



# Final Risk Retention Rule: Special ABCP Conduit Option

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# Introduction

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In October, 2014, the SEC, FDIC, Federal Reserve, OCC, FHA and HUD (the **Joint Regulators**) adopted a final rule (the **Final Rule**) to implement the credit risk retention requirements of Section 15G of the Securities Exchange Act of 1934, which were added to that statute pursuant to Section 941 of the Dodd-Frank Act. Section 15G required the Joint Regulators to jointly implement rules to require any securitizer to retain an economic interest in a portion of the credit risk for any asset that the securitizer, through the issuance of an asset-backed security (**ABS**), transfers to a third party.

The Joint Regulators initially proposed the credit risk retention rule in April, 2011 and, in response to extensive comments, re-proposed the rule in August, 2013 pursuant to a Second Notice of Proposed Rulemaking (the **Re-proposed Rule**). The Final Rule was issued more than one year after the issuance of the Re-proposed Rule and retains much of the framework from the Re-proposed Rule but with some changes in response to market comment.

# Introduction *(continued)*

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## Final Rule

The Final Rule requires a sponsor of most ABS transactions (including privately placed issuances) to retain at least 5% of the credit risk of the assets collateralizing the ABS and restricts the transfer, hedging or pledge of credit risk that the sponsor is required to retain.

Unless an exemption is available, sponsors must retain risk in accordance with the standardized risk retention options (i.e., an eligible horizontal residual interest, an eligible vertical interest or a combination of both) or in accordance with one of the risk retention options available for specific types of securitizations.

## Special ABCP Conduit Option

Consistent with the Re-proposed Rule, the Final Rule includes a risk retention option specifically designed for certain asset-backed commercial paper (**ABCP**) structures. Although the Joint Regulators have made some modifications to the Re-proposed Rule intended to accommodate a wider variety of ABCP market practices, the special ABCP conduit risk retention option remains largely unchanged.

A description of the special ABCP conduit option begins on page 3. A summary comparing the Final Rule to the Re-proposed Rule begins on page 17.

# General Requirements for Special ABCP Conduit Option

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An *ABCP conduit sponsor* satisfies the risk retention requirement with respect to an *eligible ABCP conduit* that issues *ABCP* if, for each *ABS interest* the *ABCP conduit* acquires from an *intermediate SPV*:

1. The intermediate SPV's originator-seller retains an economic interest in the credit risk of the transferred assets **using one of the generally permitted risk retention methods or the special revolving pool securitization option**; and
2. The ABCP conduit sponsor:
  - (a) approves each originator-seller;
  - (b) approves each intermediate SPV;
  - (c) establishes criteria governing ABS interests and the underlying securitized assets;
  - (d) administers the ABCP conduit by monitoring its interests, arranging debt placement, compiling monthly reports, and ensuring compliance with documents and the ABCP conduit's credit and investment policy; and
  - (e) establishes and adheres to procedures for complying with (a) through (d) above.

# Forms of Originator-Seller Risk Retention Permitted by the Special ABCP Conduit Option

<b>Horizontal</b>	<p>The originator-seller may hold at least 5% of the <b>fair value</b> of the <b>first-loss tranche</b> of the ABS interests issued by the issuing entity. This obligation may be satisfied in whole or in part by the use of a fully funded reserve account held by a trustee.</p>
<b>Vertical</b>	<p>The originator-seller may hold 5% of the <b>face value</b> of <b>each class of ABS interest</b> issued by the issuing entity. The re-proposal provides that a vertical interest may be held in the form of a <b>single security</b> representing 5% of each class of ABS interest issued.</p>
<b>Combination</b>	<p>The originator-seller may hold <b>horizontal interests and vertical interests</b> in <b>any proportion</b> as long as the total risk retention is at least equal to 5% of the <b>value</b> (fair value for the horizontal interest portion and face value for the vertical interest portion) of the issued ABS interests.</p>
<b>Revolving Pool Securitizations</b>	<p>If the originator-seller is the <b>sponsor of a revolving pool securitization</b> (an issuing entity established to fund revolving asset pools through issuance of multiple series), it may satisfy the risk retention obligation if it holds a <b>seller's interest</b> equal to 5% of the unpaid balance of all outstanding investors' ABS interests. The originator-seller may also satisfy the requirement by combining the seller's interest with the horizontal interest described above or with a form of horizontal risk retention fashioned specifically for revolving pool securitizations.</p>

# Originator-Seller Hedging Restrictions

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- Originator-sellers are **prohibited from selling or hedging** their related credit risk.
- As was the case under the Re-proposed Rule, the Final Rule's sunset provisions (the prohibitions on sale and hedging for non-RMBS transactions) **expire** on the latest of:
  - (a) 2 years after the closing date of the securitization transaction;
  - (b) the date on which the principal balance of the securitized assets has been reduced to 33% of the original principal balance; and
  - (c) the date on which the principal obligations under the ABS interests have been reduced to 33% of the original principal obligations.

# Originator-Sellers Must Separately Comply with Risk Retention

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- The use of the ABCP conduit option by an ABCP conduit sponsor does not relieve any originator-seller from any separate requirement that the originator-seller itself comply with the Final Rule.



# Periodic Disclosure to Investors

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ABCP conduit sponsor must provide to each ABCP investor (**no later than the first sale** of ABCP to such investor and **at least monthly thereafter**) the following information (which shall be as of a date not more than 60 days prior to the first use of such information with investors):

1. **Name and form of organization** of the *regulated liquidity provider* to the eligible ABCP conduit and the **material terms of the liquidity coverage** and **notice of any failure to fund**.
2. With respect to each ABS interest held:
  - (a) **asset class** or brief description of the underlying receivables;
  - (b) the **SIC code** of the originator-seller or majority-owned OS affiliate that will retain risk; and
  - (c) a description of the **form and percentage amount of the risk retention by each originator-seller**.



# Disclosure to Regulators

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**Upon request**, an ABCP conduit sponsor using the special ABCP conduit option must disclose to the **SEC** and its **appropriate Federal banking agency** the information it provides to investors and the **name of each originator-seller or majority-owned originator-seller affiliate** that will retain credit risk.

# Sales or Transfer of ABS Interests Between Eligible ABCP Conduits

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An eligible ABCP conduit may transfer an ABS interest to another eligible ABCP conduit if:

1. The **sponsors of both ABCP conduits** are in compliance with the special ABCP conduit option; and
2. The **same regulated liquidity provider** provides 100% liquidity coverage to both ABCP conduits.

# Duty to Comply

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1. The ABCP conduit sponsor must adhere to policies and procedures that are **reasonably designed to monitor compliance** by each originator-seller with its risk retention obligations.
2. If an ABCP conduit sponsor determines an originator-seller no longer complies with its risk retention obligations, the sponsor must:
  - i. **notify ABCP holders, the SEC and its appropriate Federal banking agency** in writing of:
    - A. the **name and form of organization** of the relevant originator-seller that **fails to retain required credit risk** and the **amount** of the relevant ABS interests held by the ABCP conduit;
    - B. the **name and form of organization** of the relevant originator-seller or majority-owned originator-seller affiliate that **improperly hedges its credit risk** and the **amount** of the relevant ABS interests held by the ABCP conduit; and
    - C. the **remedial activities** taken; and
  - ii. **take other appropriate steps**, which may include, curing any breach or removing any non-complying ABS interest from the ABCP conduit.

# Key Definitions

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## ABS Interest

1. Any type of interest or obligation issued by an issuing entity, whether or not in certificated form, including a security, obligation, beneficial interest or residual interest (other than certain non-economic REMIC interests), **payments on which are primarily dependent on the cash flows of the collateral owned or held by the issuing entity**; and
2. Does not include common or preferred stock, limited liability interests, partnership interests, trust certificates, or similar interests that:
  - (a) are issued primarily to evidence ownership of the issuing entity; and
  - (b) the payments, if any, on which are not primarily dependent on the cash flows of the collateral held by the issuing entity; and
3. Does not include the right to receive payments for services provided by the holder of such right, including servicing, trustee services and custodial services.

# Key Definitions *(continued)*

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## Asset-Backed Security

A fixed income or other **security** collateralized by any type of **self-liquidating financial asset** (including a loan, lease, mortgage, or other secured or unsecured receivable) that allows the holder of the security to receive **payments that depend primarily on cash flow from the asset**.

# Key Definitions *(continued)*

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## Eligible ABCP Conduit

1. An **issuing entity** of **ABCP**.

**ABCP** = commercial paper with maturities of 397 days or less

2. **Bankruptcy remote** from the **sponsor** and any **intermediate SPV**.

3. Assets it may acquire are ABS interests that are:

- (a) Collateralized solely by assets originated by an **originator-seller** or one or more **majority-owned originator-seller affiliates**.
- (b) **SUBIs** and other similar trust or SPV interest where the trust or SPV receives legal title to the leased property underlying leases originated by an originator-seller that were transferred to an intermediate SPV in exchange with securities collateralized **solely by such leases and servicing assets**.
- (c) Interests in **revolving pool securitizations** collateralized solely by assets originated by an originator-seller or majority-owned originator-seller affiliate and servicing assets.
- (d) Collateralized by assets otherwise described in (a), (b) and (c) above that are required by an originator-seller is a business combination that qualifies for business combination accounting under GAAP.

# Key Definitions *(continued)*

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## Eligible ABCP Conduit *(continued)*

4. Assets acquired by the ABCP conduit are received directly from the intermediate SPV, from an underwriter of the intermediate SPV's securities, or from another person that acquired such securities directly from the intermediate SPV.
5. The ABCP conduit must be collateralized **solely** by the eligible assets described above and servicing assets.
6. A **regulated liquidity provider** must provide 100% liquidity coverage **not subject to credit performance of the underlying ABS or receivables or reduced by credit support.** A liquidity facility that only funds performing assets does not meet the requirements of the proposed rule.



# Key Definitions *(continued)*

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## Intermediate SPV

1. Direct or indirect wholly-owned subsidiary of the originator-seller or has nominal equity owned by a trust or corporate service provider that specializes in providing independent ownership of SPVs and is not affiliated with any other transaction party.
2. Bankruptcy remote from the eligible ABCP conduit and the originator-seller.
3. Acquires assets that are originated by the originator-seller or acquires ABS interests that are issued by another intermediate SPV or the originator-seller that are collateralized solely by such interests.
4. Issues ABS interests solely collateralized by such assets.

# Key Definitions *(continued)*

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## Originator-Seller

An entity that **originates assets** and sells or transfers such assets, directly or through a majority-owned affiliate, to an intermediate SPV.

## Regulated Liquidity Provider

1. Depository institution.
2. Bank holding company.
3. Savings and loan holding company.
4. Foreign banks whose home country supervisor has adopted BCBS (Basel) capital standards and is subject to these standards.

# ABCP Conduit Option in Final Rule Largely the Same as in the Re-proposed Rule

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1. All originator-sellers to the conduit must retain credit risk in one of the generally permitted forms (i.e., horizontal, vertical or any combination) or in the form of the special seller's interest option for a revolving pool securitization transaction.
2. ABCP of an eligible ABCP conduit must have 100% liquidity support from a regulated liquidity provider. Available liquidity cannot be subject to reduction for non-performing assets or other reasons. Only one liquidity provider permitted per ABCP conduit.
3. Transactions must be effectuated through an "intermediate SPV." Multiple-layer (depositor) SPE structures allowed.
4. Originator-seller names need not be disclosed to investors unless an originator-seller is not in compliance with its risk retention obligations.
5. Sponsor must monitor originator-seller compliance with risk retention obligations.
6. If all of the conditions set forth in the ABCP conduit option are satisfied, conduit sponsor has no other risk retention obligation. If all conditions are not satisfied, sponsors can use either the special ABCP conduit option or other available risk retention methods.

# Changes Made in Final Rule

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1. ABCP conduits may invest in “ABS interests” rather than only in “asset-backed securities.” ABS interests is a broader term that includes many ABCP conduit transactions structured as loans.
2. Maximum maturity of ABCP lengthened from 270 days to 397 days.
3. Intermediate SPVs may be owned either by investors in the business of owning special purpose entities or by originator-sellers.
4. Eligible ABCP conduits may acquire assets from other eligible ABCP conduits that have the same regulated liquidity provider.
5. ABCP conduits may finance assets acquired by originator-sellers in business combinations that qualify for business combination accounting under GAAP.
6. Disclosure of fair value of originator-seller retained risk no longer required. Instead, percentage amount and form of originator-seller retained risk must be disclosed.

# Significant ABCP Concerns with Re-proposed Rule – How Addressed in Final Rule?

Issue in Re-proposed Rule	Specific Concerns Raised to Joint Regulators	How Addressed in Final Rule
1. Inability to use program enhancement as risk retention.	<ul style="list-style-type: none"> <li>- Ignores substantial “skin in the game” of sponsors (or related bank credit providers).</li> <li>- Inconsistent with European approach.</li> </ul>	No change.
2. Originator-seller compliance with rule through retention of horizontal interests must be determined and reported based on the fair value of ABS interests.	<ul style="list-style-type: none"> <li>- Using fair value would be expensive and difficult and unnecessary given the nature of ABCP conduit investments in customer securitizations.</li> </ul>	No change, but fair value may be calculated based on cut-off dates, which may alleviate the burden of the fair value calculation for some revolving transaction structures.
3. “ABCP” maturity limited to 270 days.	<ul style="list-style-type: none"> <li>- ABCP conduits often have right to issue longer dated obligations to manage sponsor bank liquidity issues.</li> </ul>	Maximum maturity increased to 397 days.
4. Need to grandfather existing transactions.	<ul style="list-style-type: none"> <li>- Conduit sponsors might not have bargaining power to impose risk retention obligations required by Rule.</li> </ul>	No grandfathering. “Seasoned” transactions (loans outstanding the longer of two years and until the original principal balance reduced by more than 67%) not subject to risk retention rules.
5. Multiple SPV conduit structures not considered.	<ul style="list-style-type: none"> <li>- Cross-bank ABCP conduit structures often utilize multiple issuing entities.</li> </ul>	Not addressed.
6. Transactions that do not require SPVs not permitted.	<ul style="list-style-type: none"> <li>- SPEs not necessary to achieve bankruptcy-remoteness in some jurisdictions.</li> </ul>	No change.

# Significant ABCP Concerns with Re-proposed Rule – How Addressed in Final Rule? *(continued)*

Issue in Re-proposed Rule	Specific Concerns Raised to Joint Regulators	How Addressed in Final Rule
<p>7. Partially supported ABCP conduits may not use the special ABCP conduit option. 100% liquidity support must be unconditional (<i>i.e.</i>, may not be subject to performance of the underlying ABS or receivables pool or, presumably, subject to a funding out for conduit bankruptcy).</p>	<p>- Banks that sponsor partially supported ABCP conduits that provide program enhancement at least equal to 5% of the conduit’s assets have substantial “skin-in-the-game” and such conduits are well protected against potential losses on the underlying assets.</p>	<p>No change.</p>
<p>8. ABCP conduits cannot enter into transactions that don’t meet the definition of “asset-backed security” under the Re-proposed Rule.</p>	<p>- Many ABCP conduit investments are in the form of loans or other obligations that don’t technically meet the definition of an “asset-backed security.”</p>	<p>Eligible ABCP conduits may invest in “ABS interests,” which is a broader term than asset-backed securities and would include many loan structures invested in by ABCP conduits.</p>
<p>9. Eligible ABCP conduit activities now clearly limited only to transactions that meet the requirements of the rule.</p>	<p>- Some ABCP conduits enter into transactions other than customer securitization transactions that would not be subject to the policy reasons behind the risk retention rule.</p>	<p>No change.</p>

# Significant ABCP Concerns with Re-proposed Rule – How Addressed in Final Rule? *(continued)*

Issue in Re-proposed Rule	Specific Concerns Raised to Joint Regulators	How Addressed in Final Rule
<p>10. Special risk retention options (other than the special seller’s interest option for revolving master trusts) and the asset-specific exemptions are not available for originator-sellers to satisfy the special ABCP option.</p>	<p>- ABCP conduits may invest in transactions that would otherwise be subject to special options or exemptions under the rule (e.g. FFELP student loan securitizations).</p>	<p>No change (except that the revolving master trust option set forth in the Re-proposed Rule has been modified in the Final Rule to be the revolving pool securitization option).</p>
<p>11. Multiple liquidity providers not permitted.</p>	<p>- Many ABCP conduits obtain liquidity support from more than one source.</p>	<p>Liquidity facility must come from a single provider. Liquidity providers not prohibited from hedging, so can sell risk participations to other parties.</p>
<p>12. Intermediate SPVs of underlying transactions must be owned by originator-sellers.</p>	<p>- Some customer SPVs may be owned by third parties in the business of owning such equity.</p>	<p>Fixed in the definition of intermediate SPV.</p>



# Significant ABCP Concerns with Re-proposed Rule – How Addressed in Final Rule? *(continued)*

Issue in Re-proposed Rule	Specific Concerns Raised to Joint Regulators	How Addressed in Final Rule
13. Reporting of originator-seller compliance with risk retention through retention of horizontal interests includes disclosure of fair value of ABCP conduit's interests.	- Burdensome given the breadth of an ABCP conduit's interests and daily changes in their composition and value.	Fair value disclosure no longer required. Instead, monthly investor report must include description or the percentage and form of each originator-seller's retained interest.

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