

MEMO# 25162

May 2, 2011

ABS Risk Retention Requirements

[25162]

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TO: FIXED-INCOME ADVISORY COMMITTEE No. 33-11
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 30-11
MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 25-11 RE: ABS RISK RETENTION
REQUIREMENTS

The Securities and Exchange Commission ("SEC"), 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") recently jointly proposed rules, pursuant to Section 941(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), that would require securitization sponsors to retain an economic interest in the assets that they securitize (the "Release"). [\[1\]](#) Comments on the proposal, which is summarized below, are due June 10, 2011.

We will hold a conference call on Friday May 6 at 2 pm eastern time to discuss a possible comment letter from the ICI. The dial-in number is 888-455-9681 and the passcode is 29437. Please let Jennifer Odom (jodom@ici.org or 202/326-5833) know if you will participate on the call. You may also provide comments directly to Sarah Bessin (sarah.Bessin@ici.org or 202/326-5835).

Summary

Section 941(b) of the Dodd-Frank Act amended Section 15G of the Securities Exchange Act of 1934 (the "Exchange Act") to require the Agencies to jointly adopt rules that: (i) require a securitizer of an asset-backed security ("ABS") to retain not less than five percent of the credit risk of any asset that the securitizer, through the issuance of the ABS, transfers, sells, or conveys to a third party; and (ii) prohibit a securitizer from hedging or otherwise transferring the credit risk that the securitizer is required to retain under Section 15G or the rules adopted by the Agencies. Section 15G also exempts certain types of securitization transactions from the risk retention requirements and authorizes the Agencies to exempt or establish a lower risk retention requirement for other types of securitization transactions. The definition of ABS used in the proposed rules is the broader definition found in the

Exchange Act, [\[2\]](#) rather than the definition used in Regulation AB, [\[3\]](#) and includes securities that are exempt from registration under the Securities Act of 1933.

The Agencies have proposed rules to implement the requirements of Section 941(b) that would generally apply the risk retention requirements to sponsors [\[4\]](#) of ABS and provide for different forms of risk retention a sponsor may use to satisfy the rules' requirements. The proposed rules prohibit a sponsor from hedging or otherwise transferring its retained interest in the ABS.

The proposed rules would, among other things:

- Exempt from the risk retention requirements, ABS:
 - guaranteed by the Federal National Mortgage Association ("Fannie Mae") or the Federal Home Loan Mortgage Corporation ("Freddie Mac");
 - backed by certain qualifying assets defined under the rules, including qualified residential mortgage loans, qualifying commercial loans, qualifying commercial real estate loans, and qualifying automobile loans;
 - backed by the U.S. government that are (i) collateralized solely (excluding cash and cash equivalents) by obligations issued by the United States or an agency of the United States; (ii) collateralized solely (excluding cash and cash equivalents) by assets that are fully insured or guaranteed as to the payment of principal and interest by the United States or an agency of the United States; or (iii) fully guaranteed as to the timely payment of principal and interest by the United States or any agency of the United States; and
 - ABS issued or guaranteed by a state or municipality if the security is exempt under Section 3(a)(2) of the Securities Act from registration under that Act. The Release notes that there may be some ABS in which the sponsor is a municipal entity, but the ABS are issued by a special purpose entity that is created at the direction of that municipal entity, which does not issue or guarantee the ABS. The Release requests comment on whether the rules should also exempt from the risk retention requirements ABS where the sponsor is a municipal entity. [\[5\]](#)
- Provide for alternative forms of risk retention for certain types of ABS, including:
 - Asset-backed commercial paper conduits ("ABCP") – sponsors of ABCP [\[6\]](#) could choose to use one of the standard forms of risk retention proposed under the rules, or this option, which would be available only for certain types of short-term, single-seller or multi-seller ABCP programs that meet specified criteria. Under this option, the sponsor of an eligible ABCP conduit would be allowed to satisfy its risk retention obligations under the proposed rule if each "originator-seller" that transfers assets to collateralize the ABCP issued by the conduit retains a specified residual interest in each intermediate special purpose vehicle established by or on behalf of that originator-seller for purposes of issuing interests to the eligible ABCP conduit; and
 - Commercial mortgage-backed securities ("CMBS") – as is true of the alternative for ABCP, this alternative is also non-exclusive; a sponsor could use this option, which is available for CMBS that satisfy certain conditions, or one of the standard options the Agencies have proposed. Under this option, a sponsor of CMBS may meet its risk retention requirements if a third-party purchaser acquires a specified residual interest (a first-loss position) in the issuing entity and certain additional conditions are met.

endnotes

[1] Credit Risk Retention, Securities Exchange Act Release No. 64148 (Mar. 30, 2011), available at <http://www.sec.gov/rules/proposed/2011/34-64148.pdf>.

[2] Section 3(a)(77) of the Exchange Act defines “asset-backed security” as a fixed-income or other security collateralized by any type of self-liquidating financial asset (including a loan, a lease, a mortgage, or a secured or unsecured receivable) that allows the holder of the security to receive payments that depend primarily on cash flow from the asset. The definition goes on to provide a list of examples. The definition of “security” under the Exchange Act specifically excludes “any note, draft, bill of exchange, or banker’s acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.” See Section 3(a)(10).

[3] Item 1101(c) of Regulation AB.

[4] “Sponsor” would be defined in the same manner as the term is defined under Item 1101(l) of Regulation AB (“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”).

[5] The Release does not address municipal tender option bond (“TOB”) programs. Municipal TOBs are not issued or guaranteed by a municipality. We understand some members have questioned whether a TOB trust is a sponsor for purposes of the proposed risk retention rules.

[6] ABCP is defined, under the proposed rules, 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.”