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Credit Risk Retention – Joint Regulatory Re-Proposed Rules

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On August 28, 2013, six federal agencies[1] jointly re-proposed rules[2] to implement the credit risk retention requirements of Section 15G of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), which was added by Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The Agencies originally proposed rules to implement the credit risk retention requirements on March 29, 2011.[3]

The supplementary information that accompanies the re-proposed rules includes over 100 specific questions on which comments are sought. Comments on the re-proposed rules must be received by October 30, 2013.

SCOPE OF THE RE-PROPOSED RULES

Generally, the re-proposed rules require a sponsor of a publicly registered or privately placed asset-backed securities transaction to retain at least 5% of the credit risk related to the securitization and restrict the transfer, hedging and pledging of the sponsor's retained interest. No risk retention is required with respect to specified asset classes if all of the underlying loans in a securitization comply with the qualification provisions set forth in the re-proposed rules for those asset classes, namely for residential mortgages, commercial loans, commercial real estate loans and auto loans. Other general exemptions from the proposed credit risk retention rules are also provided for certain specified transactions.

The re-proposed rules delineate, among other things, the permitted forms of risk retention, including standard forms and certain transaction-specific forms, the circumstances in which a sponsor may allocate its risk retention responsibilities to the originator of the loans included in the securitization, the disclosure requirements applicable to each permitted form, restrictions on transferring, hedging and pledging the retained credit risk, and the definitions of "qualified residential mortgage," "qualifying commercial loan," "qualifying CRE loan" and "qualifying automobile loan."

PERMITTED FORMS OF RISK RETENTION

The original proposal provided five principal options for satisfying the risk retention requirements, including vertical risk retention, horizontal risk retention, L-shaped risk retention, seller's interest (for revolving asset master trusts) and representative sample risk retention.

The re-proposed rules provide for a "menu of options" to satisfy the risk retention requirements, including "standard" options as well as options designed for specific structures and asset classes.[4] Unless a transaction qualifies for an exemption from the risk retention requirements or for one of

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[1] The Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation (the "FDIC"), the U.S. Securities and Exchange Commission (the "Commission"), the Federal Housing Finance Agency (the "FHFA") and the Department of Housing and Urban Development (collectively, the "Agencies").

[2] Referred to herein as the "re-proposal" or the "re-proposed rules." The re-proposed rules and supplementary information are available at **http://www.sec.gov/rules/proposed/2013/34-70277.pdf**.

[3] Referred to herein as the "original proposal." The original proposal and supplementary information are available at **http://sec.gov/rules/proposed/2011/34-64148.pdf**. Orrick's white paper summarizing the original proposal is available at **http://www.orrick.com/Events-and-Publications/Documents/3565.pdf**.

[4] The representative sample form of risk retention included in the original proposal has been eliminated in the re-proposal.

the reduced risk retention alternatives, the sponsor would be required to retain a portion of the credit risk of the securitization equivalent to at least 5% of the credit risk of the securitized assets. The retained credit risk may be in any of the forms described below, subject to the satisfaction of the related requirements.

Standard Risk Retention Options (§ .4)

Under the re-proposal, the sponsor may satisfy the risk retention requirements by retaining an eligible vertical interest, an eligible horizontal residual interest or any combination thereof, in any proportion, in a total amount equal to no less that 5% of the fair value[5] of all "ABS interests"[6] issued as part of the transaction.

Vertical Risk Retention The sponsor may retain at least 5% of the fair value of each class of ABS interests issued in the securitization. Alternatively, the sponsor may satisfy its risk retention requirements under the vertical option by electing to retain a "single vertical security" entitling the holder to a specified percentage (at least 5%) of the principal and interest payable on each class of ABS interests issued by the issuing entity (not including such single vertical security). The Agencies indicated that the single vertical security option is intended to provide sponsors with an option that is simpler than holding a separate interest in each ABS interest issued by the issuing entity, which the Agencies acknowledge could prove burdensome from a valuation and financial reporting standpoint.

Horizontal Risk Retention The sponsor may retain a first-loss position of at least 5% of the fair value of all ABS interests issued in the securitization. The horizontal option can be satisfied by the retention of one or more classes so long as each interest qualifies, individually or in the aggregate, as an eligible horizontal residual interest. Multiple retained classes would need to be consecutive in terms of subordination level. To qualify, a retained interest must have the most subordinated claim to payments of both principal and interest by the issuing entity. In addition, on any payment date on which there is a shortfall in principal or interest, payment on the horizontal residual interest must be reduced by the amount of such shortfall before payments on any other ABS interest are reduced.

- Projected Cash Flows Prior to the issuance of an eligible horizontal residual interest, a sponsor would be required to calculate projected cash flows on the horizontal residual interest and principal payments on all ABS interests and certify to investors that the horizontal residual interest is not projected to receive cash flows on any future payment date at a faster rate than the rate at which principal payments are projected to be received on all ABS interests. A sponsor would be required to retain written records of the certifications it provides in connection with projected cash flows on the horizontal residual interest until three years after all ABS interests are no longer outstanding. The re-proposal provides a detailed method for calculating the projected cash flows using the same assumptions and discount rates used to calculate the fair value of the horizontal residual

[5] The method for calculating the retained interest amount has changed from a "par value" method in the original proposal to a "fair value" method, as discussed further under "Calculation of Retained Interest Amount" below.

[6] The re-proposed rules define "ABS interests" broadly to include any type of interest or obligations, certificated or not, issued by an issuing entity, including a security, obligation, beneficial interest or residual interest, the payments on which are primarily dependent on cash flows from the securitized assets. "ABS interests" do not include interests issued primarily to evidence ownership in the issuing entity, such as common or preferred stock, that are not dependent on cash flows from the securitized assets.

interest, as described below. This feature of the rule is intended to prevent sponsors from structuring a transaction in which the eligible horizontal residual interest will receive cash flows at a disproportionally faster rate, thus diluting the sponsor's "skin in the game." The projections would be calculated once, prior to issuance, allowing for sponsors to receive the upside from a transaction that outperforms expectations. The Agencies are also considering an alternative formulation based on actual payments rather than projected cash flows that would limit the amounts payable on the horizontal residual interest by reference to amounts paid on the other ABS interests.

- Horizontal Cash Reserve Account As an alternative to retaining a horizontal residual interest, the sponsor may establish and fund a horizontal cash reserve account, to be held by a trustee for the benefit of the issuing entity, in the amount that would be required if the sponsor were to hold an eligible horizontal residual interest. Funds in the cash reserve account would be used to cover shortfalls in the cash flows on the ABS interests. The cash reserve account option includes restrictions on the release of funds to the sponsor and restrictions on the investments that may be made with the funds in the account. If money is released from the account other than to cover shortfalls in cash flows on the ABS interests (other than interest on permitted investments), the cash flow projection requirements described above would also apply to the horizontal cash reserve account option.

Combined Option While the original proposal provided for an "L-shaped" risk retention option, which consisted of a combination of vertical and horizontal risk retention in a proportion specified under the original proposal, the re-proposed rules would allow for the risk retention requirement to be satisfied using a combination, in any proportion, of the vertical risk retention option and horizontal risk retention option (including the cash reserve fund option). The Agencies indicated that this flexible approach is intended to accommodate a variety of structures utilized in the securitization industry.

Calculation of Retained Interest Amount Under the standard risk retention option, regardless of whether the retained interest is held in the form of a vertical interest, a horizontal residual interest or a combination of the two, the total interest must equal at least 5% of the fair value of all ABS interests issued in the subject securitization transaction, determined in accordance with United States generally accepted accounting principles. The fair value of the ABS interests must be determined on the date of pricing of the ABS interests.

In light of the replacement of the original proposal's par value approach with the fair value approach, the Agencies have eliminated the "premium capture cash reserve account" concept included in the original proposal, which was intended to restrict the sponsor from monetizing excess spread at the outset of a securitization that included interest-only tranches or premium bonds, potentially reducing the effect of the risk retention provisions.

Transaction-Specific Risk Retention Options

Revolving Master Trusts (Seller's Interest) **(§__.5)** The re-proposal would allow the sponsor of a revolving master trust[7] to satisfy the risk retention requirements by retaining a seller's interest of at least 5% of the unpaid principal balance of all outstanding investors' ABS interests issued by that revolving master trust.

[7] Defined as "an issuing entity that is (1) A master trust; and (2) established to issue on multiple issuance dates one or more series, classes, subclasses, or tranches of asset-backed securities all of which are collateralized by a common pool of securitized assets that will change in composition over time."

A "seller's interest" under the re-proposal is an ABS interest or ABS interests (1) collateralized by all of the securitized assets and servicing assets owned or held by the issuing entity other than assets that have been allocated to a specific series, (2) that is pari passu to each series of investors' ABS interests of the issuing entity with respect to the allocation of distributions and losses with respect to the securitized assets prior to early amortization, and (3) that adjusts for fluctuations in the outstanding principal balance of the securitized assets.

The re-proposal makes a number of modifications to the seller's interest option provided for in the original proposal, including the following:

- allowing the seller's interest to be held by one or more wholly-owned affiliates of the sponsor and recognizing that the seller's interest is often held by the depositor;
- calculating the minimum seller's interest based on the amount of the outstanding unpaid principal balance of investors' ABS interests, rather than calculating the minimum seller's interest based on the amount of trust assets (note, however, that the amount of outstanding ABS interests used in this calculation would include any sponsor/seller-retained ABS interests issued under a series);
- removing the restriction prohibiting the use of the seller's interest risk retention option for master trust securitizations backed by non-revolving assets;
- revising the definition of "seller's interest" from requiring the seller's interest to be pari passu with all other ABS interests issued by the issuing entity to requiring the seller's interest to be pari passu with investors' ABS interests at the series level;
- clarifying that servicing assets, to the extent allocated as collateral for a specific series, are not part of the seller's interest;
- allowing the seller's interest to be retained in multiple interests, rather than a single interest, to address legacy trust structures;
- prohibiting the seller's interest approach for any revolving master trust that includes senior interest-only bonds or premium bonds among the ABS interests it issues to investors; and
- allowing the sponsor to be eligible to combine the seller's interest with either of the following two horizontal types of risk retained at the series level: (A) the standard horizontal risk retention option, or (B) the residual interest option so long as (i) the sponsor maintains a specified amount of horizontal risk retention in every series issued by the trust, (ii) each series distinguishes between the series' share of the interest and fee cash flows and the series' share of the principal repayment cash flows from the securitized assets collateralizing the revolving master trust (i.e., separate waterfalls), (iii) the horizontal residual interest's claim to any part of the series' share of the interest and fee cash flows is subordinated to all accrued and payable interest and principal due to more senior ABS interests in the series and reduced by the series' share of losses, (iv) the horizontal residual interest has the most subordinated claim to any part of the series' share of the principal repayment cash flows, and (v) the trust remains a revolving trust.

The re-proposed rules also address the circumstances under which a sponsor may become non-compliant with the risk retention requirements in the early amortization context, but do not address circumstances where a sponsor becomes non-compliant with the risk retention requirements in the scheduled amortization context. Under the re-proposed rule, the sponsor of a

revolving master trust collateralized solely by revolving assets that suffers a decline in its seller's interest during an early amortization period caused by an unsecured adverse event would not violate the rule's risk retention requirements as a result of such decline if (i) the sponsor was in full compliance with the risk retention requirements on all measurement dates before the early amortization triggering event occurred, (ii) the terms of the seller's interest continue to make it pari passu or subordinate to each series of investors' ABS interests issued by the issuing entity with respect to the allocation of losses, (iii) following the commencement of early amortization, the revolving master trust issues no additional ABS interests to any person not wholly-owned by the sponsor, and (iv) to the extent that the sponsor is relying on any horizontal residual interests to reduce the percentage of its required seller's interest, those interests continue to absorb losses. The re-proposed rules also recognize excess funding accounts as a supplement to the seller's interest, and the required amount of the seller's interest may be reduced on a dollar-for-dollar basis by the amount of cash retained in an excess funding account triggered by the trust's failure to meet the minimum seller's interest.

The sponsor would be required to meet, and therefore presumably demonstrate compliance with, the 5% test not only at the closing of each issuance of ABS interests by the revolving master trust, but at every seller's interest measurement date specified under the securitization transaction documents, and no less than monthly.

Sponsors relying on the seller's interest approach would need to comply with the rule upon its effectiveness, without regard to whether the investors' ABS interests were issued before or after the rule's effective date. A sponsor's compliance with the risk retention requirements will be based on the sponsor's actual conduct, and therefore, the sponsor does not need to revise the terms of outstanding series to conform to the rule's exact requirements.

***Eligible ABCP Conduits* (§__.6)** Aside from the detailed items set forth below, the re-proposed rules for ABCP[8] securitization transactions retain the basic structure of the original proposal. In short, the sponsor of an eligible ABCP conduit can satisfy its risk retention requirements where (i) the ABCP conduit is fully supported by a liquidity facility provided by a prudentially regulated domestic financial institution or by certain foreign financial institutions, and (ii) the related sponsor-approved originator-seller or majority-owned originator-seller affiliate retains an economic interest in the credit risk of the transferred assets using one of the standard risk retention or revolving master trust options.

The following items are important modifications from the original proposal:

- Whereas previously each pool of assets would be required to have only one originator-seller, now both an originator-seller and a majority-owned originator-seller affiliate would be permitted to sell or transfer assets that they have originated to a wholly-owned (directly or indirectly) but bankruptcy remote special purpose vehicle that issues asset-backed securities collateralized solely by such assets (an "intermediate SPV").[9]

- Whereas previously all senior interests in each pool of assets were required to be purchased only by ABCP conduits, the re-proposal provides additional flexibility to finance

[8] Defined as "asset-backed commercial paper that has a maturity at the time of issuance not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited."

[9] An intermediate SPV cannot, however, acquire assets directly from non-affiliates, and thus the re-proposed rules do not accommodate aggregators who use ABCP to finance assets acquired in the open market.

credits through not only an ABCP conduit, but also other asset-backed securities channels (e.g., some originator-sellers operate a revolving master trust).

- Whereas previously originator-sellers would lose the option of choosing the risk retention requirement most suitable to the pools of assets being securitized (since the ABCP alternative risk retention option required each originator-seller to comply with the horizontal risk retention requirement), the re-proposed rules allow originator-sellers to rely on any of the risk retention options described in the re-proposed rule.

- Whereas previously disclosure of the originator-seller's identity was required, the re-proposal only requires the sponsor of an ABCP conduit to provide to each purchaser of ABCP the name and form of organization of the regulated liquidity provider that provides liquidity coverage to the eligible ABCP conduit (including a description of the form, amount, and nature of such liquidity coverage, and notice of any failure to fund).

The re-proposed rules also introduce several new concepts:

- The re-proposed rules introduce the concept of a "majority-owned originator-seller affiliate," defined 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.

- The re-proposed rules allow for multiple intermediate SPVs between an originator-seller and a majority-owned originator-seller affiliate. The intermediate SPV would be permitted to acquire assets originated by the originator-seller or its majority-owned originator-seller affiliate from the originator-seller or majority-owned originator-seller affiliate, or it could also acquire assets or asset-backed securities from another controlled intermediate SPV collateralized solely by securitized assets originated by the originator-seller or its majority-owned originator-seller affiliate, and servicing assets.

- The re-proposed rules expand the types of collateral that an eligible ABCP conduit can acquire, which would include: (1) ABS interests supported by securitized assets originated by an originator-seller or one or more majority-owned originator-seller affiliates of the originator seller, and by servicing assets; (2) special units of beneficial interest or similar interests in a trust or special purpose vehicle that retains legal title to leased property underlying leases that were transferred to an intermediate SPV in connection with a securitization collateralized solely by such leases originated by an originator-seller or majority-owned originator-seller affiliate, and by servicing assets; and (3) interests in a revolving master trust collateralized solely by assets originated by an originator-seller or majority-owned originator-seller affiliate, and by servicing assets.

Certain restrictions are clarified by the re-proposed rule:

- The ABCP conduit has to be collateralized solely by asset-backed securities acquired by the ABCP conduit in an initial issuance by or on behalf of an intermediate SPV directly from the intermediate SPV, from an underwriter of the securities issued by the intermediate SPV, or from another person who acquired the securities directly from the intermediate SPV, and servicing assets.

- The re-proposed rules require that a regulated liquidity provider must have entered into a legally binding commitment to provide 100% liquidity coverage on all the ABCP issued by

the issuing entity. In the event that the ABCP conduit is unable for any reason to repay maturing ABCP issued by the issuing entity, the total amount for which the liquidity provider may be obligated would be equal to 100% of the amount of ABCP outstanding plus accrued and unpaid interest. Liquidity coverage that only funds performing receivables or performing ABS interests would not meet the requirements of the ABCP option.

The sponsor of an eligible ABCP conduit would be responsible for compliance and therefore would be required to (i) monitor compliance by the originator-sellers, (ii) approve each originator-seller and each intermediate SPV, and (iii) establish criteria governing eligible assets. If an ABCP sponsor determines that compliance has not been maintained by an originator-seller or majority-owned originator-seller affiliate, such sponsor would be required to promptly notify investors, the Commission and its appropriate Federal banking agency, if any, in writing of (1) the name and form of organization of any originator-seller that fails to maintain its credit risk retention and the amount of asset-backed securities issued by an intermediate SPV of such originator-seller and held by the ABCP conduit, (2) the name and form of organization of any originator-seller or majority-owned originator-seller affiliate that hedges, directly or indirectly through an intermediate SPV, its risk retention in violation of its risk retention requirements and the amount of asset-backed securities issued by an intermediate SPV of such originator-seller or majority-owned originator-seller affiliate and held by the ABCP conduit, and (3) any remedial actions taken by the ABCP conduit sponsor or other party with respect to such asset-backed securities. In addition, such ABCP conduit sponsor would be required to take other appropriate steps, including, as appropriate, curing any breach of the requirements or removing from the eligible ABCP conduit any asset-backed security that does not comply with the applicable requirements.

***CMBS* (§__.7)** The rules re-propose, with some modification, an option specific to commercial mortgage backed securities (CMBS) transactions (now defined as those collateralized solely by commercial real estate loans and servicing assets), in addition to the general options discussed above. The risk retention requirement may be satisfied, in whole or in part (thereby permitting this option to be combined with a sponsor-retained vertical interest), if a third-party purchaser (or two pari passu third-party purchasers), purchases and retains for its own account an interest that would satisfy the horizontal risk retention option discussed above and if the following additional conditions are satisfied:

- the purchaser pays for its interest in cash at closing without financing (direct or indirect) from any transaction party (or affiliate thereof) other than an investor;
- each third-party purchaser reviews the credit risk of each asset in the pool prior to the sale of the CMBS including, at a minimum, underwriting standards, collateral and expected cash flows;
- no third-party purchaser may be affiliated with any transaction party other than an investor except (x) the special servicer or (y) one or more originators, as long as the assets originated by the affiliated originator(s) collectively comprise less than 10% of the principal balance of the securitized assets at closing;
- the operative documents provide (1) an unaffiliated operating advisor is appointed that does not have a direct or indirect financial interest in the transaction other than its fees as operating advisor, (2) the operating advisor is required to act in the best interest of the investors as a collective whole, (3) the standards with respect to the operating advisor's required experience, expertise and financial strength in relation to its duties over the life of the transaction, (4) the terms of the compensation of the operating advisor, (5) when the

retained horizontal risk interest is 25% or less of its initial principal balance, the special servicer is required to consult with the operating advisor in connection with (and prior to) material servicing decisions including material modifications or waivers, foreclosure or comparable conversion, or acquisition of a property, (6) the operating advisor is given access to information necessary for it to perform its duties and shall be responsible for reviewing the actions of the special servicer, reviewing all special servicer reports, reviewing calculations made by the special servicer in accordance with the transaction documents and issuing periodic reports to investors and the issuer as to the compliance by the special servicer with the standards set forth in the operating documents, and (7) the operating advisor may recommend that the special servicer be replaced if the special servicer has failed to comply with the applicable standard and such replacement would be in the interest of the investors as a collective whole (in which case the special servicer may be replaced upon the affirmative vote of a majority of the outstanding principal amount of all ABS interests voting on the matter (with holders of 5% of the outstanding principal amount of all ABS interests constituting a quorum); and

- each third-party purchaser complies with the hedging and similar restrictions as would be applicable to a retaining sponsor except (I) an initial third-party purchaser (or a sponsor retaining the required horizontal residual interest) may, on or after the date that is five years after the closing date, transfer the interest to a subsequent third-party purchaser complying with the requirements described above and (II) a subsequent third-party purchaser may transfer the acquired interest to a different subsequent third-party purchaser complying with the requirements described above (in each case, with any such requirements as may be applicable before closing being required to be satisfied at or before the time of transfer).

The sponsor would be responsible for compliance with the requirements described above and must maintain and follow policies and procedures to monitor compliance by any third-party purchasers. If the sponsor determines that compliance has not been maintained by a third-party purchaser, such sponsor would be required to promptly notify the holders of ABS interests issued in the securitization transaction of such non-compliance.

***GSEs* (§__.8)** The original proposal provided that the full guarantee of timely payments of principal and interest provided by Fannie Mae and Freddie Mac on their securitizations would be sufficient to satisfy the credit risk retention requirements of the rule, so long as such entities are operating under the conservatorship or receivership of the FHFA with capital support from the United States. This provision would also apply to a successor entity under similar circumstances. The re-proposed rules offer the same treatment for Fannie Mae and Freddie Mac as under the original proposal, without modification. In addition, the prohibition on hedging by a retaining sponsor, its affiliates and the issuing entity would not apply.

***CLOs* (§__.9)** The Agencies in the re-proposed rules reiterated their view that a CLO Manager is a "securitizer" required to retain risk under the regulations. "CLO Manager" is defined as "an entity that manages a CLO,[10] which entity is registered as an investment adviser under the Investment Advisers Act…or is an affiliate of such a registered investment adviser and itself is managed by such registered investment adviser."

[10] Defined as a "special purpose entity that (1) issues debt and equity interests and (2) whose assets consist primarily of loans that are securitized assets and servicing assets."

In addition to the standard risk retention options, the re-proposed rules add a new risk retention option for "open market CLOs", defined to mean a CLO whose assets consist of senior secured syndicated loans acquired by the CLO directly from the sellers in open market transactions (and servicing assets), that is managed by a CLO Manager and that holds less than 50% of its assets (by principal amount) in loans syndicated or originated by lead arrangers that are affiliates of the CLO. This option is intended to permit the required risk retention to be shifted from the CLO Manager to the "lead arrangers" (defined below) of the underlying loans under a set of very specific (and many commentators suggest, likely difficult to satisfy) conditions. The option does not permit the use of a combination of the standard option (CLO Manager-retained risk) and open market option (lead arranger retained risk).

In order to satisfy the risk retention requirements using this option, an open market CLO must:

- hold only "CLO-eligible loan tranches" (defined below) meeting the requirements described below (and servicing assets);
- provide in its governing documents that at all times the assets of the CLO consist of senior secured syndicated loans (defined generally consistently with current CLO practice) that are CLO-eligible loan tranches (and servicing assets);
- not invest in ABS interests or derivatives other than hedging transactions that are servicing assets to hedge risks of the open market CLO;
- purchase CLO-eligible loan tranches directly or through a warehouse facility in open market transactions on an arms-length basis; and
- not permit the CLO Manager to receive any management fee or gain on sale at the time of issuance.

A "CLO-eligible loan tranche" is a term loan in a syndicated credit facility to a commercial borrower where (x) at least 5% of the face amount of the tranche is retained by the lead arranger until the earliest of repayment, maturity, involuntary and unscheduled acceleration, payment default or bankruptcy default of the tranche (and only if the lead arranger retaining the risk complies with the limitations on hedging, transferring and pledging of the retained risk), (y) holders of the CLO-eligible loan tranche are given voting/consent rights in the underlying loan documents with respect to material waivers and amendments, including adverse changes to money terms, alterations to pro rata or voting provisions and waivers of conditions precedent, and (z) the voting, pro rata and similar provisions applicable to the security for the CLO-eligible loan tranche are not materially less advantageous to the obligor than the terms of other tranches of comparable seniority.

The "lead arranger" with respect to a CLO-eligible loan tranche is one which (1) is active in the origination, structuring and syndication of commercial loan transactions and has played a primary role in the structuring, underwriting and distribution of the CLO-eligible loan tranche in the primary market, (2) has taken an allocation at closing of the related syndicated credit facility of at least 20% of the original principal balance and no other member of the syndication group (or affiliated members) has taken a greater allocation, and (3) is identified at the time of origination in the applicable agreements, represents to holders that it and the related CLO-eligible loan tranche satisfy the risk retention requirements and covenants to retain the required risk.

Municipal Bond Repackagings (Tender Option Bonds) **(§__.10)** In response to industry comments, the Agencies included in the re-proposed rules two risk retention options for certain securitizations involving tender option bonds (TOBs), a common form of municipal bond

repackaging. While their characteristics can vary, a typical TOBs transaction involves the deposit of a single issue of highly rated, long-term municipal bonds in a trust, which issues two classes of securities: a floating rate, puttable security (a "floater") and an inverse floating rate security (a "residual").

The TOBs-specific risk retention options would be available to a "qualifying tender option bonds entity," defined as a TOBs issuing entity with respect to which:

- only two classes of securities are issued: (i) a floater that entitles the holder to put such floater to the issuing entity upon no more than 30 days' notice and that is eligible for purchase by money market funds under Rule 2a-7 of the Investment Company Act of 1940, as amended, and (ii) a residual interest entitled to all remaining income of the issuing entity;
- the collateral is limited to servicing assets and municipal securities[11] having the same issuer, obligor or source of payment;
- interest payments received on the municipal securities are excludable from gross income under the Internal Revenue Code;
- interest payments received on the securities issued by the TOBs issuing entity are likewise excludable from gross income;
- a regulated liquidity provider provides a guarantee or liquidity coverage on all of the TOBs; and
- the issuing entity qualifies under the applicable IRS revenue procedure.[12]

Two risk retention options would be available to the sponsor of a qualifying tender option bond entity. First, the sponsor may retain an interest in the issuing entity that, upon issuance, meets the requirements for an "eligible horizontal residual interest" but that, following a "tender option termination event,"[13] meets the requirements of an "eligible vertical interest." Second, the sponsor may satisfy its risk retention obligation by holding municipal securities from the same issuance of municipal securities deposited in the qualifying tender option bonds entity in a face amount equal to 5% of the value of the deposited municipal securities.

The re-proposal's inclusion of these two risk retention options for qualifying tender option bond entities represents the first time that the regulators have explicitly included TOBs within the scope of rulemaking efforts aimed at asset-backed securities, which results in a number of questions for the TOBs market to address, including how certain securities laws that are more applicable to products traditionally categorized as asset-backed securities might be applied to a typical TOBs structure.

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[11] As defined in Section 3(a)(29) of the Exchange Act.

[12] IRS Revenue Procedure 2003-84.

[13] "Tender option termination event" is defined by reference to IRS Revenue Procedure 2003-84 and generally includes bankruptcy, payment default or ratings downgrade.

WHICH PARTY IS REQUIRED TO RETAIN THE CREDIT RISK?

The Sponsor (§ .3(a))

Section 15G of the Exchange Act requires the promulgation of regulations requiring a "securitizer" to retain credit risk. Section 15G(a)(3) defines "securitizer" as (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. The Agencies interpret "issuer" as used in prong (A) to mean "depositor," or the entity that deposits the assets that collateralize the asset-backed securities with the issuing entity. The description of the entity in prong (B) is substantially identical to the definition of "sponsor" under Regulation AB, and the re-proposed rules define a "sponsor" of an asset-backed securities transaction in a manner substantially consistent with the Regulation AB definition, as "a person who organizes and initiates a securitization transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuing entity."

The re-proposed rules would generally apply the risk retention requirements of Section 15G to a sponsor of a securitization transaction, and not to the depositor.

Multiple Sponsors (§ .3(b))

Where two or more entities each meet the definition of sponsor for a single securitization transaction, the re-proposed rules allow for the credit risk to be retained by one of the sponsors, but each sponsor remains responsible for ensuring that at least one of the sponsors complies with the risk retention requirements.

For example, in a "rent-a-shelf" transaction, both the institution renting the shelf and the registrant could be considered a sponsor. In that case, the two parties could agree that only one party will retain the credit risk, but both parties would be responsible in the event of non-compliance. The re-proposed rules do not indicate how this responsibility would be divided between the parties.

Allocation to Originators (§ .11)

The re-proposal does not significantly alter the allocation to originator option provided for in the original proposal. A sponsor may allocate its risk retention obligations to the originator(s)[14] of the securitized assets in certain circumstances and subject to certain conditions, which would then reduce the sponsor's required risk retention by the portion of the obligation assumed by originators.

An originator may assume such obligations only if it has contributed a significant amount of assets to the securitization (at least 20% of the underlying assets) and is restricted to holding no more than its proportional share of the risk retention obligation. An originator would be required to acquire horizontal and vertical interests in the securitization transaction in the same proportion as the interests originally acquired by the sponsor.

Notwithstanding the assumption of the risk retention obligations by an originator, the re-proposed rules provide that the sponsor would remain responsible for compliance with the risk retention requirements. Further, in the event the sponsor determines that any originator is not in

[14] Originator is defined as "a person who, (1) through an extension of credit or otherwise, creates an asset that collateralizes an asset-backed security; and (2) sells the asset directly or indirectly to a securitizer or issuing entity."

compliance with the re-proposed rules, the sponsor would be required to promptly notify the holders of ABS interests issued in the securitization transaction of such non-compliance by the originator.

Majority-Owned Affiliates (§ .12(a))

The original proposal allowed for the transfer of the retained credit risk to one or more affiliates whose financial statements are consolidated with those of the sponsor. The re-proposal replaces the "consolidated affiliate" concept with a "majority-owned affiliate" concept and allows for a transfer of the retained credit risk to an entity that, directly or indirectly, majority controls, is majority controlled by or is under common majority control with, the sponsor.

DISCLOSURE

The re-proposed rules would require a sponsor to provide, or cause to be provided, specified disclosures to potential investors a reasonable period of time prior to the sale of the applicable asset-backed securities and to provide the same disclosures, upon request, to the Commission and to such sponsor's primary Federal regulator, if any.

Standard Risk Retention Options **(§__.4(d))** A sponsor employing the standard horizontal residual interest option would be required to disclose (i) the fair value (as a percentage of the fair value of all of the ABS interests issued and as a dollar amount) of the sponsor's retained horizontal residual interest as well as the fair value of the horizontal residual interest required to be retained, (ii) a description of the material terms of the retained horizontal residual interest, (iii) a description of the methodology used to calculate the fair value of all classes of ABS interests, (iv) the key inputs and assumptions used in measuring the fair value of all classes of ABS interest and of the retained horizontal residual interest and the reference data or other historical information used to develop such inputs and assumptions, (v) as of a disclosed date no more than sixty days prior to the closing of the securitization transaction, the number of securitizations during the previous five years in which the sponsor retained a horizontal residual interest and the number, if any, of payment dates in each securitization on which actual cash flow on the horizontal residual interest exceeded projected cash flows, and (vi) certain information relating to the fair value and material terms of any applicable horizontal cash reserve account established to satisfy the risk retention requirements.

A sponsor employing the standard vertical interest option would be required to disclose (i) whether the interest will be retained in the form of a single vertical security or an interest in each class of ABS interests, (ii) with respect to a retained single vertical security, the fair value of the retained single vertical security at the closing of the transaction, the fair value of the single vertical security that is required to be retained, each class of ABS interests underlying the single vertical security and the percentage of each class that the sponsor would have been required to retain if the sponsor retained an interest in each class, (iii) with respect to a retained interest in each class of ABS interests, the percentage of each class of ABS interests retained and the percentage of each class required to be retained, and (iv) information relating to the measurement of the fair value of the retained vertical interest substantially similar to the information required for a retained horizontal residual interest.

A sponsor employing any standard risk retention option would be required to retain written records of the applicable disclosures and, upon request, must provide such disclosures to the applicable regulators, until three years after all ABS interests are no longer outstanding.

Revolving Master Trusts (Seller's Interest) **(§__.5(g))** A sponsor relying on the seller's interest risk retention option would be required to disclose (i) the value (as a percentage of the unpaid principal balance of all of the investors' ABS interests issued in the securitization transaction and as a dollar amount) of the seller's interest at closing, (ii) the fair value (as a percentage of the fair value of all of the investors' ABS interests issued in the securitization transaction and as a dollar amount) of any horizontal risk retention employed by the sponsor at closing, (iii) a description of the material terms of the seller's interest and of any horizontal risk retention employed by the sponsor, and (iv) if the sponsor retains credit risk pursuant to any horizontal risk retention option, the disclosures applicable to the standard horizontal risk retention option described above. The sponsor would be required to retain written records of these disclosures and, upon request, must provide such disclosures to the applicable regulators, until three years after all applicable ABS interests are no longer outstanding.

Eligible ABCP Conduits **(§__.6(d))** An ABCP conduit sponsor relying on the applicable risk retention option would be required to disclose to each investor prior to or contemporaneously with the first sale of ABCP to such investor and at least monthly thereafter (i) the name and form of organization of the regulated liquidity provider that provides liquidity coverage to the eligible ABCP conduit (including a description of the form, amount, and nature of such liquidity coverage, and notice of any failure to fund), and (ii) with respect to each ABS interest held by the ABCP conduit, the asset class or a brief description of the underlying receivables, the standard industrial category code (SIC Code) for the originator-seller or majority-owned originator-seller affiliate and a description of the form, fair value and nature of the retained interest.

In addition, such ABCP conduit sponsor would be required to provide, upon request, to the Commission and its appropriate Federal banking agency, if any, all of the information required to be provided to investors and the name and form of organization of each originator-seller or majority-owned originator-seller affiliate that is retaining an interest in the securitization transactions.

CMBS **(§__.7(b)(7))** A sponsor relying on the CMBS risk retention option would be required to disclose (i) the name and other indentifying information for each third-party purchaser, (ii) each such purchaser's experience in investing in CMBS, (iii) any other material (in light of the particular transaction) information regarding the purchaser or its retention of the horizontal residual interest, (iv) a description of the fair value (as a percentage of the fair value of all of the CMBS issued and as a dollar amount) of the horizontal residual interest retained by each purchaser and the purchase price paid by each such purchaser, (v) the fair value (as a percentage of the fair value of all of the CMBS issued) of the horizontal residual interest the sponsor would have retained if the sponsor had relied on retaining such an interest, (vi) a description of the material terms of the horizontal residual interest (including the same information required to be disclosed with respect to sponsor-retained horizontal residual interests), (vii) the material terms of the documents relating to the operating advisor including certain of the information required in the documents as described above, and (viii) the representations and warranties made with respect to the underlying assets, a schedule of assets which do not comply with such representations and warranties and the factors used in determining to include such assets notwithstanding such non-compliance (e.g., compensating factors or immateriality).

GSEs **(§__.8(c))** A sponsor relying on the GSE risk retention option would be required to provide a description of the manner in which it has satisfied the credit risk retention requirement.

CLOs **(§__.9(d))** A sponsor relying on the open market CLO risk retention option would be required to disclose (A) a complete list of every asset held by the CLO (or before closing, held in a warehouse facility in anticipation of closing), including certain specific information, including the

price at which the loan tranche was acquired by the CLO and the name of the lead arranger, which list must be updated at least annually, and (B) the name and form of organization of the CLO Manager.

***Tender Option Bonds* (§__.10(e))** A sponsor relying on the TOBs risk retention option would be required to disclose the name and form of organization of the qualifying tender option bond entity and a description of the form, fair value (as a percentage of the fair value of all ABS interests issued and as a dollar amount) and nature of the interest retained by such sponsor, as well as the disclosures applicable to the standard risk retention options described above.

***Allocation to Originators* (§__.11(a)(2))** Any sponsor of a securitization transaction in which a portion of the required risk retention is allocated to an originator would be required to disclose the name and form of organization of such originator, the form, amount and nature of the allocated interest and the method of payment for such allocated interest.

TRANSFER, HEDGING AND PLEDGING RESTRICTIONS (§__.12)

Section 15G(a)(1)(A) of the Exchange Act provides that risk retention regulations shall prohibit a securitizer from directly or indirectly hedging or otherwise transferring the credit risk that is required to be retained by the securitizer. The Agencies aim to achieve this general prohibition by:

- prohibiting a sponsor from transferring any interest or assets that the sponsor is required to retain to any person other than a majority-owned affiliate;
- prohibiting a sponsor, its affiliates and the related issuing entity from purchasing or selling a security or other financial instrument, or entering into an agreement, derivative or other position, if (i) the payments on the security or financial instrument or under the agreement, derivative or position are materially related to the sponsor's retained credit risk or the assets that underlie the related ABS interests, and (ii) the security, financial instrument, agreement, derivative or position in any way reduces or limits the sponsor's financial exposure to its retained credit risk or the assets that underlie the related ABS interests; and
- prohibiting a sponsor and its affiliates from pledging as collateral for any obligation any ABS interest or asset that the sponsor is required to retain unless such obligation is with full recourse to the sponsor or affiliate.

Permitted Hedging (§ .12(d))

Similar to the original proposal, the re-proposed rules also expressly identify certain hedging activities that would be excluded from the general prohibition on hedging retained credit risk. The rules would permit a sponsor, an affiliate or an issuing entity to:

- hedge against movements of market interest rates (but not the specific interest rate associated with the ABS interest that is otherwise considered part of the retained credit risk) or currency exchange rates; or
- purchase or sell financial instruments, or enter into an agreement, derivative or position, based on an index of instruments that includes asset-backed securities, if (a) any class of ABS interests in the issuing entity that were issued in connection with the securitization transaction and that are included in the index represent no more than 10% of the dollar-weighted average of all instruments included in the index; and (b) all classes of ABS interests in all issuing entities that were issued in connection with any securitization

transaction in which the sponsor was required to retain credit risk and that are included in the index represent, in the aggregate, no more than 20% of the dollar-weighted average of all instruments included in the index.

Examples of permitted hedges provided by the Agencies include hedges related to (i) home prices, (ii) the overall value of a broad category of asset-backed securities or (iii) securities that are backed by similar assets originated and securitized by other sponsors.

The re-proposed rules would also permit an issuing entity to engage in hedging activities for the benefit of all investors in its asset-backed securities, but only up to an amount that excludes the sponsor's retained credit risk.

Sunset on Hedging and Transfer Restrictions (§__.12(f))

Under the original proposal, sponsors would have been required to hold the risk retention interest for the duration of the securitization transaction. Except for residential mortgage backed securities (RMBS) transactions (and transfers of the horizontal residual interest in CMBS securitizations, as described above), the re-proposal provides for the expiration of the hedging and transfer restrictions on the date that is the latest of:

- the date on which the total unpaid principal balance of the securitized assets collateralizing the transaction has been reduced to 33% of the total unpaid principal balance of the securitized assets at closing;
- the date on which the total unpaid principal obligations under the related ABS interests have been reduced to 33% of the total unpaid principal obligations of the ABS interests at closing; or
- two years after the closing of the securitization transaction.

***RMBS* Sunset** With respect to securitizations consisting solely of residential mortgages, the prohibitions on sale and hedging will expire on or after the date that is the later of:

- five years after the date of the closing of the securitization transaction; or
- the date on which the total unpaid principal balance of the residential mortgages that collateralize the securitization has been reduced to 25% of the total original unpaid principal balance at closing.

In addition, the prohibitions on transfer and hedging for all RMBS transactions will expire no later than seven years after the closing date of the RMBS transaction.

EXEMPTION FOR QUALIFIED RESIDENTIAL MORTGAGES (§__.13)

Securitizations consisting solely of qualified residential mortgages (QRMs) or servicing assets are exempt from the risk retention requirements set forth in the re-proposed rules if:

- on the closing date of the securitization, each QRM is currently performing;
- as of a date within 60 days of the cut-off date or similar date for establishing the composition of the asset pool, the depositor has evaluated the effectiveness of its internal supervisory controls with respect to the process for ensuring that all assets are QRMs or servicing assets and has concluded that its internal supervisory controls are effective; and

- the sponsor provides, or causes to be provided, a certification from the depositor regarding its evaluation of its internal controls to potential investors within a reasonable period of time prior to the sale, as well as to the Commission and the appropriate Federal banking agency (if any), upon request.

Servicing Assets Definition

Under the re-proposed rules, "servicing assets" means rights or other assets designed to assure the timely distribution of proceeds to ABS interest holders and assets that are related or incidental to purchasing or otherwise acquiring and holding the issuing entity's securitized assets. Servicing assets include amounts received by the issuing entity as proceeds of rights or other assets, whether as remittances by obligors or as other recoveries.

QRM Definition

A significant difference between the original proposal and the re-proposed rules is that the re-proposed rules define a QRM as a mortgage which meets the requirements of a "qualified mortgage" (QM) as defined in the Consumer Financial Protection Bureau's (CFPB) 'Ability to Repay' rules.[15] The proposed new definition of QRM would include loans that qualify for the safe harbor as well as "higher-cost" loans as defined by the CFPB and does not include any loan-to-value (LTV) or credit history requirements.

General Requirements/Eligibility Criteria

- Regular, substantially equal periodic payments (except for the effect of interest rate changes)
    - No increase in principal balance or deferral of principal
    - No balloon payments allowed except for certain small portfolio lenders if certain conditions, including the following, are met:
        - The loan satisfies most of the QM requirements (balloon payment does not result in an increase of the principal balance; maturity date not to exceed 30 years; total points and fees not to exceed 3% of the total loan amount (except for loans less than $100,000); creditor verification of income, assets and obligations of borrower)
        - The interest rate does not increase over the life of the loan
        - Amortization period not to exceed 30 years
        - The loan term is five years or longer
        - The loan is generally not subject, at consummation, to a commitment to be acquired by another person, other than in limited circumstances
- Maturity date not to exceed 30 years
- Total points and fees limited based on size of loan
    - For loans greater than $100,000, may not exceed 3% of the total loan amount

[15] Section 129C of the Truth in Lending Act (15 USC 1639c), effective January 10, 2014.

  - For loans less than $100,000, the total points and fees are limited as prescribed in the re-proposed rule

- Underwritten by taking monthly payments for mortgage-related obligations into account, including a maximum interest rate during the first five years after the date on which the first regular periodic payment will be due
- Consideration and verification of borrower's current or reasonably expected income or assets other than the value of the dwelling, as well as current debt obligations, alimony and child support payments
- Verification of employment status, if relied upon
- Debt to income (DTI) ratio not to exceed 43%
- Interest-only loans and negative amortization loans prohibited
- Special, temporary rules for qualified mortgages apply to loans eligible for purchase, guarantee or insurance by a GSE while under the conservatorship or receivership of the FHFA, the FHA, the VA, the U.S. Department of Agriculture or the Rural Housing Service

Repurchase of Non-Qualified Residential Mortgage Loans (§ .13(c))

If, after the closing date of the securitization transaction, it is determined that one or more residential mortgage loans collateralizing the asset-backed securities do not meet all of the criteria to be a QRM, the sponsor will not lose the exemption for the securitization so long as:

- the depositor complied with the certification requirement described above;
- the sponsor repurchases the loan(s) from the issuing entity at a price at least equal to the remaining aggregate unpaid principal balance and accrued interest on the loan(s) no later than 90 days after the determination that the loans do not satisfy the QRM requirements; and
- the sponsor promptly notifies, or causes to be notified, the investors in the asset-backed securities collateralized by the residential mortgage loans of any loan(s) collateralizing the asset-backed securities that are required to be repurchased, including the amount of such repurchased loan(s) and the cause for such repurchase.

QM-plus Alternative

The Agencies are seeking comment on an alternative approach that would add additional requirements to the QRM definition, including:

- loans must be secured by the principal dwelling of the borrower;
- loans must be first liens, and no junior liens would be permitted except for refinance loans;
- borrowers must meet certain credit history requirements;
- LTV could not exceed 70% (taking into account junior liens, where permitted); and
- loans that qualify as QMs based on certain exceptions such as GSE-eligibility and small creditor exceptions would not qualify as QRMs.

EXEMPTIONS FOR OTHER QUALIFYING ASSETS (§__.15)

Consistent with both Section 15G of the Exchange Act and the original proposal, the re-proposal would offer an exemption from the credit risk retention requirement for issuances of asset-backed securities collateralized solely by qualifying commercial loans, commercial real estate (CRE) loans or automobile loans, and servicing assets related to these asset classes. The re-proposed rules, however, include modified underwriting standards for each of the three asset classes, allow for the blending of qualifying loans with non-qualifying loans within each asset class and include modified remedies for loans that are determined to be non-qualifying after closing.

Under the re-proposal, as of a date within 60 days of the cut-off date or similar date for establishing the composition of the asset pool, the depositor would be required to evaluate the effectiveness of its internal supervisory controls with respect to the process for ensuring that all loans in the securitization satisfy the requirements for qualifying commercial loans, CRE loans or automobile loans, as applicable. The sponsor would be required to provide, or cause to be provided, a certification from the depositor regarding its evaluation of its internal controls to potential investors within a reasonable period of time prior to the sale, as well as to the Commission and the appropriate Federal banking agency (if any), upon request.

Qualifying Commercial Loans (§ .16)

Under the re-proposal, a "commercial loan" is defined as any secured or unsecured loan to a company or individual for business purposes, other than any loan to purchase or finance one-to-four family residential property or any CRE loan.

In order for a commercial loan to be a "qualifying commercial loan" under the re-proposed rules, it would be required to meet the following requirements, among others:

- The originator must have conducted an analysis of the borrower's ability to service all outstanding debt over the next two years, and have determined that, following origination, the borrower would have a total liabilities ratio of less than or equal to 50%, a leverage ratio of no more than 3.0, and a debt service coverage ratio of no less than 1.5.
- The loan payments must be required at least quarterly and the payment amount must be determined based on straight-line amortization of principal and interest over a term no longer than five years from origination.
- The primary repayment source for the loan must consist of business revenue of the borrower.
- If the loan is collateralized, the collateral must be subject to a perfected security interest (which must be a first lien if the purpose of the loan is to finance or refinance the purchase of tangible or intangible property) and the documentation must include a variety of covenants designed to ensure that the collateral is maintained, insured and available to satisfy the borrower's obligations.
- The documentation must include certain covenants that require the provision of financial information and restrict the borrower's ability to incur additional debt or transfer or pledge its assets.

The principal changes from the original proposal are (i) that first liens on collateral are not required, except in the case of property that the loan documents indicate was intended to be financed by the loan, and (ii) agricultural loans are no longer specifically excluded.

Qualifying Commercial Real Estate Loans (§ .17)

Under the re-proposal, a "CRE loan" is defined as a loan secured by a property with five or more single family units or by nonfarm nonresidential real property for which the primary source of repayment is expected to be the proceeds of the sale, refinancing or permanent financing of the property or rental income associated with the property. Certain related assets, including land development and construction loans, any other land loans and unsecured loans to developers, are excluded from this exempt category.

In order for a CRE loan to be a "qualifying CRE loan" under the re-proposed rules, it would be required to meet the following requirements, among others:

- The borrower's ability to repay its obligations must be verified by taking specified steps, including analyzing the borrower's ability to service all outstanding debt obligations during the next two years, and documenting and verifying that the borrower has satisfied all debt obligations over a look-back period of at least two years.
- The debt service coverage ratio must be a required minimum (1.5 for certain qualifying leased CRE loans, 1.25 for qualifying multi-family property loans, and 1.7 for any other type of CRE loan).
- The CRE loan must have a fixed interest rate, or, if the rate is adjustable, must have been paired by the borrower at or prior to origination with a derivative that effectively results in a fixed rate.
- Loan payments must be based on straight-line amortization not exceeding 25 years from the closing date (or 30 years for a qualifying multifamily loan), with payments required at least monthly over a term of at least 10 years.
- The LTV ratio must be 65% or less and the combined LTV ratio must be 70% or less, although in certain cases where very low capitalization rates are used, the maximum LTV ratio is limited to 60% and the maximum combined LTV ratio is limited to 65%.
- An appraisal prepared no more than six months before the origination date must be obtained and an environmental risk assessment of the property must be conducted.
- The property must be subject to a first lien security interest, and junior liens on the underlying real property and leases, rents, occupancy, franchise and license agreements are restricted unless a total combined LTV ratio is satisfied.
- The documentation must include a variety of covenants designed to ensure that the collateral is maintained and available to satisfy the borrower's obligations, including a covenant to comply with all legal obligations with respect to the property.
- The documentation must include covenants that require the provision of financial information and restrict the borrower's ability to incur additional debt secured by the mortgaged property or transfer or pledge the property, other than loans which when aggregated with the CRE loan do not exceed the applicable combined LTV ratio, or loans to

finance the purchase of machinery and equipment that is pledged as additional collateral for the CRE loan.

- The borrower must be required to maintain insurance that provides coverage in an amount no less than the amount of the CRE loan and such insurance must name the lender as additional insured or loss payee.

Certain modifications from the original proposal include the following:

- Whereas the maximum term loan was 20 years, under the re-proposed rules a qualifying CRE loan is now limited in term to 25 years on a straight-line amortization basis, or 30 years for a qualifying multi-family property.
- Whereas the minimum debt service coverage ratio was 1.7, or at least 1.5 for qualifying multi-family properties and certain properties with at least 80% triple-net leases, under the re-proposed rules the borrower with respect to a qualifying CRE loan must satisfy a minimum debt service coverage ratio of 1.5 if the loan is a qualifying leased CRE loan, 1.25 if the loan is a qualifying multi-family property loan, or 1.7 for all other CRE loan types.
- Whereas the combined LTVs at the time of origination were 65% or less or 60%, where the appraisal uses a capitalization rate no greater than specified, under the re-proposed rules the combined LTVs at the time of origination are no greater than 70% or 65%, where the appraisal uses a capitalization rate no greater than specified.
- Whereas loans to REITs would have been ineligible, the re-proposed rules do not exclude loans to REITs from potential eligibility.

Qualifying Automobile Loans (§ .18)

An "automobile loan" is defined in the re-proposed rules as a loan to an individual to finance the purchase of, and secured by a first lien on, a passenger car or other passenger vehicle (such as a minivan, SUV or light-duty truck) for personal, family or household use. The definition does not include fleet sale loans, personal cash loans secured by previously purchased vehicles, loans to finance commercial vehicles or farm equipment not used for personal, family or household purposes, lease financings or salvage or scrap parts loans.

In order for an automobile loan to be a "qualifying automobile loan" under the re-proposed rules, it would be required to meet the following requirements, among others:

- Prior to origination, the originator must 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%.
- A borrower's DTI ratio must be supported through verified and documented income.
- The loan must have a fixed interest rate.
- Originators must verify and document from a credit report within 30 days of origination of any loan that the borrower was not (i) currently 30 days or more past due on any debt obligation, (ii) 60 days or more past due within the past 24 months, and (iii) the subject of any bankruptcy, foreclosure, or similar proceeding within the previous 36 months.

- In addition to a down payment of 10% of the vehicle purchase price (from personal funds), the borrower must also meet pay-down requirements from personal funds and trade-in allowance, if any, at least equal to the total of: (i) vehicle title tax and titles fees, (ii) any dealer-imposed fees, and (iii) additional warranties, insurance or other products purchased.

- Initial payments are due within 45 days of the contract date and the borrower is not permitted to defer principal or interest under the loan documents.

Certain modifications from the original proposal include the following:

- Whereas the down payment requirement was 20%, under the re-proposed rules the down payment requirement is 10% of the vehicle purchase price.

- Whereas two credit reports were required, under the re-proposed rules the requisite information can be derived from a single credit report.

- Whereas originally the originator had to retain physical title, under the re-proposed rules, the lender need only to comply with appropriate state law for recording a lien on the title.

- Whereas loan payments were on a straight-line amortization basis and the maximum loan term was five years, under the re-proposed rules, the borrower pays level monthly payments that fully amortize the loan over a term not to exceed the lesser of six years from the origination date or ten years minus the difference between the current model year and the vehicle's model year.

- Whereas distinctions were made between new and used car purchase prices and loan terms, the re-proposed rules do not distinguish between new and used vehicles.

Remedies for Non-Qualifying Loans

Whereas under the original proposal the sponsor was required to repurchase any non-qualifying loan, under the re-proposed rules, if it is determined that a qualifying CRE, commercial or automobile loan does not satisfy the applicable underwriting standards, the sponsor would not automatically become ineligible for the exemption if the depositor satisfied the certification requirements regarding its evaluation of its internal supervisory controls and either the failure of the loan to meet any of the requirements is not material or no later than 90 days after the determination that the loan does not meet one or more of the requirements, the sponsor remediates the deficiency or repurchases the loan and provides certain notifications.

Blended Asset Pools

The original proposal did not provide any relief from the required risk retention requirement unless all assets in the securitization pool were qualifying assets. The re-proposed rules allow a sponsor to reduce its 5% risk retention requirement in the case of asset-backed securities backed by commercial, CRE or automobile loans by the ratio of the combined unpaid principal balance of qualified loans to the total unpaid principal balance of the loans in the pool. The Agencies are considering imposing a 2.5% risk retention floor for any securitization that includes both qualifying and non-qualifying CRE, commercial and automobile loans. The re-proposed rules do not permit a reduction of risk retention where the asset-backed securities are backed by pools of loans comprised of mixed asset classes (e.g., automobiles and commercial loans). In the case of blended asset pools the sponsor must disclose to investors and, upon request, to its primary Federal regulator and the Commission (A) the manner in which the sponsor determined the aggregate risk

retention requirement for the pool after including qualifying assets with zero percent risk retention, (B) a description of the qualified and non-qualified asset groups, and (C) any material differences between the qualified and non-qualified asset groups 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 (§__.19)

In addition to the general exemptions described in greater detail below, exemptions from the re-proposed rules are included in the re-proposal for securitizations of obligations issued by or fully insured or guaranteed by the United States or an agency of the United States and servicing assets, for asset-backed securities that are fully guaranteed by the United States or any agency of the United States, for certain Farm Credit Administration related securitizations, for certain securitizations sponsored by the FDIC, for securitizations issued or guaranteed by state or municipal government entities and for certain public utility securitizations.

Exemptions are also included for any securitization transaction that (A) is collateralized solely by residential, multifamily or health care facility mortgage loan assets that are fully or partially insured or guaranteed by the United States or an agency of the United States, and servicing assets, or (B) involves the issuance of asset-backed securities that are insured or guaranteed by the United States or an agency of the United States and are collateralized solely by residential, multifamily or healthcare facility loan assets or interests in such assets, and servicing assets.

Resecuritizations (§ .19(b)(5) and (6))

In the original proposal, the Agencies proposed to exempt single class pass-through resecuritizations if such resecuritization met the two following conditions: (1) the resecuritization must be collateralized solely by servicing assets and tranches of asset-backed securities transactions that comply with, or are exempt from, the risk retention requirements of the current proposal ("15G-compliant"); and (2) the resecuritization must issue only a single class of ABS interests and provide for the pass-through of all principal and interest payments received on the underlying ABS interests (net certain expenses).

The re-proposal adds first-pay-class resecuritizations as an additional category of exempted transactions, so long as the resecuritization transaction is collateralized solely by first-pay classes[16] of asset-backed securities that are 15G-compliant and backed by first lien residential mortgage loans.

This additional exemption permits resecuritizations to structure the transaction to reallocate prepayment risk but does not permit the reallocation of credit risk or realized losses. Furthermore, the additional exemption does not permit the resecuritization to issue an inverse floater or similarly structured ABS interests.

Seasoned Loans (§ .19(b)(7))

The re-proposal includes an exemption for securitization transactions collateralized soley by servicing assets and by seasoned loans that have not been modified since origination and that have

[16] 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.

never been delinquent for 30 days or more. With respect to asset-backed securities backed by residential loans, "seasoned loan" is defined as a loan that has been outstanding and performing for at least seven years or, if less than seven years, for the longer of five years and until the outstanding principal balance of the loan has been reduced to 25% of the original principal balance. With respect to all other classes of asset-backed securities, "seasoned loan" is defined as a loan that has been outstanding and performing for the longer of two years and until the outstanding principal balance of the loan has been reduced to 33% of the original principal balance.

FFELP Student Loans (§__.19(e))

The re-proposal includes a reduced risk retention requirement for securitization transactions collateralized solely by student loans originated under the Federal Family Education Loan Program (FFELP) and servicing assets. Rather than applying a 5% risk retention requirement, the re-proposed rules would apply a risk retention requirement of (i) 0% if the securitized FFELP student loans are guaranteed as to 100% of defaulted principal and accrued interest, (ii) 2% if the securitized FFELP student loans are guaranteed as to at least 98% of defaulted principal and accrued interest, and (iii) 3% if the securitized FFELP student loans are guaranteed as to less than 98% of defaulted principal and accrued interest.

FOREIGN TRANSACTIONS SAFE HARBOR (§__.20)

The re-proposed rules will not apply to securitizations that are not required to be registered under the Securities Act of 1933, as amended, if no more than 10% of the securities issued are sold to or for the benefit of U.S. persons, and if the sponsor and issuer are non-U.S. persons as delineated in the proposed rules.

Please contact any of the below-listed authors of this Client Alert, any of the members of our Structured Finance Group or other Orrick attorneys with whom you work to discuss any questions you may have with regard to the foregoing.

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