asset (including a loan, lease, mortgage, or other secured or unsecured receivable) that allows the holder of the security to receive payments that depend primarily on cash flow from the asset." *See* 15 U.S.C. § 78c(a)(77).

[3] Memorandum from Michael H. Krimminger to the Board of Directors, FDIC, Notice of Proposed Rulemaking to Implement Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act at 5 (Credit Risk Retention) (March 21, 2011).

[4] *See* S. Rep. No. 111-176, at 129 (2010).

[5] The term "securitizer" includes both "(A) an issuer of an asset-backed security; or (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." 15 U.S.C. § 78o-11(a)(3). For purposes of Section 15G, a "sponsor" of an ABS transaction is a "securitizer."

[6] *See* n. 18 of Preamble to the Proposed Rule.

[7] *See* Part III.B.9 (premium capture cash reserve account) of Preamble to the Proposed Rule.

[8] The down payment must be in an amount equal to at least the sum of:

(i) the closing costs payable by the borrower in connection with the transaction;

(ii) 20 percent of the lesser of the estimated value of the property as determined by a qualifying appraisal, and the purchase price of the property to be paid in connection with the transaction; and

(iii) if the estimated market value is less than the purchase price to be paid in connection with the transaction, the difference between these amounts.

[9] *See* 26 U.S.C. 150(d)(2) (bonds issued by a not-for-profit corporation operated exclusively for the purpose of acquiring student loans and organized at the request of a State or political subdivision thereof).

[10] The resecuritization transaction must meet two requirements: (i) the transaction must be collateralized solely by existing ABS issued in a securitization transaction for which credit risk was retained as required under the rule or which was exempted from the requirements of the rule, and (ii) the transaction must be structured so that it involves the issuance of only a single class of ABS interests and provides for the pass-through of all principal and interest payments received on the underlying ABS to the holders of such class.

[11] Requirements for the safe harbor provision include:
(i) the securitization transaction is not required to be and is not registered under the Securities Act of 1933;
(ii) no more than 10 percent of the dollar value by proceeds (or equivalent if sold in a foreign currency) of all classes of ABS interests sold in the securitization transaction are sold to U.S. persons or for the account or benefit of U.S. persons;
(iii) neither the sponsor of the securitization transaction nor the issuing entity is (A) chartered, incorporated, or organized under the laws of the U.S., or a U.S. State or Territory or (B) the unincorporated branch or office located in the U.S. of an entity not chartered, incorporated, or organized under the laws of the U.S., or a U.S. State or Territory (collectively, a U.S.-located entity);
(iv) no more than 25 percent of the assets collateralizing the ABS sold in the securitization transaction were acquired by the sponsor, directly or indirectly, from a consolidated affiliate of the sponsor or issuing entity that is a U.S.-located entity.

Appendix A – Regulators Propose “Skin in the Game” Rule

Pursuant to the proposal, the Agencies are seeking comment on an unprecedented 174 specific questions. Notwithstanding the comprehensive nature of the proposed rule, the Agencies are seeking through the comment process a better understanding of the industry and the market implications of the proposal consistent with their statutory responsibilities to adopt rules to implement section 941. The Agencies specifically seek comment on the following issues:

General

1. Do the proposed rules appropriately implement the terms “securitizer” and “originator” as used in section 15G and consistent with its purpose?

2. Are there other terms, beyond those defined in §__.2 of the proposed rules, that the Agencies should define?

3. (a) As a general matter, is it appropriate to impose the risk retention requirements on the sponsor of an ABS transaction, rather than the depositor for the transaction?
(b) If not, why?

4. (a) With respect to the terms defined, would you define any of the terms differently?
(b) If so, which ones would you define differently, and how would you define them? For example, credit risk is defined to mean, among other things, the risk of loss that could result from failure of the issuing entity to make required payments or from bankruptcy of the issuing entity.

5. Is it appropriate for the definition of credit risk to include risk of non-payment by the issuing entity unrelated to the assets, such as risk that the issuing entity is not bankruptcy remote?

6. Are all of the definitions in §__.2 of the proposed rules necessary? For instance, is a definition of "asset" necessary?

7. (a) As proposed, where two or more entities each meet the definition of sponsor for a single securitization transaction, the proposed rules would require that one of the sponsors retain a portion of the credit risk of the underlying assets in accordance with the requirements of the rules. Is this the best approach to take when there are multiple sponsors in a single securitization transaction?

(b) If not, what is a better approach and why? For example, should all sponsors be required to retain credit risk in some proportional amount, should the sponsor selling the greatest number of assets or with a particular attribute be required to retain the risk, or should the proposed rules only allow a sponsor that has transferred a minimum percentage (e.g., 10 percent, 20 percent, or 50 percent) of the total assets into the trust to retain the risk?

8. (a) Should the proposed rules allow for allocation of risk to a sponsor (among multiple sponsors in a single transaction) similar to the proposed rules' parameters for allocation of risk among multiple originators?

(b) Why or why not?

9. A securitization transaction is proposed to be defined as a transaction involving the offer and sale of asset-backed securities by an issuing entity. In a single securitization transaction, there may be intermediate steps; however, the proposed rules would only require the sponsor to retain risk for the securitization transaction as a whole.[1] Should the rules provide additional guidance for when a transaction with intermediate steps constitutes one or more securitization transactions that each should be subject to the rules' risk retention requirements?

Risk Retention Requirement

10. The Agencies request comment on whether the minimum five percent risk retention requirement established by the proposed rules for non-exempt ABS transactions is appropriate, or whether a higher risk retention requirement should be established for all non-exempt ABS transactions or for any particular classes or types of non-exempt ABS.

11. If a higher minimum requirement should be established, what minimum should be established and what factors should the Agencies take into account in determining that higher minimum? For example, should the amount of credit risk be based on expected losses, or a market-based test based on the interest rate spread relative to a benchmark index?

12. (a) Would the minimum five percent risk retention requirement, as proposed to be implemented, have a significant adverse effect on liquidity or pricing in the securitization markets for certain types of assets (such as, for example, prudently underwritten residential mortgage loans that do not satisfy all of the requirements to be a QRM)?

(b) If so, what markets would be adversely affected and how? What adjustments to the proposed rules (e.g., the minimum risk retention amount, the manner in which credit exposure is measured for purposes of applying the risk retention requirement, or the form of risk retention) could be made to the proposed rules to address these concerns in a manner consistent with the purposes of section 15G? Please provide details and supporting data.

Permissible Forms of Risk Retention

13. Is the proposed menu of options approach to risk retention, which would allow a sponsor to choose the form of risk retention (subject to all applicable terms and conditions), appropriate?

14. (a) Should the Agencies mandate that sponsors use a particular form of risk retention (e.g., a vertical slice or a horizontal slice) for all or specific types of asset classes or specific types of transactions?
(b) If so, which forms should be required for with which asset classes and why?

15. Does the proposed menu approach achieve the objectives of the statute to provide securitizers an incentive to monitor and control the underwriting quality of securitized assets and help align incentives among originators, sponsors, and investors?

16. Is each of the proposed forms of risk retention appropriate? In particular, the Agencies seek comment on the potential effectiveness of the proposed forms of risk retention in achieving the purposes of section 15G, their potential effect on securitization markets, and any operational or other problems these forms may present.

17. Are there any kinds of securitizations for which a particular form of risk retention is not appropriate?

18. How effective would each of the proposed risk retention options be in creating incentives to monitor and control the quality of assets that are securitized and in aligning the interests among the parties in a securitization transaction?

19. (a) Are there other forms of risk retention that the Agencies should permit?
(b) If so, please provide a detailed description of the form(s), how such form(s) could be implemented, and whether such form(s) would be appropriate for all, or just certain, classes of assets.

20. Should the proposed rules require disclosure as to why the sponsor chose a particular risk retention option?

21. (a) Are there ways that sponsors could avoid the risk retention requirements in an effort to reduce or eliminate their risk retention requirements?
(b) If so, how should we modify the proposed rules to address this potential?

22. Are the methodologies proposed for calculating the required five percent exposure under each of the options appropriate?

23. (a) Are there other ways that the minimum five percent requirement should be calculated?
(b) Would such calculation methods be difficult to enforce?
(c) If so, how can we address those difficulties?
(d) Are there other alternatives?

Vertical Risk Retention

24. Are the disclosures proposed sufficient to provide investors with all material information concerning the sponsor's retained interest in a securitization transaction, as well as to enable investors and the Agencies to monitor the sponsor's compliance with the rule?

25. (a) Should additional disclosures be required?
(b) If so, what should be required and why?

26. Are there any additional factors, such as cost considerations, that the Agencies should consider in formulating an appropriate vertical risk retention option?

Horizontal Risk Retention

27. Do the conditions and limitations in the proposed rules effectively limit the ability of the sponsor to structure away its risk exposure?

28. (a) Is the restriction on certain payments to the sponsor with respect to the eligible horizontal residual interest appropriate and sufficient?
(b) Why or why not?

29. (a) Is the proposed approach to measuring the size of horizontal risk retention (five percent of the par value of all ABS interests in the issuing entity that are issued as part of the securitization transaction) appropriate?
(b) Would a different measurement be better? Please provide details and data supporting any alternative measurements.

30. Are the disclosures proposed sufficient to provide investors with all material information concerning the sponsor's retained interest in a securitization transaction, as well as enable investors and the Agencies to monitor whether the sponsor has complied with the rule?

31. (a) Should additional disclosures be required?
(b) If so, what should be required and why?

32. Are there any additional factors, such as accounting or cost considerations that the Agencies should consider with respect to horizontal risk retention?

33. Should a sponsor be prohibited from utilizing the horizontal risk retention option if the sponsor (or an affiliate) acts as servicer for the securitized assets?

34. Are the terms and conditions of the horizontal cash reserve account appropriate?

35. Do the terms and conditions ensure that such an account will expose the sponsor to the same type and amount of credit risk and have the same incentive effects as an eligible horizontal residual interest?

36. (a) Should the eligible horizontal residual interest be required to be structured as a "Z bond" such that it pays no interest while principal is being paid down on more senior interests?
(b) Why or why not?

L-Shaped Risk Retention

37. Are the disclosures proposed sufficient to provide investors with all material information concerning the sponsor's retained interest in a securitization transaction, as well as enable investors and the Agencies to monitor whether the sponsor has complied with the rule?

38. (a) Should additional disclosures be required?
(b) If so, what should be required and why?

39. Are there any additional factors, such as cost considerations, that the Agencies should consider with respect to L-shape risk retention?

40. (a) Should the Agencies permit or require that a higher proportion of the risk retention held by a sponsor under this option be composed of a vertical component or a horizontal component?
(b) What implications might such changes have on the effectiveness of the option in helping achieving the purposes of section 15G?

Revolving Asset Master Trusts (Seller's Interest)

41. (a) Should a sponsor of a revolving asset master trust be permitted to satisfy its base risk retention requirement by retaining the seller's interest, as proposed?
(b) Why or why not?

42. (a) Are there additional or different conditions that should be placed on this option?
(b) If so, please explain in detail what other conditions would be appropriate.

43. Are there alternative methods of structuring risk retention for revolving asset master trust securitization transactions that should be permitted? Provide detailed descriptions and data or other support for any alternatives.

44. Are the proposed disclosures sufficient to provide investors with all material information concerning the sponsor's retained interest in a securitization transaction, as well as enable investors and the Agencies to monitor whether the sponsor has complied with the rule?

45. (a) Should additional disclosures be required?
(b) If so, what should be required and why?

46. Should a seller's interest form of risk retention be applied to any other types of securitization transactions? If so, explain in detail and provide data or other support for application to other types of securitization transactions.

Representative Sample

47. Should we include the representative sample alternative as a risk retention option?

48. Are the mechanisms that we have proposed adequate to ensure monitoring of the randomization process if such an alternative were permitted?

49. Is the requirement that the designated pool contain at least 1,000 assets appropriate, or should a greater number of assets be required or a lesser number be permitted?

50. Are there material characteristics other than the average unpaid principal balance of all the assets that should be identified in the rule for purposes of the equivalent risk determination and disclosure requirements?

51. Are there any better ways to ensure an adequate randomization process and the equivalence of the representative sample to the pool of securitized assets? For example, would it be appropriate and sufficient if the sponsor were required to use a third party to conduct the random selection with no subsequent testing to determine if the sample constructed has material characteristics equivalent to those of the securitized assets?

52. (a) Alternatively, would it be adequate if the sponsor was required to provide a third-party opinion that the selection process was random and that retained exposures are equivalent (i.e., share a similar risk profile) to the securitized exposures?
(b) Would this opinion resemble a credit rating, thereby raising concerns about undue reliance on credit ratings?
(c) If this approach were adopted, should the Agencies impose any standards of performance to be followed by such a third party, or that such third party have certain characteristics?

53. If the Agencies adopt a representative sample option, should the same disclosures be required regarding the securitized assets subject to risk retention that are required for the assets in the pool at the time of securitization and on an ongoing basis?

54. Should the retained exposures, as proposed, be subject to the same servicing standards as the securitized exposures?

55. Are the disclosures proposed sufficient to provide investors with all material information concerning the sponsor's retained interest in a securitization transaction, as well as enable investors and the Agencies to monitor whether the sponsor has complied with the rule?

56. (a) Should additional disclosures be required?
(b) If so, what should be required and why?

57. (a) Is the condition that a sponsor obtain an agreed upon procedures report from an independent, public accounting firm appropriate?
(b) If not, is there another mechanism that should be included in the option that helps ensure that the sponsor has constructed the representative sample in conformance with the requirements of the rule?

58. (a) Is the requirement that the sponsor determine equivalency with a 95 percent two-tailed confidence appropriate?
(b) If not, what measurement of equivalency do you recommend and why?

Asset-Backed Commercial Paper Conduits

59. Is the proposed risk retention option for eligible ABCP conduits appropriate?

60. (a) Have the Agencies appropriately defined the terms (such as an eligible ABCP conduit, intermediate SPV and originator-seller) that govern use of this option?
(b) Is the foregoing description of ABCP structures accurate?

(c) Are there additional ABCP structures that are not easily adaptable to the risk retention options proposed?

(d) If so, should the proposed ABCP option be revised to include these structures and if so, how?

61. Should the proposed option for securitizations structured using ABCP conduits require financial disclosure regarding the liquidity provider?

62. (a) Also, should other entities be permitted to be liquidity providers for purposes of the rule? For example, should the rule permit an insurance company to be an eligible liquidity provider if the company is in the business of providing credit protection (such as a bond insurer or re-insurer) and is subject to supervision by a State insurance regulator or is a foreign insurance company subject to comparable regulation to that imposed by U.S. insurance companies?

(b) Why or why not?

63. In addition, the Agencies seek confirmation that the terms of this option effectively prevent structures such as SIVs and ABCP programs that operate as arbitrage programs from using this option.

64. Should the rule, as proposed, allow the liquidity provider to be a depository institution holding company or a subsidiary of a depository institution instead of just the depository institution?

65. Are the disclosures proposed sufficient to provide investors with all material information concerning the originator-seller that will retain an interest in the securitization transaction and of each regulated liquidity provider that provides liquidity support to the eligible ABCP conduit, as well as enable investors and the Agencies to monitor whether the sponsor has complied with the rule?

66. (a) Should additional disclosures be required?

(b) If so, what should be required and why?

(c) For example, should a sponsor be required to disclose the material assumptions and methodology used in determining the aggregate dollar amount of interests issued by each intermediate SPV?

(d) Would such a disclosure be beneficial to investors?

(e) In light of the broad range of asset classes that underlie ABCP conduits, would such a disclosure pose any operational or other challenges for sponsors of ABCP conduits?

67. (a) Should we, as proposed, require that the ABCP be for a term of 270 days or less?

(b) Should we allow for a longer term, such as up to one year?

Commercial Mortgage-Backed Securities

68. (a) Should the rules allow a third-party purchaser to retain the required amount of risk in a CMBS transaction as described above?

(b) Why or why not?

69. (a) Should a third-party purchaser option be available to other asset classes besides CMBS? Would expanding this option to other asset classes fulfill the purposes of section 15G?

(b) If so, would any adjustments or requirements be necessary?

70. Should the use of this option be conditioned, as proposed, on a requirement that the third-party purchaser separately examine the assets in the pool and/or not sell or hedge the interest it is required to retain?

71. (a) Should the use of this option be conditioned, as proposed, on the requirement that the sponsor disclose the actual purchase price paid by the third-party purchaser for the eligible horizontal residual interest?

(b) Why or why not?

72. Is any disclosure concerning the financial resources of the third-party purchaser necessary in light of the requirement that the third-party purchaser fund the acquisition of the eligible horizontal residual interest in cash without direct or indirect financing from a party to the transaction?

73. (a) Should the rule specify the particular types of information about a third-party purchaser that should be disclosed, rather than requiring disclosure of any other information regarding the third-party purchaser that is material to investors in light of the circumstances of the particular securitization transaction?

(b) Should the specific types of information about a third-party purchaser be in addition to any other information regarding the third-party purchaser that is material to investors in light of the circumstances of the particular securitization transaction?

74. Are the conditions relating to servicing, including those related to an Operating Advisor, appropriate or should they be modified or supplemented?

75. Should the Agencies require any other disclosure relating to representations and warranties concerning the assets for CMBS?

76. (a) We are aware of at least one industry group developing model representations and warranties for CMBS.[2] Should the rule require that a blackline of the representations and warranties for the securitization transaction against an industry-accepted standard for model representations and warranties be provided to investors at a reasonable time prior to sale?

(b) Would this provide more information regarding the adequacy of the representation and warranties being provided?

(c) Would this be a costly requirement?

(d) Could investors easily create their own blacklines if needed?

77. Are the disclosures proposed sufficient to provide investors with all material information concerning the third-party purchaser's retained interest in the securitization transaction, as well as to enable investors and the Agencies to monitor whether the sponsor has complied with the rule?

78. (a) Should additional disclosures be required?

(b) If so, what should be required and why?

Government-Sponsored Enterprises

79. Is our proposal regarding the treatment of the Enterprises appropriate?

80. Would applying the hedging prohibition to all of the credit risk that the Enterprises are required to retain when using § ___.11 to satisfy the risk retention requirements be an unduly burdensome result for the Enterprises?

81. (a) Instead of the broad exception from the hedging prohibition for the Enterprises, when satisfying the risk retention requirements pursuant to § ___.11, should the rules prohibit an Enterprise from hedging five percent of the total credit risk in any securitization transaction where the Enterprise acts as a sponsor (thus ensuring the Enterprise retains at least that amount of exposure to the credit risk of the assets)?

(b) Would this be consistent with statutory intent?

(c) Would that be feasible for the Enterprises to monitor?

Cash Reserve Accounts

82. Do you believe the premium capture cash reserve account will be an effective mechanism at capturing the monetization of excess spread, promoting sponsor monitoring of credit quality, and promoting the sound underwriting of securitized assets?

83. The Agencies seek input on alternative methods for removing incentives to monetize excess spread and whether the proposed premium capture reserve account would have any adverse effects on securitizations that are inconsistent with the purposes of section 15G. For example, is the method of calculating the premium capture cash reserve account appropriate or are there alternative methodologies that would better achieve the purpose of the account?

84. Should amounts from the premium capture reserve account be used only for amounts due to the senior-most class of ABS interests?

85. (a) Alternatively, are the conditions imposed on the premium capture cash reserve account more than what is needed to achieve the objectives of the account?

(b) If so, how?

Allocation to the Originator

86. (a) Should the proposed rules permit allocation to originators where the sponsor is using other menu options, such as the L-shaped risk retention option in § __6. of the proposed rules, and if so, under what specific conditions and requirements?

(b) In what cases is it likely that this alternative approach actually would be used?

(c) What are the specific benefits of an alternative approach, and do they outweigh concerns regarding complexity?

87. Should the rule permit allocation to originators if the sponsor elects the horizontal cash reserve account option in proposed § __.5(b)?

88. (a) Should the proposed rules permit allocation of risk to originators that have originated less than 20 percent of the asset pool?

(b) Alternately, is the minimum 20 percent threshold sufficient to ensure that an originator allocated risk has an incentive to monitor the quality of the entire collateral pool?

89. (a) Are there alternative mechanisms for allocating risk to an originator that should be permitted by the Agencies? For example, should the rules permit or require that an originator that is

allocated risk retention by a sponsor retain exposure only to the assets that the originator itself originates?

(b) If so, how might such an allocation mechanism feasibly be structured, incorporated into the rule, and monitored by investors and supervisors?

90. Should the rules permit sponsors to allocate risk to a third party, and if so, how to ensure that incentives between the sponsor and investors are aligned in a manner that promotes quality underwriting standards?

91. Are the proposed disclosures sufficient to provide investors with all material information concerning the originator's retained interest in a securitization transaction, as well as to enable investors to monitor the originator(s) and the Agencies to assess the sponsor's compliance with the rule?

92. (a) Should additional disclosures be required?

(b) If so, what should be required and why?

93. (a) As proposed, the retaining sponsor is responsible for compliance with the rule and must maintain and adhere to policies and procedures reasonably designed to monitor compliance by each originator retaining credit risk, including the anti-hedging restrictions.

(b) What are the practical implications if the originator fails to comply?

94. (a) To help ensure that the originator has sufficient incentive to retain its interest in accordance with the rule, should the rule require that a sponsor obtain a contractual commitment from the originator to retain the interest in accordance with the rule?

(b) If so, how should the Agencies implement this requirement?

95. Are there other methods that could be implemented to help ensure that a sponsor satisfies its obligations under the rule?

Hedging, Transfer, and Financing Restrictions

96. (a) Under the proposal, a sponsor would not be permitted to 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 affiliated. Is the permitted transfer to consolidated affiliates appropriate?

(b) Why or why not?

97. Is the proposed hedging prohibition appropriately structured?

98. (a) Would the proposal inadvertently capture any kinds of hedging that should be permissible?

(b) If so, please provide specific recommendations on how we can appropriately tailor the requirements.

99. Does the proposed approach appropriately implement the statutory requirement to prohibit direct and indirect hedging?

100. (a) Does the proposal permit hedging that is inconsistent with risk retention and should be prohibited?

(b) If so, please provide specific recommendations on how we can more appropriately tailor the requirements.

101. Are the proposed provisions concerning the pledging of retained assets appropriate? Should the rule instead prohibit the pledging of retained assets even where the financial transaction is recourse to the sponsor or consolidated affiliate?

102. (a) Under the proposal, a sponsor (or a consolidated affiliate) would be prohibited from transferring the retained interest or assets until the retained interest or assets were fully repaid or extinguished. Is this appropriate, or should a sponsor be permitted to freely transfer or hedge its retained exposure after a specified period of time?

(b) If so, should a period of time be established for different types of securitizations?

103. Are the proposal's requirements pertaining to index hedging appropriate?

104. Are the 10 percent and 20 percent thresholds discussed above consistent with market practice and the underlying goals of the statutory risk retention requirements?

105. Should credit protection and hedging by the issuing entity of any portion of the credit risk on the securitized assets be permitted or, because such credit protection and hedges could limit the incentive of investors to conduct due diligence on the securitized assets, should all credit protection and hedging by the issuing entity (other than interest rate and currency risk) be prohibited?

Overall Approach to Defining QRMs

106. Is the overall approach taken by the Agencies in defining a QRM appropriate?

107. What impact might the proposed rules have on the market for securitizations backed by QRM and non-QRM residential mortgage loans?

108. What impact, if any, might the proposed QRM standards have on pricing, terms, and availability of non-QRM residential mortgages, including to low and moderate income borrowers?

109. (a) The Agencies seek general comment on the overall approach of using certain longstanding HUD standards for certain definitions and standards within the QRM exemption and whether the Agencies should adopt a different approach.

(b) Are there any other existing, transparent, and widely recognized standards that the Agencies should use for ensuring that lenders follow consistent and sound processes in determining whether a residential mortgage loan meets the qualifications for a QRM?

110. The Agencies seek comment on all aspects of the proposed definition of a QRM, including the specific terms and conditions discussed in the following section.

111. (a) The Agencies seek comment on whether mortgage guarantee insurance or other types of insurance or credit enhancements obtained at the time of origination would or would not reduce the risk of default of a residential mortgage that meets the proposed QRM criteria but for a higher adjusted LTV ratio. Commenters are requested to provide historical loan performance data or studies and other factual support for their views if possible, particularly if they control for loan underwriting or other factors known to influence credit performance.

(b) If the information indicates that such products would reduce the risk of default, should the LTV ratio limits be increased to account for the insurance or credit enhancement?

(c) If so, by how much?

112. (a) If the proposed QRM criteria were adjusted for the inclusion of mortgage guarantee insurance or other types of insurance or credit enhancements, what financial eligibility standards should be incorporated for mortgage insurance or financial product providers and how might those standards be monitored and enforced?

(b) What disclosure regarding the entity would be appropriate?

113. Are there additional ways that the Agencies could clarify the standards applicable to QRMs to reduce the potential for uncertainty as to whether a residential mortgage loan qualifies as a QRM at origination?

114. (a) The Agencies request comment on each of these conditions for QRM eligibility. In addition, should a loan be disqualified from being a QRM if the creditor has “reason to know” of another recorded or perfected lien on the property in a purchase transaction?

(b) If so, what would constitute a “reason to know” by the creditor?

Borrower Credit History

115. Are the proposed credit history standards useful and appropriate indicators of the likelihood that a borrower might default on a new residential mortgage loan?

116. Are there additional or different standards that should be used in considering how a borrower’s credit history may affect the likelihood that the borrower would default on a new mortgage?

117. (a) Should the Agencies include minimum credit score thresholds as an additional or alternative QRM standard?

(b) If so, how might the rules incorporate privately developed credit scoring models in a manner that (i) ensures that borrowers, originators, and investors have adequate notice, and an opportunity to comment on, changes to scoring methodologies that may affect a borrower’s eligibility for a QRM, (ii) maintains a level competitive playing field for providers and developers of credit scores, and (iii) ensures that any credit scoring methodology used for QRM purposes is and remains predictive of a borrower’s default risk?

118. The Agencies request comment on the appropriateness of the safe harbor that would allow an originator to satisfy the documentation and verification requirements regarding a borrower’s credit history by obtaining credit reports from at least two consumer reporting agencies that compile and maintain files on consumers on a nationwide basis.

Payment Terms of QRMs

119. (a) The Agencies request comment on all aspects of the proposed rules’ limits on the payment terms of a QRM. In addition, the Agencies request comment on the following matters.

(b) Should additional or different payment terms be established for QRMs? Commenters requesting additional or different limits are encouraged to provide data indicating that such additional or different terms would result in a lower risk of default.

(c) Would different interest rate caps, such as a one percent (100 basis points) increase in any twelve month period, be more appropriate than the caps set forth in the proposal?

(d) Recognizing the very damaging effects that prepayment penalties had on some borrowers during the recent housing market distress, the proposed rules do not permit any loans with prepayment penalties to qualify as a QRM. Often, the borrower that suffered because of the existence of such penalties were those with large, unaffordable payment shocks as low initial rates expired or those whose credit standing improved after origination of the loan, but who were not able to benefit from such improvements by refinancing into a potentially lower rate loan. Given the tight credit and product standards proposed for QRMs, such conditions are less likely to be relevant to QRM borrowers, and some QRM borrowers might reasonably benefit from an opportunity to obtain a mortgage with modest prepayment penalties in the early years of the loan in exchange for lower interest rate. Should the Agencies permit prepayment penalties in QRM loans (to the extent otherwise possible within the limits established for QMs)?

(e) If so, what, if any, limitations should apply to such penalties?

Additional Requirements for QRMs

120. The Agencies seek comment on the appropriateness of the proposed LTV and combined LTV ratios for the different types of mortgage transactions.

121. The Agencies request comment on the proposed amount and acceptable sources of funds for the borrower’s down payment.

122. Should other valuation approaches be considered in determining the value of the real property pledged on the mortgage transaction?

123. The Agencies seek comment on the appropriateness of the proposed front-end ratio limit of 28 percent and the proposed back-end ratio limit of 36 percent.

124. (a) The Agencies request comment on all aspects of the proposed definition of “points and fees” for QRM purposes. In addition, the Agencies seek comment on the following matters.

(b) Should the exclusion for “bona fide discount points” and certain bona fide third-party charges be included in the final rule?

(c) If so, in what manner?

(d) Would an adjustment to the limitation on points and fees for smaller loans, if implemented under section 129C(b)(2)(D) of TILA, be appropriate for QRMs?

125. The Agencies solicit comment on whether the definition of QRM should include servicing requirements.

126. (a) Should the proposed servicing requirements be more or less robust?

(b) If so, how should the proposed servicing requirements be changed?

127. (a) Should servicers be required, as is proposed, to have policies and procedures that provide for loss mitigation activities if the borrower is 90 days delinquent, but default may not have occurred under the mortgage loan transaction documents?

(b) Should the policies and procedures require, or at least not prohibit, initiation of loss mitigation activities, including loan modifications, when default is reasonably foreseeable?

(c) What would be the practical implications of such an approach?

128. (a) Should servicers be required, as is proposed, to have policies and procedures that provide for loss mitigation actions for QRMs (within 90 days after delinquency, unless the delinquency is cured) when the estimated net present value of the action would exceed the estimated net present value of recovery through foreclosure?

(b) Should those policies and procedures be required to include specific actions, such as (i) restructuring the mortgage loan; (ii) reducing the borrower's payments through interest rate reduction, extension of loan maturity, or similar actions; (iii) making principal reductions, or (iv) taking other loss mitigation action in the event that the estimated net present value of that action would exceed the estimated net present value of recovery though loan foreclosure?

(c) What would be the practical implications of such an approach?

129. The Agencies seek comment on whether other servicing standards should be included, consistent with the statute's authority.

130. (a) What are the practical implications of the proposed QRM servicing standards?

(b) Do commenters envision operational issues in implementing the standards?

(c) If so, please describe.

(d) Are the standards sufficiently clear?

(e) If not, which should be clarified?

131. Would the proposed QRM servicing conditions restrict or impede the ability or willingness of certain classes of originators to originate QRMs?

132. (a) Is the scope of the QRM servicing standards appropriate?

(b) Are there alternatives to QRM servicing standards that would better address servicing issues?

133. (a) Should the servicing requirements be part of the pooling and servicing agreement rather than part of the mortgage transaction documents?

(b) Should they be included in both sets of documentation?

134. (a) If a creditor or an affiliate has an ownership interest in a subordinate lien mortgage and the creditor services the first lien mortgage, should the creditor be required to implement pre-defined processes to address any potential conflicts of interest when the first lien loan becomes 90 days past due?

(b) What types of processes should be required?

(c) Would specification of a particular process unduly limit the ability of the creditor to address different circumstances that may arise?

135. (a) Should the Agencies impose a standard requiring that a particular risk mitigation activity maximize the recovery based on net present value to avoid potential conflicts of interests between different classes of investors?

(b) How would that be determined?

(c) Would this approach improve the ability of servicers to best represent the interest of all investors?

(d) What would be the practical implications under such an approach?

136. (a) Are the proposed compensation requirements appropriate?

(b) For example, should the compensation structure be more specific, depending on the type of risk mitigation action deemed appropriate?

(c) If so, how?

137. (a) Pursuant to servicers' obligations to investors under the terms of securitization transaction documents, servicers are generally required to advance scheduled payments of principal and interest to investors after a borrower has become past due for some period of time (with respect to private label securities, usually until foreclosure is started), to the extent that such monthly advances are expected to be reimbursed from future payments and collections or insurance payments or proceeds of liquidation of the related mortgage loan. These monthly advances are intended to maintain a regular flow of scheduled principal and interest payments on the certificates rather than to guarantee or insure against losses. Does funding of these delinquent payments create liquidity constraints for servicers that incent servicers to take action (e.g., start foreclosure) that may not be in the investors' best interest?

(b) Should the Agencies put limits on servicers advancing delinquent mortgagors' payments of principal and interest to investors?

(c) Would such a limitation harm investors' interests?

(d) What are the practical implications of such an approach?

138. (a) Should the Agencies require servicing standards for a broader class of securitized residential mortgages?

(b) If so, how?

139. For commenters responding to any of the foregoing questions or with recommendations for different or additional approaches to servicing standards, are such approaches consistent with the statutory factors the Agencies are directed to take into account under the QRM exemption?

140. The Agencies are in the process of developing national mortgage servicing standards, which would cover all residential mortgage loans, including QRMs. In light of this, the Agencies seek comment on whether the establishment of national mortgage servicing standards is a more effective means to address the problems associated with servicing of all loans.

141. (a) Should the Agencies require, as a condition to qualify for the QRM exemption, that the sponsor repurchase the entire pool of loans collateralizing the ABS if the amount or percentage of the loans that are required to be repurchased due to the failure to meet the QRM standards reaches a certain threshold.?

(b) If so, what threshold would be appropriate?

142. (a) Should the Agencies permit a sponsor, within the first four months after the closing of a QRM securitization, to substitute a comparable QRM loan for a residential mortgage loan that is determined, post-closing, to not be a QRM (in lieu of purchasing the loan for cash)?

(b) If so, is four months an appropriate period or should the rule allow more or less time?

143. The Agencies seek comment on the potential benefits and costs of the alternative approach, with a broader QRM exemption combined with a stricter set of risk retention requirements for non-QRM mortgages.

144. (a) If such an alternative approach were to be adopted, what stricter risk retention requirements would be appropriate in order to provide additional incentives to underwrite a greater share of origination volume within the QRM definition?

(b) Should such stricter requirements involve the form of risk retention or a higher amount of risk retention?

(c) Are there other changes that would achieve the same objective?

145. How would this approach help to ensure high quality loan underwriting standards and align the interests of investors?

146. (a) Would this approach have the practical effect of exempting the securitization of most residential loans from the risk retention requirement?

(b) If so, how would this positively and/or negatively affect investors in such securitizations?

(c) Would an offering of an ABS backed by loans complying with the lower standards in the alternative approach adequately promote the necessary alignment of incentives among originators, sponsors, and investors?

147. What impact might a broader QRM definition have on the pricing, liquidity, and availability of loans that might fall outside the broader QRM boundary?

148. Would the lower QRM standards under the alternative approach be consistent with the requirement that QRMs be fully exempted from section 15G's risk retention requirements?

149. How could this type of alternative approach be designed to limit the likelihood that loans with significant credit risk are included in the pool and thus not subject to risk retention?

150. (a) Should underwriting standards be developed for residential mortgage loans that are different from those proposed for the QRM definition and under which a sponsor would be required to retain more than zero but less than five percent of the credit risk?

(b) If so, what should those underwriting standards be and how should they differ from those established under the QRM provisions?

(c) For example, should such underwriting standards allow for a loan-to-value ratio of up to 90 percent for purchase mortgage loans if there is mortgage insurance that would provide investors similar amounts of loss protection upon default as would be provided by a mortgage with a loan-to-value ratio of 80 percent?

(d) If additional underwriting standards were established for residential mortgages, what amount of risk retention less than five percent should be required for loans meeting such standards, and should it be required to be held in a particular form?

151. If any new underwriting standards for residential mortgages were to be established and permit the inclusion of mortgage guarantee insurance or other types of insurance or credit enhancements, what financial eligibility standards should be incorporated for mortgage insurance or financial product providers?

152. Should additional asset classes beyond those specified in section 15G be established and, if so, how should the associated underwriting standards for such additional asset classes be defined? Commenters are encouraged to provide supporting data regarding the prevalence of each asset class

in the ABS market, as well as loan-level performance data that provides information on the characteristics, terms, and conditions of the underlying loans and that may be useful in developing standards that identify loans within such asset class that have low credit risk.

Exemption for Qualifying Commercial, CRE, or Automobile Loans

153. The Agencies request comment on the appropriateness of a total exemption for sponsors of ABS issuances collateralized exclusively by qualifying CRE, commercial, or automobile loans that meet the underwriting standards set forth in §__.18 to §__.20 of the proposed rules. Commenters who support a partial exemption are encouraged to provide information regarding the methodology the Agencies should use to calibrate the retention requirement, in a manner that considers the relative risk of the securitization transaction, both within and across the proposed asset classes.

154. (a) Are the proposed standards appropriate for a qualifying commercial loan?
(b) Are these standards sufficient and appropriate to ensure that qualifying commercial loans are of very low credit risk?

155. Are the metrics to measure a borrower's financial capacity, and the specified parameter for each metric, an appropriate standard?

156. (a) Are the proposed requirements for a qualifying CRE loan appropriate?
(b) Are these standards sufficient to ensure that qualifying CRE loans have very low credit risk?

157. Are the DSC metrics employed for measuring a borrower's financial capacity, and the specified parameter for each type of CRE property, an appropriate standard?

158. The Agencies are proposing the same DSC ratio (1.5) for qualifying leased CRE loans and qualifying multifamily CRE loans, where the DSC analysis is based on at least two years of actual performance. The Agencies request comment whether the risk of default for qualifying non-Enterprise multifamily CRE loans is demonstrably lower as to justify a lower DSC ratio (such as 1.3). For example, the Agencies acknowledge that several highly-publicized defaults on large multifamily CRE loans had a much weaker structure (e.g., pro-forma underwritten DSC ratio or DSC ratio lower than 1.2) than what is contained in the proposed rules. Commenters should provide relevant criteria to be applied to qualify for a reduced DSC ratio and multifamily CRE loan performance data supporting the conclusion that multifamily loans meeting such criteria, as a class, have a correspondingly reduced risk of default to support a reduced DSC ratio for such loans.

159. (a) Are the proposed requirements for a qualifying automobile loan appropriate?
(b) Are these standards sufficient and appropriate to ensure that qualifying automobile loans have very low credit risk?

160. Are the DTI ratios employed for measuring a borrower's financial capacity an appropriate standard?

161. (a) The Agencies seek comment on whether the sponsor should be required to repurchase the entire pool of loans collateralizing the ABS if the amount or percentage of the loans that are required to be repurchased due to the failure to meet the underwriting standards under §__.18, §__.19 or §__.20, as applicable, of the proposed rules reaches a certain threshold.

(b) If so, what threshold would be appropriate?

General Exemptions

162. (a) Have the Agencies appropriately implemented the exemption in section 15G(e)(3)(B) of the Exchange Act?

(b) Why or why not?

163. Are we correct in believing the federal department or agency issuing, insuring, or guaranteeing the ABS or collateral will monitor the quality of the assets securitized?

164. (a) While it appears that Congress may have intended to exempt all existing federal insurance or guarantee programs for residential, multifamily, or health care facility mortgage loans, comments are requested on the proposed rules where private securitization may be used in the following areas. Are there risks in exempting assets or ABS that are not significantly insured or guaranteed by a federal agency?

(b) If so, what level of federal guarantee or insurance should be required?

(c) Would inclusion of additional requirements be appropriate in the public interest and for the protection of investors?

(d) Why or why not?

(e) Would inclusion of additional requirements be disruptive to any federal guarantee or insurance programs established or authorized by Congress?

(f) If so, how and to what extent?

165. (a) Have the Agencies appropriately implemented the exemption in section 15G(e)(3)(A) of the Exchange Act and the exemptive authority in section 15G(c)(1)(G)(ii) and (iii)?

(b) Why or why not?

166. (a) Is the proposed exemption for ABS issued or guaranteed by a State or municipal entity appropriate?

(b) Is it under or over-inclusive?

(c) There may be some ABS in which the sponsor is a municipal entity (i.e., a State or Territory of the United States, the District of Columbia, any political subdivision of any State, Territory or the District of Columbia, or any public instrumentality of one or more States, Territories or the District of Columbia), however, the ABS are issued by a special purpose entity, that is created at the direction of the municipal entity, but are not issued or guaranteed by the municipal entity. Should the rules also exempt from the risk retention requirements asset-backed securities where the sponsor is a municipal entity?

(d) There are some municipal ABS that are issued by a municipal entity and exempt by reason of Section 3(a)(2) of the Securities Act but may include assets originated using the same underwriting criteria as private label securitizations. Should the rules, as proposed, exempt them?

167. (a) Are there any ABS that are collateralized solely by obligations issued by the United States or an agency of the United States where the process of packaging and securitizing those obligations may raise issues that the risk retention requirement was designed to address?

(b) For example, would a securitization by a non-governmental securitizer of debt issued by the Tennessee Valley Authority raise any issues such that the Agencies should provide only a partial exemption?

(c) If so, what type of transactions and how should the Agencies determine the amount and form of risk retention to be required?

168. (a) Are there other types of resecuritization transactions backed solely by 15G-compliant ABS that should be exempt from the risk retention requirements?

(b) If so, what principles and factors should the Agencies use in considering whether other types of resecuritizations backed by 15G-compliant ABS should be exempted from the risk retention requirements of section 15G?

(c) Should the Agencies consider granting an exemption only if it is clear that the resecuritization transaction does not expose investors in the resecuritization to different levels or types of credit risk in the securitized assets than the underlying 15G-compliant ABS?

169. (a) Should the rule provide an exemption for a sequential-pay resecuritization that is collateralized only by 15G-compliant ABS? In this type of resecuritization, the rights to principal repayment of the holders of the different classes differ solely with respect to the timing of such repayments. Longer duration classes receive no payments of principal until shorter duration classes have been paid off in full and principal shortfalls are allocated on a pro-rata basis based upon the unpaid principal balance of each class. As the shorter duration classes are paid off, the unpaid principal balances of the longer duration classes begin to represent a larger portion of the total unpaid principal balances of the underlying ABS and, therefore, the longer duration classes are allocated an ever-increasing percentage of credit losses as the ABS matures.

(b) If an exemption for sequential-pay resecuritizations backed by 15G-compliant ABS is appropriate, how could such an exemption be written to ensure the exemption is limited to this particular structure?

170. (a) Should the Agencies provide an exemption for prepayment-tranched resecuritizations that are backed solely by 15G-compliant ABS? This form of resecuritization involves the sponsor of the resecuritization creating tranches based on the prepayments of the underlying ABS (i.e., prepayments received by the ABS in the first-level ABS securitization). One type of prepayment-tranched resecuritization is a planned amortization class (PAC) resecuritization. PAC bonds receive principal payments based on the level of prepayments and will have their expected duration if the actual speed of prepayments on the underlying ABS falls within a designated range. In order to create a PAC bond with greater certainty of cash flow than the underlying ABS, one or more support (SUP) classes that are highly sensitive to varying levels of prepayment are created as part of the same transaction. If the rate of prepayments is faster than that assumed in the creation of the PAC, the SUPs receive more principal in order to prevent an overpayment of principal on the PAC. If the rate of prepayment is slower, principal is redirected from the SUPs in order to achieve the specified repayment schedule on the PAC. In either case, credit losses are allocated on a pro rata basis based on the unpaid principal balance attributable to each class. Accordingly, the effect of faster-than-expected rates of prepayment will tend to expose holders of the PAC bonds to relatively greater losses than the holders of the SUPs, while slower-than-expected rates of prepayment will tend to have the opposite effect. Moreover, in transactions where more than one PAC bond is created, the distribution of principal repayments to the PACs are based on priority and, therefore, the holders of the PACs are exposed to levels of credit risk that differ from that of the underlying ABS.

(b) If an exemption of prepayment-tranched resecuritizations or certain types of such resecuritizations (such as PAC structures) is appropriate, how could an exemption be written to ensure that the exemption does not extend to other resecuritizations?

171. As noted above, the proposed exemptions require the underlying ABS be 15G-compliant ABS. In practice, initially this may mean that only resecuritizations based on ABS guaranteed by Fannie Mae and Freddie Mac will qualify for this exemption. Does this raise any competitive or other issues and if so, how can they be mitigated without eliminating the requirement there be risk retention on the underlying ABS?

172. (a) Is the proposed language for this exemption appropriate?
(b) Does any portion of the exemption cause an ambiguity that should be addressed?

173. (a) Are there securitization transactions that would not be covered by the exemptions in the proposed rules that should be exempted from risk retention requirements pursuant to section 15G(e)(3) of the Exchange Act?
(b) If so, what are the features and characteristics of such securitization transactions that would properly exempt them from risk retention requirements pursuant to section 15G(e)(3)?

174. (a) Are there any extra or special considerations relating to these circumstances that we should take into account?
(b) Should the more than 10 percent proceeds trigger be higher or lower (e.g., 0 percent, 5 percent, 15 percent, or 20 percent)?

[1] For example, in auto lease securitizations, the auto leases and car titles are originated in the name of a separate trust to avoid the administrative expenses of retitling the physical property underlying the leases. The separate trust will issue to the issuing entity for the asset-backed security a collateral certificate, often called a ‘‘special unit of beneficial interest’’ (SUBI). The issuing entity will then issue the asset-backed securities backed by the SUBI certificate.

[2] *See*, e.g., comment letter to the Commission from CRE Finance Council dated January 19, 2011, available at http://www.sec.gov/comments/df-title-ix/asset-backed-securities/assetbackedsecurities-37.pdf .