The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 27658

October 30, 2013

ICI Submits Comment Lettter on Credit Risk Retention Re-Proposal for Asset-Backed Securities

[27658]

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TO: FIXED-INCOME ADVISORY COMMITTEE No. 24-13
SEC RULES MEMBERS No. 99-13
MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 31-13
CLOSED-END INVESTMENT COMPANY MEMBERS No. 88-13
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 29-13
INVESTMENT ADVISER MEMBERS No. 69-13 RE: ICI SUBMITS COMMENT LETTTER ON CREDIT RISK RETENTION RE-PROPOSAL FOR ASSET-BACKED SECURITIES

On October 30, ICI submitted a comment letter on the re-proposed rules ("Proposed Rules") issued jointly by the Securities and Exchange Commission, Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Federal Housing Finance Agency, and Department of Housing and Urban Development (together, the "Agencies") to implement the credit risk retention requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). [*] The comment letter is attached, and is summarized below.

I. Asset-Backed Commercial Paper Programs

The letter recommends several further refinements to the Proposed Rules with respect to the risk retention option for asset-backed commercial paper ("ABCP") programs.

First, ICI expresses concern that the proposed "100 percent liquidity coverage" definition under the Proposed Rules would make it impossible for many sponsors of ABCP programs to meet the conditions of the Proposed Rules. The letter therefore recommends that the definition of "100 percent liquidity coverage" be revised only to consider liquidity coverage, and not credit enhancement, which is a separate element of these programs. The letter acknowledges, however, that the Agencies have a legitimate interest in requiring an "eligible ABCP conduit," as defined under the Proposed Rules, to be subject to a minimum level of credit enhancement, and therefore recommends that the definition of "eligible

ABCP conduit" be revised to add an additional condition that would require at least five percent program-wide, first loss credit enhancement.

Second, ICI recommends that fully-supported bank-sponsored ABCP programs that meet certain characteristics should be exempt from the risk retention requirements under the Proposed Rules, and suggests a set of criteria for the exemption.

II. Municipal Tender Option Bond Programs

The original proposal did not address the applicability of the risk retention requirements to tender option bond ("TOB") programs. In our comment letters responding to the original proposal, ICI requested that the Agencies expressly exempt TOB programs from the risk retention requirements. Under the Proposed Rules, the Agencies do not propose to exempt TOB programs, but instead provide two additional risk retention options for TOB programs.

The comment letter reiterates ICI's recommendation that sponsors of TOB programs should be exempt from the risk retention requirements under the Proposed Rules. The comment letter requests that, if the Agencies do not accept our argument that TOB program sponsors should be exempt from the Proposed Rules, the Agencies consider several modifications to the Proposed Rules to better reflect how TOB programs are structured.

Fund Residual Holders Should be Deemed Third-Party Purchasers

The Proposed Rules provide two additional risk retention options for sponsors of TOB programs. Under the Proposed Rules, as under the original proposal, "sponsor" means "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 letter requests confirmation that, for purposes of the Proposed Rules, the sponsor is the bank that creates the TOB program. The letter further requests that the Proposed Rules be revised to reflect that, consistent with market practice, funds or other institutional investors in municipal bonds that purchase residual interests ("residuals") in the trust may satisfy the risk retention obligations of the sponsor as third-party purchasers. The letter explains that confirming that fund residual holders may serve as third-party purchasers would be consistent with the fact that they bear the burden of risk associated with the residual interest. Furthermore, deeming these residual holders to be sponsors is unnecessary for purposes of the Proposed Rules, and could potentially result in adverse and unforeseen implications under other Dodd-Frank Act rules, as well as other provisions of the federal securities laws and rules.

Permit Multiple Fund Residual Holders

The Proposed Rules limit a "qualified tender option bond entity" to issuing only "a single residual equity interest that is entitled to all remaining income of the TOB issuing entity." The letter states that this requirement is inconsistent with current market practice. The letter explains that several funds in a fund complex that are managed by the same, or an affiliated, investment adviser often purchase residuals issued by a single TOB trust, and explains the reason for this practice. ICI therefore recommends the Agencies broaden the definition of "qualified tender option bond entity" to permit a sponsor of a TOB trust to satisfy its risk retention obligation by allowing more than one fund in a fund complex to hold residuals in the trust.

Recommended Revisions to TOB Risk Retention Options

The letter agrees that the Proposed Rules should include risk retention options tailored to

TOB programs, but expresses concern that one of the options under the Proposed Rules is inconsistent with the manner in which TOB programs are structured. Accordingly, the letter recommends modifications to this option and two additional risk retention options for TOB program sponsors or third-party residual holders.

The Proposed Rules provide that a sponsor with respect to TOBs issued by a "qualified tender option bond entity" may satisfy its risk retention obligation by complying with the standard risk retention methods (i.e., vertical, horizontal, or a combination thereof), or may choose to rely on one of two additional risk retention options particular to TOBs:

- The sponsor may retain 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" ("TOTE") as defined in Section 4.01(5) of IRS Revenue Procedure 2003-84, as amended or supplemented from time to time will meet requirements of an eligible vertical interest.
- The sponsor may satisfy its risk retention requirements by holding 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 5 percent of the face value of the municipal securities deposited in the qualified tender option bond entity.

The letter explains that the first TOB risk retention option, as drafted, is technically inconsistent with the manner in which TOB trusts are structured. ICI therefore recommends that the Agencies modify this option to permit a sponsor or residual holder to satisfy the risk retention requirement by purchasing and retaining a residual interest having an up-front cash investment value equal to five percent of the initial market value of the municipal securities in the TOB program. As discussed in ICI's prior letter, holding the residual in a TOB program is substantially equivalent to holding horizontal risk prior to the occurrence of a TOTE and a vertical interest after a TOTE because: (i) prior to the occurrence of a TOTE, the residual holder bears all market risk, and (ii) after the occurrence of a TOTE, any credit losses are shared pro rata between the floaters and the residuals.

In addition to these two risk retention options for TOB programs, ICI recommends, as we have previously, that the Agencies deem a sponsor's risk retention requirement to be satisfied in a TOB program transaction in which the residual interest holder is either (i) the same as, or an affiliate of, the entity that provides a liquidity facility, or (ii) an unaffiliated entity, such as a fund residual holder serving as a third-party purchaser, that either (a) agrees to subordinate its right to payment to the floater holders and the liquidity provider until the occurrence of a TOTE; or (b) agrees to reimburse the liquidity facility provider for any losses, in recognition of the fact that all of the market risk associated with the underlying assets is already borne by the residual interest holder.

III. Commercial Mortgage-Backed Securities

The Proposed Rules continue to permit a third-party purchaser to satisfy the risk retention requirements of a sponsor of commercial mortgage-backed securities ("CMBS") under modified conditions. Although the Proposed Rules have eliminated the requirement for the third-party, or "B-piece" purchaser to retain its interest for the life of the transaction, they still contain significant transfer restrictions. ICI therefore reiterates our recommendation that the Agencies adopt a tiered approach to transfer. Under our recommended approach, a third-party purchaser would be required to retain its interest for a one-year period. For the following four years, the third-party purchaser could transfer its interest to a "qualified

transferee" that must meet the same criteria as the third-party purchaser, and for the remainder of the transaction, no restrictions would be imposed on transfer or hedging.

Under the Proposed Rules, two (but no more than two) third-party purchasers may satisfy a sponsor's risk retention obligation under the CMBS option. The letter notes that it is common for several funds in a fund complex that are managed by the same, or an affiliated, investment adviser to purchase B-piece interests in a single CMBS transaction. ICI therefore requests that the definition of "third-party purchaser" be expanded, consistent with current market practice, to permit multiple funds that are managed by the same, or an affiliated, investment adviser to serve as third-party purchasers.

IV. Other Issues

The letter: (i) requests confirmation that the final risk retention rules will only apply prospectively to ABS structures created after the effective date of the final rules; (ii) recommends that the Agencies ensure that the final rules do not raise conflicts with any final rules adopted under the "Volcker Rule," as well as other existing or proposed federal securities laws and rules; and (iii) reiterates ICI's concern that, because of the joint nature of this rulemaking, the Agencies must develop workable standards for risk retention prior to the rules' adoption.

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Attachment

endnotes

[*] For a summary of the Proposed Rules, see ICI Memorandum No. 27561 (Sept. 13, 2013), available at http://www.ici.org/my_ici/memorandum/memo27561. The Proposed Rules were issued in response to the many comments the Agencies received on their April 2011 proposal on credit risk retention ("original proposal"). ICI submitted two letters on the original proposal. See Letter to Elizabeth M.Murphy, Secretary, Securities and Exchange Commission, et al., from Karrie McMillan, General Counsel, Investment Company Institute, dated July 29, 2011; Letter to Office of the Comptroller of the Currency, et al., from Ashurst LLP, Citibank, N.A., Deutsche Bank AG, New York Branch, Société Générale, New York Branch,Wells Fargo Bank, N.A., Investment Company Institute, dated August 31, 2012.