

MEMO# 25368

July 29, 2011

ICI Comment Letter on ABS Risk Retention Proposal

[25368]

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TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 62-11
FIXED-INCOME ADVISORY COMMITTEE No. 57-11
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 46-11
MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 38-11
SEC RULES MEMBERS No. 95-11 RE: ICI COMMENT LETTER ON ABS RISK RETENTION PROPOSAL

On July 29, 2011, ICI filed a comment letter on proposed risk retention rules jointly issued by the Securities and Exchange Commission, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, and the Department of Housing and Urban Development (together, the “Agencies”). The proposed rules would implement the credit risk retention requirements of Section 15G of the Securities Exchange Act of 1934 (“Exchange Act”), as added by Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The risk retention requirements, and the proposed rules, generally require a sponsor of asset-backed securities (“ABS”) to retain not less than five percent of the credit risk of any asset that the sponsor, through the issuance of the ABS, transfers, sells, or conveys to a third party. [\[1\]](#) Our comment letter is attached, and is summarized below.

Summary

The comment letter supports the goal of the proposed rules to better align the interests of securitizers of ABS with those of investors in ABS. The comment letter raises concerns, however, that the proposed standards for risk retention may not be appropriate or necessary for certain classes of ABS in which registered investment companies (“funds”) invest. In addition, the comment letter asserts that certain of the standards proposed with respect to mortgage-backed securities (“MBS”) may impair the viability of the MBS markets.

Asset-Backed Commercial Paper Programs

The proposal includes a risk retention option specifically designed for asset-backed commercial paper (“ABCP”) programs that meet certain conditions. The comment letter notes that most existing ABCP programs could not meet the proposed rule’s conditions. The letter therefore recommends, in lieu of the ABCP risk retention option, that the Agencies exclude or exempt from the proposal’s risk retention requirements those bank-sponsored ABCP programs that meet the strict criteria suggested in the letter. The letter explains that these criteria reflect an alignment of interests between the ABS sponsor and investor, making it unnecessary to impose further risk retention requirements on such bank-sponsored ABCP programs.

Municipal Tender Option Bond Programs

The proposal is silent regarding municipal tender option bond programs (“TOBs”). The comment letter requests clarification that TOBs are not within the scope of the proposal or, alternatively, that they be exempted from its requirements. The comment letter discusses the many features that distinguish TOBs from traditional ABS, and explains why TOBs do not raise the concerns the risk retention requirements were intended to address. The letter also asserts that applying the proposed risk retention requirements to TOBs would not be in the public interest. The structural characteristics of TOB programs would make it difficult for their sponsors to satisfy the proposed risk retention requirements. If TOB sponsors were forced to restructure their programs significantly to comply with the proposed rules’ requirements, the increase in the cost of TOB program sponsorship could adversely affect the state and local governments that indirectly receive funding through these programs.

Mortgage-Backed Securities

Section 15G of the Exchange Act provides that the Agencies’ risk retention requirements shall not apply to MBS that are collateralized solely by “qualified residential mortgages” (“QRMs”), and requires that the Agencies jointly define what constitutes a QRM. The comment letter supports a QRM standard that would exempt from the risk retention requirements only MBS backed by very high quality loans. The letter explains that some ICI members support the Agencies’ QRM standard as proposed, while other members are concerned that the Agencies’ proposed standard may be somewhat too restrictive and could result in a lack of liquidity in the QRM market.

The Agencies have proposed a rule, implementing another provision of Section 15G, that would permit a sponsor of commercial mortgage-backed securities (“CMBS”) to satisfy its risk retention obligation if a third-party purchaser acquires a five percent horizontal, first-loss position, subject to certain conditions. The comment letter explains that ICI members that manage funds that may be “B-piece buyers” in a CMBS transaction, and thereby may serve in the role of third-party purchaser, have concerns about certain of these conditions. One of the conditions of the proposed rule is that a third-party purchaser may not sell or hedge the interest it is required to retain under the rule. The comment letter asserts that requiring the third-party purchaser to retain its interest for the life of the transaction would strongly discourage funds from purchasing these interests, and recommends a less restrictive approach that we believe would still address the Agencies’ policy objectives.

Another condition of the proposed CMBS risk retention option is that the sponsor would be required to disclose to potential investors in the CMBS transaction (and to the Agencies, upon request), information about the third-party purchaser including, among other things, the identity of the purchaser, the amount of the residual interest that the purchaser will

retain or has retained in the transaction, the purchase price paid for the interest, and the material terms of the interest. The comment letter supports most of the proposed disclosure requirements, but recommends elimination of the proposed requirement to disclose the purchase price paid for the interest. The letter explains that such disclosure is inconsistent with market practice and requiring it would discourage investors from serving in the role of third-party purchaser. This information typically is confidential, and is unnecessary to disclose publicly, given that information would be disclosed about the amount of the interest held.

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[Attachment](#)

endnotes

[\[1\]](#) See ICI Memorandum No. 25162, dated May 2, 2011.

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