Risk Retention Re-Proposed – Game Changers

Last Updated : September 25, 2013

Chapman and Cutler LLP
Attorneys at Law · Focused on Finance®

Some Big Questions

1. Where does the risk retention re-proposal fall in the overall regulatory landscape?
2. What is a quality securitization? Have the regulators gone beyond their Dodd-Frank authority/mission into the realm of product paternalism?
3. Who should hold the risk? Do the regulators have it right?
4. How do we measure risk? Is it practical to measure fair value for some transactions?
5. Do we have to change the way we do business? (Will technical issues persist in final rule?)
6. What do we have to disclose to the market? To Uncle Sam? What problems and issues might result from such additional disclosure?
7. What is the utility of the safe harbors in the re-proposal?

CLOs

- CLO Managers in Open Market CLOs will be required to hold 5% risk retention.
  - CLO managers don't transfer loans to CLO issuers, but regulators are taking expansive view on statutory definition of securitizer.
- Exception for senior, secured syndicated commercial loans.
  - Requirements to meet exception are most likely not feasible.
- Paternalistic or Prescriptive approach of regulators.

Revolving Master Trust

- Definition of "Seller's Interest."
  - Re-proposed definition contemplates that seller's interest remain pari passu with respect to allocations of payments and losses prior to an early amortization event, which conflicts with virtually every revolving master trust cash flow structure.
- Combining Seller's Interest with Horizontal Risk Retention.
  - Options for combination are very narrowly drawn and require certain revisions to work at all.
  - Measuring the amount and duration of the required risk retention under the proposed combination option imposes more onerous requirements than would be the case if sponsor were to rely on the seller's interest option or the standard horizontal risk retention option independently.
  - Options for combination do not go far enough because they do not appear to give credit for a range of retained interests that create meaningful skin-in-the-game.
- Introduction of "fair value" measures in place of PCCRA seem unnecessarily broad and burdensome, particularly in the context of revolving master trusts.

ABCP

- Who's the sponsor?
  - Most ABCP conduit administrators don't sell assets to the ABCP conduit.
- What can be financed?
  - Re-proposal limits eligible ABCP conduit assets to ABS and servicing assets.
- How does horizontal risk retention work for pools of assets that aren't funded through master trusts?
  - Sponsor must certify that closing date projected cash flow for each payment date does not exceed the closing date projected principal payment rate.
  - Each sale of assets into a transaction would be a "closing date."

ABCP (continued)

- How do you determine fair value of retained risk positions?
  - Each originator-seller must retain a risk position with a fair value at least equal five percent of all ABC interests issued as part of the related transaction.
  - As drafted, fair value would need to be calculated each time that ABCP is issued or assets are added to the transaction.
  - Complicated to calculate fair value with revolving asset pools.
- How do you comply with the disclosure requirements?
  - Scope is unclear. Are the specific disclosure requirements for the ABCP safe harbor intended to be as broad as those that would apply under the standard risk retention options?
  - Originator-sellers would need to undertake the burdensome fair value calculations, even if the ABCP conduit is not required to disclose the information to investors.

Autos

- Auto loan exception.
  - Prescribed underwriting standards inconsistent with current market.
  - No current transaction could meet exception.
  - Unlikely auto lenders could conform underwriting to prescriptions of the exception.
- Good news is that regulators appear to intend to revise the rule to make the horizontal risk retention option workable for auto lenders.
  - Lenders must certify that horizontal interest would not amortize more quickly than senior ABS based on projections at closing.
  - Disclosure of reference data and historical information for required cash flow projections is often proprietary and lenders will be sensitive to disclosing.