



Risk Retention Re-proposal: Special ABCP Conduit Option

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Introduction

On August 28, 2013, the SEC, FDIC, Federal Reserve, OCC, FHA and HUD (the **Joint Regulators**) issued a second Notice of Proposed Rulemaking (the **Re-proposed Rule**) in connection with the requirement under Section 941 of Dodd-Frank that they 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 prepared the Re-proposed Rule in response to comments received regarding the risk retention regulation that the Joint Regulators initially proposed on April 29, 2011 (the **Original Proposed Rule**). Comments on the Re-proposed Rule are due on October 30, 2013.

Introduction *(continued)*

Re-proposed Rule

The Re-proposed Rule would require a sponsor of most securitizations (including privately placed issuances) to retain at least 5% of the credit risk related to that securitization and would restrict the transfer, hedging or pledge of the risk that the sponsor is required to retain.

Special ABCP Conduit Option

Consistent with the Original Proposed Rule, the Re-proposed Rule includes a risk retention option specifically designed for certain asset-backed commercial paper (**ABCP**) structures. The Joint Regulators have proposed some modifications to the Original Proposed Rule intended to accommodate a wider variety of ABCP market practices, but more changes are needed. The Re-proposed Rule fails to provide clear guidance or relief to ABCP conduits or their arrangers.

Comparison of Original Proposed Rule and Re-proposed Rule

Original Proposed Rule	Re-proposed Rule
1. All originator-sellers (“O-S”) to the conduit must hold 5% horizontal risk retention - if they do, conduit sponsor has no other risk retention obligation.	1. All originator-sellers to the conduit must hold risk retention in one of the generally permitted forms (horizontal, vertical or any combination) or use the special seller’s interest option for revolving master trusts. If satisfied, conduit sponsor has no other risk retention obligation.
2. ABCP of an eligible ABCP conduit must have 100% liquidity support from a regulated liquidity provider.	2. Same, although the re-proposal "clarifies" that available liquidity can't 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.”	3. Same, although the re-proposal allows for multiple-layer (depositor) SPE structures.
4. Originator-seller names and details of their risk retention must be disclosed to investors.	4. Originator-seller names need not be disclosed to investors unless an O-S is not in compliance with its risk retention obligations.
5. Sponsor must monitor originator-seller compliance with risk retention obligations.	5. Same.
6. Sponsors can use other available risk retention methods.	6. Same.

Forms of Risk Retention Permitted by the Special ABCP Conduit Option

Horizontal	The originator-seller may hold at least 5% of the fair value of the first-loss tranche 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.
Vertical	The originator-seller may hold 5% of the fair value of each class of ABS interest issued by the issuing entity. The re-proposal provides that a vertical interest may be held in the form of a single security .
Combination	The originator-seller may hold horizontal interests and vertical interests in any proportion as long as the total risk retention is at least equal to 5% of the fair value of the issued ABS interests.
Revolving Master Trusts	If the originator-seller is the sponsor of a revolving master trust , it may satisfy the risk retention obligation if it holds a seller's interest 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 master trusts.

Hedging Restrictions

- Originator-sellers are **prohibited from selling or hedging** their related credit risk.
- Under the re-proposal'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.

Significant ABCP Concerns with Original Proposed Rule – How Addressed in Re-proposed Rule?

Issue in Original Proposed Rule	Specific Concerns Raised to Joint Regulators	How Addressed in Re-proposal
1. Inability to Use Program Enhancement as Risk Retention.	<ul style="list-style-type: none"> - Ignores substantial “skin in the game” of sponsors (or related bank credit providers). - Inconsistent with European approach (CRD2). 	Not addressed.
2. Originator-sellers can only use horizontal risk retention.	<ul style="list-style-type: none"> - One size fits all approach doesn’t reflect the gamut of customer transactions invested in by conduits. 	<ul style="list-style-type: none"> - Originator-sellers may use any combination of horizontal or vertical forms of risk retention and the special seller’s interest option for revolving master trusts. - Unclear how horizontal risk retention applies to revolving pools of assets financed by ABCP conduits.
3. Requirement to disclose originator-seller names to investors.	<ul style="list-style-type: none"> - Inconsistent with confidential nature of transactions and agreements with conduit customers. - Inconsistent with proposed reporting under Reg AB II. - Not needed by investor community given liquidity, program support and quality of administration. 	Only SIC (NAICS?) Codes of originator-seller must be disclosed <u>unless</u> the originator-seller fails to comply with risk retention requirements.

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

Issue in Original Proposed Rule	Specific Concerns Raised to Joint Regulators	How Addressed in Re-proposal
4. Duty to monitor.	- Post closing behavior of customers can't be controlled by conduit sponsors.	Not accepted. ABCP conduit sponsor must adopt policies and procedures that are "reasonably designed to monitor compliance" with originator-sellers' risk retention obligations.
5. "Technical problems."	- Multiple originator-sellers not permitted.	Multiple originator-sellers ok as long as affiliated by 50% or more common ownership.
	- SPV-originated transactions not permitted.	Not accepted.
	- Transactions that don't require SPVs not permitted.	Not accepted.
	- Multiple SPV conduit structures seemingly not permitted.	Not addressed.
	- SPV not permitted to hold risk retention.	Permitted. O-S must hold "economic interest."
	- "ABCP" maturity limited to 270 days.	Not accepted.
	- Need to clarify that "sponsor" in context of ABCP conduits means O-S or affiliated SPV which transfers/deposits securitized assets.	Not addressed.
	- Need to grandfather existing transactions.	Not accepted.
	- Originator-sellers that also obtain funding from non-conduit sources.	Permitted.

New Issues for ABCP Created by the Re-proposed Rule

1. Partially supported ABCP conduits may not use the special ABCP conduit rule. 100% liquidity support must be unconditional (*i.e.*, may not be subject to performance of the underlying ABS or receivables pool or, presumably, subject to a funding out for conduit bankruptcy).
2. Eligible ABCP conduit activities now clearly limited only to transactions that meet the requirements of the rule.
3. Special risk retention rules (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 rule.
4. "Eligible ABCP conduits" seemingly may not finance certain basic asset class structures (*e.g.*, assets acquired must be ABS collateralized by receivables rather than the receivables themselves; lease transactions seemingly cannot be collateralized by residuals, etc). These results were probably unintentional.
5. ABCP conduits cannot enter into transactions that don't meet the definition of "asset-backed security" under the Re-proposed Rule.

Appendix:

The Proposed Special ABCP Conduit Risk Retention Option

General Requirements for Special ABCP Conduit Risk Retention Option

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 seller's interest option for revolving master trusts**; and
2. The ABCP conduit sponsor:
 - (a) approves each originator-seller and majority-owned OS affiliate;
 - (b) approves each intermediate SPV;
 - (c) establishes criteria governing ABS interests and the underlying 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.

Originator-Sellers Must Separately Comply with Risk Retention

- The use of the ABCP conduit risk retention option by an ABCP conduit sponsor does not relieve any originator-seller from any separate requirement to comply with the risk retention regulation.

Periodic Disclosure to Investors

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**):

1. **Name and form of organization** of the *regulated liquidity provider* to the eligible ABCP conduit and the **form, amount and nature 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 (NAICS?) code** of the originator-seller or majority-owned OS affiliate that will retain risk; and
 - (c) a description of the **form, fair value and nature of the retained interest**.

Disclosure to Regulators

Upon request, an ABCP conduit sponsor using the special risk retention 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 OS affiliate** that will retain risk.

Duty to Comply

1. The ABCP conduit sponsor must adhere to policies and procedures that are **reasonably designed to monitor compliance** by each originator-seller and majority-owned OS affiliate with their risk retention obligations.
2. If an ABCP conduit sponsor determines an originator-seller or majority-owned OS affiliate 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 or majority-owned OS affiliate that **fails to retain required risk** and the **amount** of the relevant asset-backed securities held by the ABCP conduit;
 - B. the **name and form of organization** of the relevant originator-seller or majority-owned OS affiliate that **improperly hedges its risk** and the **amount** of the relevant asset-backed securities 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 from the ABCP conduit.

Key Definitions

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, **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)*

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)*

Eligible ABCP Conduit

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

ABCP = commercial paper with maturities of 9 months or less

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

3. Assets it may acquire are ABS collateralized solely by:

- (a) assets originated by an **originator-seller** or one or more **majority-owned OS affiliates**.
- (b) **SUBIs** and other similar trust or SPV interest where the trust or SPV receives legal title to the leased property underlying leases that were transferred to an intermediate SPV in exchange with securities collateralized **solely by such leases and servicing assets**.
- (c) Interests in **revolving master trusts** collateralized solely by assets originated by an originator-seller or majority-owned OS affiliate and servicing assets.

Key Definitions *(continued)*

Eligible ABCP Conduit *(continued)*

4. **Not collateralized** by ABS otherwise purchased or acquired by the intermediate SPV, its originator-seller or a majority-owned OS affiliate.
5. 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.
6. The ABCP conduit must be collateralized **solely** by the eligible assets described above and servicing assets.
7. 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)*

Intermediate SPV

1. Direct or indirect wholly-owned subsidiary of the originator-seller.
2. Bankruptcy remote from the eligible ABCP conduit, the originator-seller and any majority-owned OS affiliate.
3. Acquires assets that are originated by the originator-seller or majority-owned OS affiliate or acquires asset-backed securities that are issued by another intermediate SPV or the originator-seller that are collateralized solely by such interests.
4. Issues ABS solely collateralized by such assets.

Majority-Owned OS Affiliate

1. Directly or indirectly majority controlled by or under common majority control with an originator-seller participating in an eligible ABCP conduit.
2. “Majority control” means ownership of more than 50% of the equity of an entity or ownership of any other controlling interest in the entity as determined by GAAP.

Key Definitions *(continued)*

Originator-Seller

An entity that **originates assets** and sells or transfers such assets directly, or indirectly through a majority-owned OS 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.

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