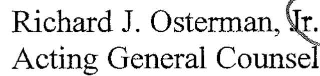
MEMORANDUM TO: The Board of Directors

FROM: Richard J. Osterman, Jr.
Acting General Counsel



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DATE: August 19, 2013

SUBJECT: Second Notice of Proposed Rulemaking to Implement Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Credit Risk Retention)

RECOMMENDATION

We recommend that the FDIC Board of Directors ("Board") approve and authorize for publication in the *Federal Register* the attached notice of proposed rulemaking ("NPR," "proposed rule," or "new proposal") that would implement the credit risk retention requirements of section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[1] If approved, the NPR would be jointly issued with the Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System ("FRB"), and the Securities and Exchange Commission ("Commission") and, with respect to the portions addressing residential mortgages, the Federal Housing Finance Agency ("FHFA") and the

[1] Pub. L. No. 111-203, 124 Stat. 1376 (2010).

Department of Housing and Urban Development ("HUD") (collectively, the "Agencies"). The NPR uses the term "Agencies" to refer to the appropriate agencies that have rulemaking authority with respect to the asset class, securitization transaction, or other matter discussed, and this convention is also used below. Public comments on the proposed rule would be due by October 30, 2013, and the comment period would start upon the first of the Agencies' posting on its website.

BACKGROUND

This NPR would be the second joint Notice of Proposed Rulemaking to be issued by the Agencies to implement the credit risk retention requirements of Section 941 of the Dodd-Frank Act. The first joint Notice of Proposed Rulemaking relating to credit risk retention was approved by the Board on March 29, 2011 (the "original proposal" or "first NPR") and subsequently published as a joint Notice of Proposed Rulemaking in the *Federal Register* on April 29, 2011.[2] The proposed rule includes major modifications from the original proposal.

I. The Credit Risk Retention Provisions of Section 941 of the Dodd-Frank Act

Section 941 of the Dodd-Frank Act amended the Securities and Exchange Act of 1934 by adding a new section 15G ("section 15G"),[3] which generally requires a securitizer (or sponsor) of asset-backed securities ("ABS") to retain not less than 5 percent of the credit risk of the assets collateralizing the ABS issuance. It also generally prohibits the securitizer from directly or indirectly hedging or otherwise transferring the credit risk that the securitizer is required to retain.[4]

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[2] Credit Risk Retention, Proposed Rule, 76 Federal Register 24090 (April 29, 2011).
[3] Codified at 15 U.S.C. § 78o-11.
[4] See 15 U.S.C. § 78o-11(b), (c)(1)(A) and (c)(1)(B)(i).

Section 15G exempts certain types of assets from the risk retention requirements and authorizes the Agencies to exempt or establish a lower risk retention requirement for other types of assets. Of particular note, section 15G exempts securitizations consisting exclusively of qualified residential mortgages ("QRMs") from the risk retention requirements,[5] and directs the Agencies to develop a definition for QRM that takes into consideration underwriting and product features that historical loan performance data indicate result in a lower risk of default.[6] The Agencies' QRM definition may be no broader than the definition of Qualified Mortgage ("QM"), as implemented by the Consumer Financial Protection Bureau ("CFPB"). Additionally, section 15G requires the Agencies to establish a risk retention requirement of less than 5 percent for residential mortgages, commercial mortgages, commercial real estate ("CRE") loans, and automobile loans that meet underwriting standards established by the FDIC, FRB, and OCC (collectively the "Federal banking agencies").[7]

II. Rationale for Risk Retention

The securitization markets remain an important link in the chain of entities providing credit to U. S. households, businesses, and state and local governments.[8] When properly structured, securitization provides economic benefits that can lower the cost of credit.[9] However, when incentives are not properly aligned and there is a lack of discipline in the origination

[5] See 15 U.S.C. § 78o-11(c)(1)(C)(iii).
[6] 15 U.S.C. § 78o-11(c)(4)(A) and (B).
[7] See 15 U.S.C. § 78o-11(c)(1)(B)(ii) and (2).
[8] Securitization may reduce the cost of funding, which is accomplished through several different mechanisms. For example, firms that specialize in originating new loans and that have difficulty funding existing loans may use securitization to access more liquid capital markets for funding. In addition, securitization can create opportunities for more efficient management of the asset-liability duration mismatch generally associated with the funding of long-term loans, for example, with short-term bank deposits. Securitization also allows the structuring of securities with differing maturity and credit risk profiles from a single pool of assets that appeal to a broad range of investors. Moreover, securitization that involves the transfer of credit risk allows financial institutions that primarily originate loans to particular classes of borrowers, or in particular geographic areas, to limit concentrated exposure to these idiosyncratic risks on their balance sheets.
[9] Report to the Congress on Risk Retention, Board of Governors of the Federal Reserve System, October 2010, available at http://federalreserve.gov/boarddocs/rptcongress/securitization/riskretention.pdf (Board Report).

process, securitization can harm investors, consumers, financial institutions, and the financial system. During the financial crisis, many securitization transactions masked credit risks, reduced transparency, and complicated the ability to reduce loan defaults and mitigate losses. The significant fee and other income from securitization led lenders and other market participants to focus more on origination volume, which generates fees, than on sound underwriting standards. These deficiencies were largely due to the prevailing "originate-to-distribute" business model, which rewarded volume over asset quality, as lenders retained little or no continuing exposure in loans they originated for securitization.[10]

The risk retention requirements of section 15G are intended to help address these problems by requiring securitizers to retain an economic interest in the credit risk of assets they securitize. As indicated in the legislative history of section 15G, "When securitizers retain a material amount of risk, they have 'skin in the game,' aligning their economic interest with those of investors in asset-backed securities."[11] By requiring a securitizer to retain a portion of the credit risk of the securitized assets, section 15G incentivizes securitizers to monitor and ensure the quality of assets underlying a securitization transaction. Further, when the assets collateralizing the ABS meet underwriting and other standards that help ensure the assets pose low credit risk, the statute provides or permits an exemption.[12] Notably in this regard, section 15G recognizes that the risk retention requirements should not apply to residential mortgage securitizations collateralized solely by QRMs, that is, residential mortgages with underwriting or product features that historical loan performance data indicate result in a lower risk of default.

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[10] See S. Rep. No. 111-176, at 128 (2010).
[11] See id. at 129.
[12] See 15 U.S.C. § 78o-11(c)(1)(B)(ii), (e)(1)-(2).

III. The Original Proposal

The original proposal's definition of QRM included a requirement for a loan-to-value ("LTV") ratio no higher than 80 percent (and lower, if the mortgage was a refinancing), credit history metrics, conservative debt-to-income ("DTI") requirements (no greater than 36 percent), and certain other requirements. The original proposal also included underwriting standards for commercial, CRE, and automobile loans underlying ABS to qualify for exemption from risk retention.

The original proposal offered several options for satisfying the risk retention requirements, most of which would have required that the risk retained equal 5 percent of the par value of the ABS interests issued in the securitization transaction. The basic retention option would have permitted the sponsor to hold all of the risk retention on either a vertical basis (5 percent of each class of ABS interests) or on a horizontal basis (as a first-loss position), or to hold half of the risk retention on a vertical basis and half as a first-loss horizontal position. The original proposal also required that a sponsor retain in a special premium capture cash reserve account (the "PCCRA"), as additional risk retention, the proceeds from the sale of excess spread and from premiums realized on the sale of ABS. Finally, the original proposal did not contain provisions which would have permitted the required risk retention to be transferable (or "sunset") after a period of years.

The Agencies received over 10,500 comment letters, including nearly 300 unique comment letters, in response to the first NPR. A large majority of commenters criticized the Agencies' 80 percent LTV and other underwriting standards for QRM, citing issues such as: potential for increased credit costs and, especially for low- and moderate-income borrowers and

first-time home buyers, restricted credit access; the potential difficulty that the underwriting standards could create in reducing the participation of the Federal National Mortgage Association ("FNMA") and the Federal Home Loan Mortgage Corporation ("FHLMC") (collectively the "Enterprises") in the mortgage market; and inconsistency with legislative intent. Commenters also criticized the PCCRA requirement, and many letters suggested changes to other aspects of the original proposal.

IV. Major Differences Between the Original Proposal and the New NPR

After taking into account the comment letters on the first NPR, the Agencies have developed a new NPR that makes a number of changes to the original proposal. The most significant changes include the following:

- The proposed rule would generally define a QRM as a mortgage meeting the requirements for QM (as set forth as part of the CFPB's Ability to Repay rule, and any amendments thereto). The CFPB's rule requires lenders to consider consumers' ability to repay home loans and provides a presumption of ability to repay for qualified mortgages. Among other criteria, the QM definition excludes loans that contain risky features that contributed to the high level of mortgage defaults during the recent financial crisis. In general, a QM loan must have the following features: (1) regular periodic payments that are substantially equal; (2) no negative amortization, interest only, or balloon features; (3) a maximum loan term of 30 years; (4) total points and fees that do not exceed 3 percent of the total loan amount; (5) payments underwritten using the maximum interest rate that may apply during the first 5 years of the loan; (6) consideration and verification of the consumer's income and assets (including employment status, if relied upon), current debt obligations,

alimony, and child support; and (7) total DTI that does not exceed 43 percent, including mortgage-related obligations. The proposed new definition of QRM does not include LTV or credit history requirements. However, data show that defaults (i.e., delinquencies of 90 days or longer) for loans meeting the QM definition are significantly lower than those for non-QM loans, satisfying the requirements of the statute. As discussed more fully later, the Agencies also ask questions in the preamble to the rule about an alternate approach for defining QRM that would utilize QM along with an LTV ratio of no more than 70 percent and other criteria;

- For non-QRM mortgages and other types of assets that are not exempted from risk retention, the 5 percent risk retention requirement would be calculated on the basis of fair value (rather than par value) of the securitization transaction, which essentially increases the value of the retained interest, and is set on the day on which the price of the ABS interests to be sold to third parties is determined;
- Given the increase in the value of the retained interest due to the change to fair value, the Agencies propose to remove the requirement for PCCRA;
- While the risk retention requirement would not technically sunset under the proposed rule, the prohibition on sale and hedging of the required risk retention would terminate after specified time periods, considering that losses from initial underwriting decline after the period of time when delinquencies historically tend to peak;
- The proposed rule would permit a sponsor to hold any combination of vertical and horizontal first-loss interests that together represent 5 percent of the fair value of the securitization, rather than requiring that retention be held only as all vertical or all

horizontal or as a combination only on a 50/50 basis. This option does not reduce the overall risk retention obligation and would provide sponsors with greater flexibility in structuring their retention of credit risk in a manner compatible with market practices, while still ensuring that risk retention is meaningful;

- The proposed rule would permit commercial, CRE, and automobile loans satisfying underwriting requirements for exemption from risk retention to be blended in asset pools with non-qualifying loans of the same asset class subject to the full 5 percent risk retention. These blended pools would be eligible for reduced, but not less than 2.5 percent risk retention. The Agencies believe allowing these blended pools will help ensure market liquidity, while still requiring full risk retention on non-qualifying assets;
- The proposed rule would also include a new risk retention option for open market collateralized loan obligations ("CLOs") that would allow CLO managers/sponsors to satisfy risk retention requirements if the lead arrangers of loans purchased by the CLO retained the required risk. This option would align incentives of the party most involved with the credit quality of the loans, the lead arranger, with the interests of investors. For CLOs not meeting the definition of open market CLOs and associated eligibility conditions, the CLO manager/sponsor would be responsible for required risk retention; and
- The proposed rule would also include a number of other changes from the original proposal, including deletion of the representative sample option that was determined to be not practical to implement; certain modifications to provisions regarding underwriting for qualifying commercial, CRE, and automobile loans; exemptions for

certain special types of securitizations; and numerous changes to definitions and other provisions.

PROPOSED RULE

I. Detailed Summary of the Proposed Rule

Set forth below is a detailed summary of the proposed rule. Additional specific information about the proposed rule and the comments received is set forth in the attached NPR.

A. Scope and Applicability

The new proposal would apply to sponsors of securitizations that involve the issuance of an ABS. The new proposal defines an ABS by reference to section 3(a)(79) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(77), which defines ABS 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...." The new proposal's risk retention requirements would apply to all ABS offerings, irrespective of whether the offering must be registered with the Commission under the Securities Act of 1933.

The new proposal uses the term "ABS interest" to refer to all types of interests or obligations issued by an issuing entity, whether or not in certificated form, including a security, obligation, beneficial interest, or residual interest, whose payments are primarily dependent on the cash flows of the collateral owned or held by the issuing entity.

Section 15G generally directs the Agencies to apply the risk retention requirements of the statute to a "securitizer" of ABS. Section 15G(a)(3) states that the term "securitizer" with respect to an issuance of ABS includes "(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."[13] The new proposal would define a "sponsor" of an ABS transaction as a "securitizer" for purposes of section 15G, and defines the term "sponsor" in a manner consistent with the definition of that term under Commission Regulation AB, which governs disclosures for ABS offerings under the Federal securities laws.[14] Risk retention requirements would not apply to the FDIC when, in its capacity as receiver or conservator, it acts as sponsor of a securitization.

Staff believes that applying the risk retention requirement to the sponsor of an ABS is appropriate in light of the active and direct role that a sponsor typically has in arranging a securitization transaction and selecting assets for securitization. In circumstances where two or more entities each meet the definition of sponsor for a single securitization transaction, one of the sponsors must retain the entire amount of credit risk required under the new proposal; however, each sponsor would be responsible for ensuring compliance with the sponsor risk retention requirements.

Additionally, the new proposal, like the original proposal, would permit a sponsor to allocate its risk retention obligations to the originators of the securitized assets in certain circumstances and subject to certain conditions. The new proposal defines the term "originator" generally to be a person that "creates" an asset that collateralizes an ABS. Only the original creditor under a loan or receivable – and not a subsequent purchaser or transferee – is an "originator" of the loan or receivable for purposes of the new proposal.[15]

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[13] See 15 U.S.C. § 78o-11(a)(3).
[14] The use of the term "sponsor" enhances consistency among rules that affect securitization, including the Commission's Regulation AB, and other rulemaking under Title IX of the Dodd-Frank Act.
[15] See 15 U.S.C. § 78o-11(a)(3).

B. General Risk Retention Requirement

Consistent with section 15G, the new proposal generally would require a sponsor to retain an economic interest equal to at least 5 percent of the aggregate credit risk of the assets collateralizing an issuance of ABS. The 5 percent risk retention requirement established in the new proposal would be a regulatory minimum; however, the sponsor, originator, or other third party to a securitization may need to structure the transaction to include additional exposure to the credit risk of securitized assets in response to the demands of rating agencies, investors, or other market participants.

Staff believes that the proposed risk retention requirement will give sponsors a meaningful incentive to monitor and control the quality of the securitized assets and help align the interests of the sponsor with those of the investors. The newly proposed risk retention requirements would apply regardless of whether a sponsor is an insured depository institution, a bank holding company or subsidiary thereof, a registered broker-dealer, or other type of entity, or whether or not the sponsor is a supervised entity.[16]

Section 15G expressly authorizes the Agencies to determine the permissible forms through which the required amount of risk retention must be held. The new proposal would provide sponsors with added flexibility in satisfying risk retention requirements. As a result, the 50/50 combination L-Shaped option is no longer separately proposed. Further, with the added flexibility, and in response to comments that implementation would not be practical, the new proposal would remove the representative sample option that was included in the original

[16] See proposed rule, sections 3 through 10. Similar to the original proposal, the new proposal, in some instances, would permit a sponsor to allow another person to retain the required amount of credit risk (e.g., originators, third-party purchasers in commercial mortgage-backed securities transactions, and originator-sellers in asset-backed commercial paper conduit securitizations). However, in such circumstances, the new proposal includes limitations and conditions designed to ensure that the purposes of section 15G continue to be fulfilled. Further, even when a sponsor would be permitted to allow another person to retain risk, the sponsor would still remain responsible under the rule for compliance with the risk retention requirements.

proposal. The measurement calculation for the horizontal residual interest (as well as vertical retention interests) under the new proposal would be fair value, in accordance with U. S. Generally Accepted Accounting Principles ("GAAP") instead of the par value standard included in the original proposal. This change was made in order to ensure appropriate risks are retained. The amount to be retained would be determined as of the day on which the price of the ABS interests to be sold to third parties is determined. Because this change essentially increases the value of the 5 percent retained risk, it enabled the Agencies to eliminate the PCCRA requirement from the proposed rule. The options included in the new proposal recognize the various types of assets securitized and the different structures that have developed in the market and, thus, should reduce the potential for the proposed rule to negatively affect the availability and cost of credit to consumers and businesses.

In order for investors and the supervisory authority of a sponsor to monitor compliance with the fair value approach, the new proposal also includes disclosure requirements that are an integral part of, and specifically tailored to, each of the permissible forms of risk retention. The requirements would include disclosure of the assumptions and methodologies used in determining the amount of risk retention. The disclosure requirements are intended to provide investors with material information concerning the sponsor's retained interests in a securitization transaction and to provide an efficient mechanism to monitor compliance with the risk retention requirements.

Vertical Risk Retention Option

Under the new proposal, a sponsor electing to satisfy the 5 percent risk retention requirements wholly through the vertical risk retention option would hold a single eligible vertical security or a separate interest in each class (tranche) of ABS interests issued as part of

the securitization transaction. The percentage of the fair value of each tranche so retained must be identical. The single vertical security retention option was not included in the original proposal and adds risk retention flexibility. The new proposal defines "single vertical security" as an ABS interest entitling the sponsor to specified percentages of the principal and interest paid on each class of ABS interests in the issuing entity (other than the single vertical security), which specified percentages result in the fair value of each interest in each such class being identical. The essential difference between the two vertical options is that the single vertical security option would permit a sponsor to hold a single security rather than multiple securities.

Horizontal Residual Risk Retention Option

Under the new proposal, a sponsor electing to satisfy risk retention requirements wholly through the horizontal residual risk retention option would retain a first-loss exposure in an amount equal to at least 5 percent of the fair value of all ABS interests. An interest would qualify as an "eligible horizontal interest" only if it has the most subordinated claim to payments of principal and interest by the issuing entity and, for any payment date on which an issuing entity has insufficient funds to pay all of its contractual interest and principal due, only if it will receive payment in an amount that is reduced by the amount of any shortfall in amounts to be paid to any other ABS interest that would otherwise occur. In addition, amounts projected to be payable on the horizontal residual interest would be limited based on projected cash flows used to calculate the fair value of the transaction. Under an alternative formulation described in the new NPR, the amounts payable to the holder of the horizontal interest would be limited by reference to amounts paid to holders of the other ABS interests. The original proposal did not permit holders of horizontal residual interests to receive any share of prepayments.

Cash Reserve Fund Option

In lieu of retaining an eligible horizontal residual interest, the new proposal, like the original proposal, would allow the sponsor to fund a cash reserve account in an amount equal to the eligible horizontal residual interest that otherwise would be required to be held by the sponsor. This cash reserve fund is a form of horizontal residual interest. The cash reserve account would be maintained by a trustee and would be subject to restrictions on withdrawal by the sponsor. For securitizations where the underlying loans or the ABS interests issued are denominated in a foreign currency, the amounts in the account generally may be invested in sovereign bonds issued in that currency or in fully insured deposit accounts denominated in the foreign currency in a foreign bank, subject to certain supervisory requirements.

Combined Option

The new proposal would provide sponsors with additional flexibility in satisfying risk retention requirements, while ensuring that risk retention remains meaningful, by allowing retained interests in the form of an eligible vertical interest, eligible horizontal residual interest (or cash reserve account), or any combination thereof, in any proportion.

C. Transaction-Specific Risk Retention Options

The new proposal, like the original proposal, would offer several transaction-specific risk retention options.

Revolving Asset Master Trusts

For securitizations collateralized by assets held in a revolving asset master trust (a "master trust"),[17] such as credit card accounts or dealer floor plans, the sponsor must typically retain what is commonly known as a "seller's interest," which is an undivided interest in the

[17] In general, a revolving asset master trust is authorized to issue more than one series of ABS backed by a single pool of revolving assets.

portion of the collateral that is not allocated to make payments to other investors. The proposed rule modifies the seller's interest definition from that set forth in the original proposal to reflect certain market practices.

In general, the new proposal would allow a sponsor of an ABS issuance for which the issuing entity is a revolving master trust to satisfy the risk retention requirement by retaining a seller's interest in an amount not less than 5 percent of the unpaid principal balance of all outstanding ABS interests held by investors in the issuing entity, or by combining a seller's interest with certain other retentions. The new proposal would also revise certain aspects of the original proposal in ways that make the requirements more reflective of market practices. In addition, the new proposal would allow the retention interest to be held by any wholly owned affiliate of the sponsor.

ABCP Conduits

The new proposal would allow a separate risk retention option for an ABCP conduit that is supported by receivables originated by one or more originators and that meets certain other conditions (an "eligible ABCP conduit"). This option is designed to accommodate the special structure of ABCP conduits as well as the manner in which exposure to the credit risk of the underlying assets typically is retained by participants in the securitization chain.

Where an ABCP conduit is fully supported by a liquidity facility provided by a prudentially regulated domestic financial institution or by certain foreign financial institutions, the new proposal would allow the sponsor of the conduit to satisfy the risk retention requirement if, for each ABS the ABCP conduit acquires from an intermediate special purpose vehicle ("SPV"), the related originator-seller or majority-owned originator-seller affiliate retains risk in the same form, amount, and manner as would be required under the standard risk retention or

master trust options.[18] The new proposal would define "majority-owned originator-seller affiliate" as an entity that, directly or indirectly, majority controls, is majority controlled by, or is under common majority control with, an originator-seller participating in an eligible ABCP conduit. For purposes of this proposed definition, "majority control" would mean ownership of more than 50 percent of the equity of an entity, or ownership of any other controlling financial interest in the entity (as determined under GAAP). The new proposal also would: permit affiliated groups of originator-sellers to finance credits through a single intermediate SPV; allow multiple, intermediate SPVs between an originator-seller and a majority-owned originator-seller affiliate; and allow an intermediate SPV to sell ABS it issues to parties other than ABCP conduits. Additionally, the option requires the standard industrial classification code for these originator-sellers to be disclosed. It does not require their identity to be initially disclosed to investors, although it would require the sponsor to provide to investors the names and organization form, among other items, of any originator-seller that fails to retain risk as proposed, as well as any remedial actions taken by the sponsor.

The new proposal would include several conditions designed to ensure this option is available only to the type of single-seller or multi-seller ABCP conduits described above and that it would not be available to entities or ABCP programs that operate as securities or arbitrage programs. The new proposal also would impose certain obligations directly on the sponsor in recognition of the key role the sponsor plays in organizing and operating an eligible ABCP

[18] The proposed rule's requirements as to full liquidity coverage provide that, in the event that the ABCP conduit is unable for any reason to repay maturing ABCP issued by the issuing entity, the liquidity provider shall be obligated to pay an amount equal to any shortfall, and the total amount that may be due pursuant to the liquidity coverage shall be equal to 100 percent of the amount of the ABCP outstanding at any time plus accrued and unpaid interest (amounts due pursuant to the required liquidity coverage may not be subject to credit performance of the ABS held by the ABCP conduit or reduced by the amount of credit support provided to the ABCP conduit, and liquidity support that only funds performing receivables or performing ABS interests does not meet the requirements of this section).

conduit. For example, the new proposal would provide that the sponsor of an eligible ABCP conduit would be responsible for compliance by originator-sellers with the risk retention requirements, for approving the originator-sellers, and for establishing criteria governing eligible assets.

CMBS Issuances

Section 15G provides that, with respect to CMBS, the regulations prescribed by the Agencies may permit risk retention of a first-loss position to be acquired and held by a third-party purchaser that negotiates for the purchase of such first-loss position, holds adequate financial resources to back losses, conducts due diligence on each asset in the asset pool before the issuance of the CMBS, and meets the same standards for risk retention as the securitizer. Therefore, if certain conditions are satisfied, the new proposal would permit a CMBS sponsor to allocate the horizontal risk retention to up to two third-party purchasers. The original proposal permitted only one third-party purchaser. The purchase would be required to be a cash transaction. Unlike the original proposal, the new proposal would allow third-party purchasers to combine interests with the sponsor to satisfy risk retention requirements in circumstances where the third-party purchasers held the horizontal residual interest and the sponsor retained any additional required interest as a vertical retention.

The new proposal (as was generally the case under the original proposal) would require, in connection with this risk retention option, that the CMBS transaction documents mandate the appointment of an independent Operating Advisor. The Operating Advisor would be required to act in the best interest and for the benefit of investors as a collective whole. The original proposal did not include requirements for assessing the appropriateness of the Operating Advisor and provided proposed duties that included oversight of servicer activities and various

consultation requirements. The new proposal would require the underlying securitization transaction documents to include standards with respect to the Operating Advisor's experience, expertise, and financial strength to fulfill its duties. Additionally, the new proposal would modify the Operating Advisor's duties by requiring that the Operating Advisor be consulted by the special servicer (the servicer that has the right to service assets upon the occurrence of one or more specified conditions) on all material decisions in connection with servicing the securitized assets only when the eligible horizontal residual interest has a principal balance of 25 percent or less of its initial principal balance. The new proposal would also require the Operating Advisor to review the actions of the special servicer and have authority to recommend the appointment of a new special servicer for the transaction. Actual replacement of the special servicer would require an affirmative vote of a majority of the outstanding principal balance of all ABS interests voting on the matter.

Government-Sponsored Enterprises

As in the original proposal, under the new proposal, the guarantee provided by an Enterprise (that is a sponsor) would satisfy the risk retention requirements, provided the Enterprise is operating under the conservatorship or receivership of FHFA with capital support from the U. S. government. Similarly, an equivalent guarantee provided by a limited-life regulated entity that succeeds to the charter of an Enterprise also would satisfy the risk retention requirement if the entity operates under the authority and oversight of FHFA with capital support from the U. S. government. If either Enterprise or a successor limited-life regulated entity were to begin to operate other than as described, then the Enterprise or entity would be required to choose a different retention option.

Open Market CLOs

No special option for CLOs was included in the original proposal, and it was noted that the CLO manager was the sponsor for purposes of the rule. Commenters objected that CLO managers would typically not have the financial capacity to hold risk retention. The new proposal would offer a separate risk retention option for a CLO (i) whose assets consist only of senior, secured syndicated loans constituting CLO-eligible loan tranches that are acquired directly from the sellers thereof in open market transactions and of servicing assets, (ii) that is managed by a CLO manager, and (iii) that holds less than 50 percent of its assets, by aggregate outstanding principal amount, in loans syndicated by lead arrangers that are affiliates of the CLO or originated by originators that are affiliates of the CLO ("open market CLOs"). Under this risk retention option, the 5 percent risk retention requirement could be satisfied by lead arrangers of loans purchased by the CLO rather than the CLO manager. As defined in the new proposal, a "lead arranger" is the institution that: is active in the origination, structuring, and syndication of commercial loan transactions and played a primary role in the structuring, underwriting, and distribution on the primary market of the CLO-eligible loan tranche; took an allocation of the syndicated credit facility under the terms of the transaction that includes the CLO-eligible loan tranche at least equal to the greater of 20 percent of the aggregate principal balance at origination or the largest allocation of any syndication member at origination; and is identified at the time of origination in the credit agreement and inter-creditor documents. A "CLO-eligible loan tranche" would be defined in the new proposal as a term loan tranche of a syndicated credit facility to a commercial borrower where a minimum of 5 percent of the face amount of the CLO-eligible loan tranche is retained by the lead arranger until the earliest of the repayment, maturity, involuntary and unscheduled acceleration, payment default, or bankruptcy default of the CLO-

eligible tranche. The new proposal also includes requirements as to lead arranger voting rights with respect to the CLO-eligible loan tranche.

Municipal Bond Repackagings

Municipal bond repackagings were not addressed in the original proposal. However, in response to comments received, and in order to reflect and incorporate the risk retention mechanisms currently implemented by the market, the new proposal would allow two additional risk retention options for certain municipal bond repackagings, known as tender option bonds, in addition to the standard risk retention option. The new proposal would closely track certain requirements for these repackagings, outlined in IRS Revenue Procedure 2003-84, that are relevant to risk retention. These tender option bonds would need to meet various qualifying requirements, as noted in the new proposal. The sponsor of a tender option bond issuance by a qualified tender option bond entity would satisfy risk retention requirements if it retains an interest that, upon issuance, meets the requirements of an eligible horizontal residual interest but that, upon the occurrence of a "tender option termination event," as defined in Section 4.01(5) of IRS Revenue Procedure 2003-84, will meet the requirements of an eligible vertical interest. Alternatively, the sponsor of a tender option bond entity would satisfy risk retention requirements if it holds municipal securities from the same issuance of municipal securities deposited in the qualified tender option bond entity, the face value of which retained municipal securities is equal to at least 5 percent of the face value of the municipal securities deposited in the qualified tender option bond entity. Among other things, the new proposal would require that a qualifying tender option bond entity have a legally binding commitment from a regulated liquidity provider to provide 100 percent guarantee or liquidity coverage with respect to all of the issuing entity's outstanding tender option bonds.

D. Transfer of Risk Retention

Allocation to the Originator

Consistent with section 15G, the new proposal would permit a sponsor to reduce its risk retention requirement by the portion of any risk retention assumed by an originator of the securitized assets, provided that the originator contributes at least 20 percent of the underlying asset pool. In addition, the sponsor may only allocate to an originator a risk retention amount that does not exceed the percentage of the securitized assets contributed by the originator. By limiting this option to originators that have originated at least 20 percent of the asset pool, the proposed rule seeks to ensure that the originator retains risk in an amount significant enough to function as a meaningful incentive for the originator to monitor the quality of all assets being securitized (and to which it would retain some credit risk exposure). The concept in the new proposal is generally unchanged from the original proposal.

Hedging, Transfer, and Financing Prohibitions

The new proposal would generally prohibit a sponsor from selling or transferring any interest or assets that it is required to retain under the rule to any person other than a majority-owned affiliate, except as discussed below. The new proposal would permit a transfer to one or more majority-owned affiliates because the sponsor would retain significant exposure to the credit risk of the securitized assets as a result of its interest in the majority-owned affiliate.

The new proposal also would generally prohibit a sponsor or any of its affiliates from hedging the credit risk the sponsor is required to retain under the rule, except as discussed below. Hedge positions that are not materially related to the credit risk of the particular securitization transaction would not be prohibited. Permitted hedges would include positions related to overall market interest rate movements, currency exchange rates, home prices, or of the overall value of

a particular broad ABS category. The new proposal also would permit hedges tied to securities that are backed by similar assets originated and securitized by other sponsors. There are proposed additional limitations on hedges, based on indices that may include one or more tranches from a sponsor's ABS transactions.

The new proposal would also prohibit a sponsor or any affiliate from pledging as collateral for any obligation any interest or asset the sponsor is required to retain, unless the obligation is with full recourse to the sponsor or affiliate.

Additionally, an originator, originator-seller, or a third-party purchaser which retains credit risk in accordance with the new proposal would be required to comply with the hedging prohibition to the same extent as the sponsor.

Duration of the Restrictions

Under the original proposal, restrictions prohibiting transfer or sale and hedging of required risk retention would have lasted for the duration of the ABS instrument, but comment was invited on this issue. The new proposal would incorporate hedging and transfer expiration timeframes. In contemplating whether duration limits for hedging and transfer would be appropriate, the Agencies carefully considered comments received regarding how credit risks relative to initial underwriting decline after a seasoning period, as well as information on credit defaults for various asset classes. The Agencies concluded that the primary purpose of risk retention – sound underwriting – is less likely to be effectively promoted by risk retention requirements after the period of time in which delinquencies historically tend to peak. After losses due to underwriting quality occur in the initial years following a securitization transaction, risk retention does little to improve the underwriting quality of ABS, as most subsequent losses are related to financial events, or in the case of residential mortgage-backed securities, life events

not captured in the underwriting process. Therefore, under the new proposal, except for residential mortgage securitizations and transfers of the horizontal residual interest in CMBS securitizations, the prohibitions on transfer and hedging would expire on the date that is the *later of* (1) when the total unpaid principal balance of the securitized assets that collateralize the transaction has been reduced to 33 percent of the original unpaid principal balance at closing, (2) when the total unpaid principal obligations under the ABS interests issued under the securitization transaction has been reduced to 33 percent of the unpaid principal obligations of the ABS interests at closing, or (3) 2 years after the securitization transaction closing.

For securitizations where all securitized assets are residential mortgages, the prohibitions on transfer or sale and hedging would expire beginning 5 years after the date of closing, if and when the total unpaid principal balance of the residential mortgages collateralizing the securitization has been reduced to 25 percent of the unpaid principal balance at closing, but in all cases, not later than 7 years after transaction closing.

With respect to CMBS, the new proposal would allow an initial third-party purchaser of an eligible horizontal residual interest at the closing of a securitization transaction or a sponsor that initially retained an eligible horizontal residual interest to transfer that interest to a subsequent qualified third-party purchaser on or after 5 years from the date of securitization transaction closing. A subsequent third-party purchaser could transfer or sell its acquired eligible horizontal residual interest at any time thereafter to another qualified third-party purchaser. This 5-year sunset on transfer prohibitions for CMBS was not included in the original proposal, but it was included in response to comments regarding industry practice and preserving liquidity and in light of the seasoning issues described above.

The proposed rule would also make restrictions on transfer and hedging inapplicable to retention interests inherited by a receiver or conservator appointed pursuant to Federal or state law. This would apply to the FDIC as well as the National Credit Union Association and FHFA when acting as receiver or conservator.

E. Exceptions and Exemptions

QRM Loans

Section 15G exempts from the risk retention requirements ABS issuances collateralized solely by QRMs and authorizes the Agencies to jointly define QRM, taking into consideration underwriting and product features that historical loan performance data indicate result in a lower risk of default. Section 15G also requires that the QRM definition be no less demanding than the definition of a QM under the Truth in Lending Act ("TILA"), as amended by the Dodd-Frank Act and regulations adopted thereunder.

The original proposal would have prohibited QRMs from having the type of product features that were observed to contribute significantly to the high levels of delinquencies and foreclosures since 2007, including negative amortization provisions, interest-only payment provisions, or provisions that would have permitted significant rate increases, as well as no- or low-documentation loans. The original proposal's QRM definition also required a maximum 80 percent LTV for purchase transactions, maximum 75 percent LTV for rate and term refinance loans, maximum 70 percent LTV for cash-out refinance loans, compliance with specified credit history conditions, that the mortgage be a first lien on a principal dwelling, and front-end and back-end DTI ratios of 28 percent and 36 percent or less, respectively. Prepayment penalties were also prohibited, and points and fees were limited.

In determining the appropriate scope of the new proposal's QRM definition, the Agencies weighed a number of factors, including the efficacy and cost of risk retention, current data on mortgage performance, the implications of the recently finalized QM definition and other rules addressing mortgages, and the current state of the mortgage market. The large majority of commenters criticized the original proposal. The new proposal would align the QRM definition with the definition of a QM in section 129C of TILA (15 U.S.C. 1639c) and its implementing regulations.[19] The CFPB issued a final QM rule on January 10, 2013, and finalized supplemental QM rules in May 2013 (together the "Final QM Rule").[20] The Final QM Rule is effective January 10, 2014. In general, a QM loan must have the following features: (1) regular periodic payments that are substantially equal; (2) no negative amortization, interest only, or balloon features; (3) a maximum loan term of 30 years; (4) total points and fees that do not exceed 3 percent of the total loan amount; (5) payments underwritten using the maximum interest rate that may apply during the first 5 years after the date on which the first regular periodic payment is due; (6) consideration and verification of the consumer's income and assets (including employment status, if relied upon), current debt obligations, alimony, and child support; and (7) total DTI that does not exceed 43 percent, including mortgage-related obligations. In recognition of the current mortgage market and expressed concerns over credit availability, the CFPB also finalized a second temporary QM definition. Under the temporary definition, a QM loan must have the features referred to in (1), (2), (3), and (4) above, in addition to being eligible for purchase, guarantee, or insurance by an Enterprise, HUD, or certain other U. S. government

[19] See 78 FR 6408.

[20] See 78 FR 6408 (January 30, 2013), entitled "Ability-to-Repay and Qualified Mortgage Standards under the Truth in Lending Act (Regulation Z); Final Rule" (January 2013 Final QM Rules). The CFPB subsequently proposed and finalized supplemental QM rules. See 78 FR 35430 (June 12, 2013) (Final Supplemental QM Rules). The CFPB's regulations implementing section 129C(b) are codified at 12 CFR part 1026.

agencies ("GSE eligible"). The CFPB also developed additional QM definitions to facilitate credit offered by certain small creditors. These additional small creditor-specific QM definitions include greater underwriting flexibility (i.e., no quantitative DTI ratio applies) and the ability to originate and hold balloon mortgages, but these would generally be ineligible as QRMs for 3 years from origination.

Under the definition of QM, QRM would also exclude home equity lines of credit, reverse mortgages, timeshares, temporary loans or "bridge" loans of 12 months or less, and most loan modifications (unless they satisfy certain requirements). Mortgages would be allowed to consist of both first and junior lien positions and any closed-end loan secured by a dwelling (including other than a principal dwelling).

The new proposal also would require that the depositor of an ABS certify that it has evaluated the effectiveness of its internal supervisory controls with respect to the process for ensuring that all assets that collateralize the ABS are QRMs and has concluded that the internal supervisory controls are effective.[21] Nevertheless, despite the use of robust processes and procedures, it is possible that one or more QRM loans collateralizing an ABS issuance may later be determined to have not satisfied the QRM definition due to inadvertent error. Under the new proposal, a sponsor would not become ineligible for the QRM exemption if it is determined that, after the closing date, one or more of the mortgages do not meet all of the criteria to be a QRM. However, to maintain the exemption, (i) the depositor must have certified as to the effectiveness of its internal supervisory controls, (ii) the sponsor must repurchase the loans determined not to be QRMs from the issuing entity at a price at least equal to the remaining principal balance and accrued interest not later than 90 days after it is determined the loans do not satisfy the QRM

[21] A "depositor" is defined to mean the entity (the depositor) that deposits the assets that collateralize the ABS with the issuing entity.

requirements, and (iii) the sponsor must cause prompt notice to be given to holders of the ABS of any loans required to be repurchased.

The Agencies believe that a QRM definition that adopts the definition of QM satisfies the statutory requirements. The QM standards eliminate the risky loan features and underwriting practices evident during the recent financial crisis and significantly lower the risk of default. The Agencies believe the QM standards will mitigate adverse effects on borrowers, originators, and the mortgage and credit markets in general. This is particularly the case in the current environment, where mortgage lending standards remain exceptionally tight and there are few private mortgage securitizations. These factors have constrained credit access for many creditworthy borrowers.[22] Lack of credit access or high credit costs often affect creditworthy lower-income borrowers and first-time home purchasers most significantly. Aligning the definition of QRM with the definition of QM achieves an appropriate balance between limiting credit risk for the protection of investors, as required under section 15G, and preserving credit access. Moreover, the aligned definition facilitates clarity for all participants in the mortgage market, as well as compliance, and reduces associated costs by providing the mortgage market the benefit of a uniform regulatory framework for underwriting residential mortgages.

Request for Comment on Alternative QRM Approach

While the proposed rule would align QRM with the definition of QM, the Agencies also ask questions in the preamble to the NPR about an alternative QRM approach ("QM-plus"). QM-plus would add the following standards to the QM criteria: a maximum 70 percent LTV ratio; collateral must be first liens on the borrower's principal dwelling – for purchase loans, no other liens could exist, but refinance loans could have junior liens subject to the LTV

[22] See Financial Stability Oversight Council Annual Report, section 5.1.4, pp. 57-59.

requirement on a combined basis; and credit history metrics regarding delinquencies and other legal actions. Additionally, loans that are QM because they meet the CFPB's provisions as GSE eligible or are small credit or balloon loan exceptions would not be considered QRMs under the QM-plus approach. Questions ask about the benefits and drawbacks of such an approach on default risk, encouraging a more robust non-QRM market, credit costs, credit availability, and operational feasibility.

Qualifying CRE, Commercial, or Automobile Loans

Under section 15G, the regulations issued by the Agencies must include underwriting standards for CRE, commercial, and automobile loans, as well as any other asset class the Federal banking agencies and the Commission deem appropriate. These underwriting standards must specify terms, conditions, and characteristics of a loan within these asset classes that indicate low credit risk with respect to the loan. Section 15G permits the Federal banking agencies to specify underwriting standards that would allow a securitizer to retain less than 5 percent of the credit risk of loans within an asset class that meet the underwriting standards ("qualifying CRE, commercial, or automobile loans").

Consistent with section 15G, the new proposal would offer a zero percent risk retention requirement for ABS issuances collateralized solely by qualifying CRE, commercial, or automobile loans, and servicing assets related to these asset classes. The underwriting standards for these qualifying loans are designed to ensure that each loan exhibits extremely low credit risk. As required under section 15G, staffs of the Federal banking agencies believe that the proposed exemptions for qualifying loans help ensure high-quality underwriting standards and encourage appropriate risk management practices by sponsors and originators of assets.

The Agencies believe that the proposed underwriting standards establish clear requirements, which are necessary to enable originators, sponsors, and investors all to be confident that any particular loan meets the current proposal's requirements for an exemption. The Agencies note concerns expressed by some commenters on the first NPR regarding the conservative nature of the originally proposed underwriting standards for these three asset classes and that commensurately the criteria will not result in more than an exceedingly small portion of assets pertaining to the respective asset classes qualifying for the exemption. The Agencies believe this is appropriate because unlike the securitized residential mortgage loan market, there is no homogeneity in the securitization market for commercial and CRE loan asset classes. Commercial and CRE loans typically focus on a common set of borrower and collateral metrics, but they are individually underwritten and tailored to a specific borrower or property and reflect not only the borrower's financial position but also the general business cycle, industry business cycle, and standards for appropriate leverage in that industry sub-sector. The Agencies acknowledge that, while there may be more homogeneity in the securitized automobile loan class, they are concerned that attempting to accommodate a significantly large share of the current automobile loan securitization market would require weakening the underwriting standards to the point where the Agencies are skeptical that they would consistently reflect loans of a low credit risk. Nevertheless, in response to comments received, the new proposal would adjust some underwriting standards for each of the three asset classes.

Following the closing of a securitization transaction, if it is determined that a qualifying CRE, commercial, or automobile loan does not satisfy the current proposal's underwriting standards, the sponsor would not automatically become ineligible for the exemption. However, to maintain eligibility for an exemption, the depositor and sponsor would need to satisfy the

certification requirements discussed previously with respect to QRM loans and either the failure of the loan to meet any of the requirements is not material or no later than 90 days after it is determined the loan does not meet one or more of the requirements the sponsor remediates the deficiency or repurchases the loan and provides notification previously discussed. Under the original proposal, sponsor repurchase of the non-qualifying loan was the sole option.

Qualifying CRE Loans

The underwriting standards for qualifying CRE loans focus primarily on the borrower's ability to repay the loan, whether the originator has obtained a perfected security interest in most types of collateral for the CRE loan, and the LTV at the time of origination. In evaluating the borrower's ability to repay the loan, the new proposal would require originators to evaluate the financial condition of the borrower and the sufficiency of any revenue generated by the CRE to cover loan payments. Among other proposed underwriting standards, a qualifying CRE loan must: (i) be an enforceable first lien on the CRE and improvements, with, in general, a perfected lien on the borrower's interest in tangible and intangible property associated with the underlying CRE; (ii) be limited in term to 25 years on a straight-line amortization basis, or 30 years for a qualifying multi-family property; (iii) with respect to the borrower, satisfy a minimum debt service coverage ("DSC") ratio of 1.5x if the loan is a qualifying leased CRE loan, 1.25x if the loan is a qualifying multi-family property loan, or 1.7x for all other CRE loan types; and (iv) at the time of origination, have a LTV ratio of no greater than 65 percent and combined LTV no greater than 70 percent, or 60 percent and 65 percent, respectively, where the appraisal uses a capitalization rate no greater than specified. Further, the borrower must be required to maintain insurance that provides coverage in an amount no less than the amount of the CRE loan and

names the lender as additional insured or loss payee. The proposed rule does not exclude loans to real estate investment trusts ("REITs") from potential eligibility.

The Agencies adjusted a number of the aforementioned and other underwriting standards after considering comments received on the original proposal and available data. Among other features, under the original proposal, the maximum loan term was 20 years; the minimum DSC was 1.7x, or at least 1.5x for qualifying multi-family properties and certain properties with at least 80 percent triple-net leases;[23] combined LTVs were each 5 percent lower; and loans to REITs would have been ineligible.

Qualifying Commercial Loans

The new proposal's standards for qualifying commercial loans would include requirements for evaluating the financial condition of the borrower and its ability to repay as well as, for secured commercial loans, covenants regarding the maintenance of, and ability to grant additional liens on, collateral.

Under the new proposal, for an ABS issuance collateralized solely by commercial loans and servicing assets to qualify for a zero percent risk retention requirement, the originator must have conducted an analysis of the borrower's ability to service all outstanding debt over the next 2 years, and have determined that, following origination, the borrower would have a total liabilities ratio of less than or equal to 50 percent, a leverage ratio of no more than 3.0, and a DSC ratio of no less than 1.5x. The loan payment amount must be determined based on straight-line amortization of principal and interest over a term no longer than 5 years from origination, and the primary repayment source for the loan must consist of business revenue of the borrower. The principal changes from the original proposal are that first liens on collateral are not required,

[23] The original proposal defined a triple-net lease as one in which the lessee, not the lessor, is obligated to pay for taxes, insurance, and maintenance on the leased property.

except in the case of property that the loan documents indicate was intended to be financed by the loan and agricultural loans are no longer specifically excluded.

Qualifying Automobile Loans

For qualifying automobile loans, the new proposal would require that, prior to origination, the originator determine and document through a credit report that the borrower has at least 24 months of credit history and that, upon origination of the loan, the borrower's monthly DTI ratio would be less than or equal to 36 percent. The DTI ratio would be supported through verified and documented income. Additionally, the new proposal would require that the originator verify and document from the credit report within 30 days of origination of the loan, that the borrower was not currently 30 days or more past due on any debt obligation; not 60 days or more past due within the past 24 months; and not the subject of any bankruptcy, foreclosure, or similar proceeding within the previous 36 months. The borrower would also be required to meet down payment requirements from personal funds and trade-in allowance, if any, at least equal to the total of: vehicle title, tax, and registration fees; any dealer-imposed fees; additional warranties, insurance, or other products purchased; and 10 percent of the vehicle purchase price. The new proposal would require the borrower to pay level monthly payments that fully amortize the loan over a term not to exceed the lesser of 6 years from the origination date or 10 years minus the difference between the current model year and the vehicle's model year. The initial payment would be due within 45 days of the contract date and the borrower would not be permitted to defer principal or interest under the loan documents. The proposed rule does not distinguish between new and used vehicles.

In response to the original proposal, some commenters urged, among other things, that the Agencies incorporate a Fair Isaac Corporation ("FICO") score in the qualifying automobile

loan underwriting criteria rather than a DTI. The Agencies acknowledge that much of the industry generally does not rely on DTI and considered the FICO suggestions. However, the Agencies believe that DTI is a more transparent and appropriate tool to assist in assessing a borrower's potential ability to repay and did not choose to incorporate a measurement standard generated by a non-regulated entity. Nevertheless, the Agencies did adjust several of the aforementioned underwriting standards, after considering comments received on the original proposal. In contrast, for example, under the original proposal, the down payment requirement was 20 percent, two credit reports were required, loan payments were on a straight-line amortization basis, the maximum loan term was 5 years, and distinctions were made between new and used car purchase prices and loan terms.

Blended Asset Pools

The original proposal did not permit a reduction of the required risk retention unless all assets in the securitization pool were qualifying assets. Commenters responding to the original proposal were concerned that requiring every asset in a collateral pool to meet the originally proposed underwriting standards would make it difficult to obtain a large enough pool of qualifying assets to issue a securitization in a timely manner, and therefore some originators would not underwrite to the qualifying asset standards. Commenters representing investors in securitization transactions generally opposed mixed pools of qualifying and non-qualifying assets, asserting that this would allow sponsors too much latitude in securitization collateral composition and potentially increase risk of credit loss for investors. After considering comments received, the Agencies believe that allowing both qualifying and non-qualifying assets to secure an ABS should promote liquidity in the relevant securitization markets without harming the goals of the risk retention requirement and that applying a zero percent risk retention

requirement to specific assets in such blended asset pools that meet the new proposal's underwriting standards would be appropriate given the high credit quality of such assets.

The new proposal would require that any non-qualifying assets that secure an ABS be subject to full risk retention requirements, including holding risk retention at 5 percent of the fair value of the assets, and also including hedging and transfer restrictions on the retained interest. The new proposal would allow the sponsor to reduce its 5 percent risk retention requirement by the ratio of the combined unpaid principal balance of qualified loans to the total unpaid principal balance of the loans in the pool. For example, if a $100 million pool of commercial mortgages included a sum total of $20 million of qualifying commercial mortgages, the ratio would be one-fifth, and the sponsor could reduce its 5 percent risk retention requirement by one-fifth, for a retention holding requirement of 4 percent. The new proposal would impose a floor of 2.5 percent risk retention for any securitization that includes both qualifying and non-qualifying CRE, commercial, and automobile loans. Additionally, the new proposal would not provide an exemption from or reduction of risk retention for ABS backed by pools of loans comprised of mixed asset classes (e.g., automobile and commercial loans).

The new proposal would also require sponsors of these mixed-pool ABS to disclose to investors, their primary Federal regulator, and the Commission the manner in which the sponsor determined the aggregate risk retention requirement for the pool after including qualifying assets with zero percent risk retention, a description of the qualified and non-qualified asset groups, and any material differences between them with respect to the composition of each group's loan balances, loan terms, interest rates, borrower credit information, and characteristics of any loan collateral.

General Exemptions

Section 15G requires the Agencies to allow a total or partial exemption from the risk retention requirements for certain types of securitization transactions. Consistent with these provisions, the new proposal would exempt from the risk retention requirements: (i) residential, multi-family, or healthcare facility mortgage loan securitizations that are themselves, or that are collateralized by assets that are, insured or guaranteed by the U. S. or an agency of the U. S. (other than the Enterprises and the Federal Home Loan Banks); (ii) securitization transactions that are collateralized solely by loans or other assets made, insured, guaranteed, or purchased by an institution that is subject to the supervision of the Farm Credit Administration, including the Federal Agricultural Mortgage Corporation; (iii) ABS issued or guaranteed by any state, or by any political subdivision of a state or territory, or by any public instrumentality of a state or territory that is exempt from the registration requirements of the Securities Act of 1933 under Section 3(a)(2) of that Act; (iv) ABS that meet the definition of qualified scholarship funding bonds under the Internal Revenue Code; (v) ABS collateralized by obligations of the U. S. government (or an agency thereof) or assets that are fully guaranteed or insured by the U. S. government (or an agency thereof); (vi) ABS fully guaranteed or insured by the U. S. government (or an agency thereof); (vii) re-securitization transactions that are collateralized solely by servicing assets and tranches of ABS transactions that comply with, or are exempt from, the risk retention requirements of the current proposal and structured as a single class of ABS interests entitled to the pass-through of principal and.interest payments received on the underlying ABS; (viii) re-securitization transactions that are collateralized solely by servicing

assets and first-pay classes[24] of ABS (for which required credit risk was already retained or which were exempt) collateralized by first-lien residential mortgages on properties located in the U. S., as long as they are structured to reallocate prepayment risk and not credit risk and do not include inverse floaters or similarly structured ABS interests; (ix) ABS collateralized solely by seasoned loans;[25] (x) ABS where the transactions are secured by the intangible property right to collect charges for the recovery of specified costs and such other assets, if any, of an issuing entity that is wholly owned, directly or indirectly by an investor-owned utility company that is subject to the regulatory authority of a state public utility commission or other appropriate state agency; (xi) FDIC-sponsored securitizations when acting as conservator or receiver; and (xii) ABS collateralized solely by servicing assets and student loans made under the Federal Family Education Loan Program ("FFELP") that are guaranteed as to 100 percent of defaulted principal and accrued interest. With respect to a securitization transaction collateralized solely by servicing assets and FFELP loans guaranteed to at least 98 percent, the risk retention requirement is proposed to be 2 percent, and with respect to any other securitization transaction collateralized solely by servicing assets and FFELP loans the risk retention is proposed to be 3 percent. Risk retention exemptions or partial exemptions described above and noted as (viii) through (xii) were

[24] First-pay class means a class of ABS interests for which all interests in the class are entitled to the same priority of payment and that, at the time of closing of the transaction, is entitled to repayments of principal and payments of interest prior to or pro-rata with all other classes of securities collateralized by the same pool of first-lien residential mortgages until such class has no principal or notional balance remaining.

[25] A seasoned loan has not been modified since its origination and has not been delinquent for 30 days or more. With respect to a residential mortgage loan, a seasoned loan is a loan that has been outstanding and performing for the longer of 5 years or until the outstanding principal balance of the loan has been reduced to 25 percent of the original principal balance. Notwithstanding the aforementioned criteria, a residential mortgage loan is considered seasoned if it has been outstanding and performing for at least 7 years. Additionally, with respect to all other loan types, a seasoned loan is a loan that has been outstanding and performing for the longer of 2 years or until the outstanding principal balance of the loan has been reduced to 33 percent of the original principal balance.

not contained in the original proposal and, in general, were added after reviewing and considering comments received.

F. Summary of New Proposal

While some of the changes to the original proposal would generally allow increased flexibility to meet risk retention requirements and generally are intended to be consistent with industry methods for risk retention for different asset types, staff believes that the menu of options approach to risk retention, together with exemptions and risk retention options for specific types of securitizations, will help ensure that securitizers and (where applicable) others retain a meaningful amount of credit risk in a way that minimizes potential adverse impacts.

Moreover, in formulating the new proposal, the Agencies considered the potential impact on credit pricing and credit availability, among other things. The Agencies have sought to balance ensuring good underwriting and increased transparency for investors while also attempting to ensure that risk retention does not reduce credit availability, that the costs of risk retention are as limited as possible, and that risk retention does not disrupt the functioning of the securitization market. Staff believes the proposed rule is consistent with the stated objectives of section 15G and will foster sound underwriting and prudent risk management practices with respect to loan origination.

POST ADOPTION INTERPRETATION OF THE PROPOSED RULE

In the preamble to the original proposal, the Agencies explained that they would jointly approve any interpretation of the rule that was intended to be relied upon by the public generally. Staff comment letters, informal written guidance to specific institutions, and matters raised in a report of examination or inspection, which are not intended to be relied upon by the public generally, would have been excluded from this joint interpretation process. Commenters

expressed concern about the ability of the Agencies to agree upon and respond to requests for guidance in a timely manner. The preamble to the new NPR states that the Agencies intend to consult when adopting staff interpretations or guidance that would be shared with the public generally, but notes that they are still considering whether to require that such interpretations and guidance be jointly issued. In addition, the new NPR makes clear that enforcement actions would not require joint agency approval.

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