

Bank of America



Bank of America Corporation
Legal Department
NC1-027-20-05
214 North Tryon Street
Charlotte, NC 28255

July 13, 2011

Department of the Treasury
Office of the Comptroller of the Currency
250 E Street, SW, Mail Stop 2-3
Washington, DC 20219
Docket Number OCC-2011-0002

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
Attn.: Elizabeth M. Murphy, Secretary
File Number S7-14-11

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Attn.: Jennifer J. Johnson, Secretary
Docket No. R-1411

Federal Housing Finance Agency
Fourth Floor
1700 G Street, NW
Washington, DC 20552
Attn.: Alfred M. Pollard, General Counsel
RIN 2590-AA43

Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Attn.: Comments, Robert E. Feldman,
Executive Secretary
RIN 3064-AD74

Department of Housing and Urban Development
Regulations Division
Office of General Counsel
451 7th Street, SW
Room 10276
Washington, DC 20410-0500
Docket Number FR-5504-P-01

Re: Credit Risk Retention Proposed Rule

Dear Madams and Sirs:

Bank of America Corporation (“Bank of America”) appreciates the opportunity to submit this letter in response to the request of the Department of the Treasury, Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission, the Federal Housing Finance Agency, and the Department of Housing and Urban Development (each an “Agency,” and

collectively the “Agencies”) for comments regarding its proposed rule regulating credit risk retention (the “Proposed Rule”).

Bank of America is one of the world’s largest financial institutions and is actively engaged in facilitating the provision of credit to individual consumers, small and middle market businesses, and corporations. Since acting as the issuer of the first publicly registered offering of non-agency residential mortgage pass-through certificates in 1977, Bank of America has continued to act as a leader in the securitization market as an issuer itself and by providing underwriting, distribution, and advisory capabilities to clients. We believe that securitization helps individual consumers, small and middle market businesses, and corporations by supporting lending and allowing for an efficient redeployment of capital and new credit creation. Accordingly, we understand the significant impact that the Proposed Rule will have on the securitization market and, as a result, on the provision of credit generally in both the primary consumer market and the commercial market.

We thank the Agencies and their staff for their significant efforts in crafting the Proposed Rule. While we suggest changes to some of its approaches, nevertheless we concur with the Agencies that changes are needed in securitization. We welcome and support many aspects of the Proposed Rule and the Agencies’ emphasis on increasing market confidence and restarting the securitization markets. Our goal with this comment letter is to provide constructive recommendations that will create a risk retention requirement that will align incentives among the various parties in the securitization process without unduly and adversely affecting market functionality and, thus, the cost and availability of credit to consumers and businesses.

We are concerned that aspects of the Proposed Rule could result in unintended consequences concerning credit availability and increased transaction costs. Unless the Proposed

Rule is revised, it will be difficult for institutions that play a central role in restarting and reinvigorating the credit markets to offer the necessary products and services they have traditionally provided. We believe that measured changes will result in solutions that are responsive to the realities of the marketplace and still encourage prudent origination practices. Similarly, if the Proposed Rule is adopted without adjustment and in a manner that is not sufficiently mindful of harmonization with other proposed regulatory changes, Agency initiatives, and realities of the marketplace, it may discourage appropriate risk mitigation transactions and reduce credit availability to homeowners, consumers, small and middle market businesses, and corporations. The alternative to securitization is a banking market funded, to a larger degree, by deposits and wholesale funding—an outcome that would not best facilitate the restoration of credit or the efficient management of bank assets and liabilities. Reversion to such a model, in which banking organizations would increasingly finance long-term assets (such as the traditional thirty-year mortgage loans that are a staple of the residential home market) with shorter term liabilities (such as deposits), creates duration mismatching that has been viewed negatively by the markets and regulators alike.

In the residential mortgage space, unless banks and other business organizations return to more normalized volumes of non-agency securitization activity, we suspect that high concentrations of credit risk will continue to reside with the Federal Housing Administration and the Government National Mortgage Association, institutions regulated by the Federal Housing Finance Agency (Fannie Mae and Freddie Mac) and, in some cases, supported by the United States Treasury and on the balance sheet of the Federal Reserve. Responsible, efficient, and transparent non-agency securitization markets should be viewed as a powerful tool to help

gradually reduce concentrations of these risks in governmental agencies. We believe that the Proposed Rule will inhibit a reduction in these concentrations of risk in any appreciable scale.

Similarly, other consumer asset classes, such as credit card or automobile loans, have weathered the recent financial crisis and are currently performing well. We are concerned that the Proposed Rule could unnecessarily disrupt these markets and the consumer financing they facilitate.

I. Executive Summary

As noted above, there are numerous provisions in the Proposed Rule that should be modified in order to prevent unintended negative consequences for homeowners, consumers, small and middle market businesses, and corporations. This comment letter discusses those provisions and offers what we believe are constructive recommendations for improvement. Many of our comments relate to specific asset classes and securitization structures. Some of our comments relate to critical substantive matters, while other comments are technical in nature. From our comments, several recurring themes emerge. Those themes are ensuring that the final risk retention rules:

- Serve the intended policy purposes of the risk retention requirement;
- Permit greater flexibility as to the entities that may hold the retained risk;
- Simplify the representative sample option so that it is workable;
- Provide better-tailored risk retention rules for different types of asset classes and securitization structures; and
- Specify a formal process for providing implementation guidance and resolving the interpretive questions under the final risk retention rules.

This letter is divided into two main parts. The first part consists of our comments of general applicability to all asset classes and securitization structures. The second part of the letter is subdivided into sections relating to particular topics as follows:

- Residential Mortgage Backed Securities Page 10
- Commercial Mortgage Backed Securities¹ Page 71
- Revolving Asset Master Trusts Page 72
- Auto Loans Page 100
- Student Loans Page 108
- Resecuritization Page 110
- Municipal Bond Repackaging/Tender Option Bonds Page 112
- Corporate Debt Repackaging Page 115
- ABCP Conduits Page 117

For further ease of reference, a complete table of contents is included at the end of this letter in Appendix A.

¹ This letter does not address issues relating to Commercial Mortgage Backed Securities (“CMBS”); comments explaining the Proposed Rule’s impact on CMBS will be forthcoming in a supplemental letter.

II. General Comments

A. The Agencies should establish a mechanism for providing interpretive guidance after the Final Rule is adopted

We have several technical concerns with the Proposed Rule that are not specific to any asset class but that we believe can be easily addressed. First, there is no apparent mechanism for raising and resolving interpretive questions concerning the risk retention rule once it is adopted in final form (the “Final Rule”). At present it is unclear which Agency industry participants should approach with questions under the Final Rule. Securitization is a dynamic and evolving form of finance and frequently changes in response to investor demands and market conditions. It will continue to change after enactment of the Proposed Rule and in ways that are impossible for anyone to predict today. The dynamic and evolving nature of securitization, when coupled with the anticipated scope and complexity of the Final Rule, will inevitably create a host of interpretive questions.

Therefore, we respectfully ask the Agencies to establish a formal process for determination of appeals, promulgation of rule clarifications, and resolution of interpretative questions. Ideally, such a process would clearly set criteria for requesting clarifications, provide for joint and uniform Agency guidance, and establish a timeline for Agency responses. The precise contours of an appeal, clarification, and question process are less important than the existence of some clearly defined process that ensures that regulatory clarification will be available via a definitive, efficient, uniform, and expeditious process. Without a clear process for providing regulatory clarification, it is likely that situations will arise in which industry participants may be left without guidance or timely final determination of their responsibilities.

B. The Final Rule should permit a consolidated affiliate of the sponsor to be the initial holder of retained risk

We believe a technical correction is necessary to clarify that risk may be retained initially by a consolidated affiliate, and need not be first held by the sponsor and then transferred. Section __.3(a) of the Proposed Rule requires sponsors of a securitization transaction to retain the risk of securitized assets, but § __.14(a) permits the retaining sponsor to transfer retained risk to a consolidated affiliate. As the Agencies noted, “[t]he rule permits a transfer to one or more consolidated affiliates because the required risk exposure would remain with the consolidated organization and, thus, would not reduce the organization’s financial exposure to the credit risk of the securitized assets.”² We strongly support that principle. This flexibility balances the legal, regulatory, and funding concerns of the sponsor and its affiliates with the intent of the Proposed Rule to align the interests of the parties.

However, requiring the sponsor to initially hold the residual interest in the issuing entity prior to transferring it to a consolidated affiliate serves no discernible purpose but may negatively impact the ability to conclude that the assets have been sold by the sponsor in a true sale for commercial law purposes. The Proposed Rule should be clarified to indicate that a consolidated affiliate may be the initial holder of the residual interest.

C. Sponsors should not be required to disclose their reasons for choosing a particular form of risk retention

We are concerned about the suggestion in Question 20 that sponsors might be required to disclose why they chose a particular form of risk retention. The disclosures that securitizers are already required to provide to investors under the Proposed Rule are sufficient to provide investors with the information they need to assess the form and amount of risk retention. Furthermore, if disclosure of sponsors’ incentives for choosing a particular risk retention option

² See Proposed Rule, 76 Fed. Reg. 24116.

is required, it would create an inappropriate basis for securities law liability and, thus, could encourage litigation whenever asset backed securities perform poorly outside of initial investor expectations but within the parameters of the risk factor and other disclosures made at the time of sale.³ Rather, to the extent liability attaches, it should be based on objectively verifiable facts.

D. Banks that utilize the FDIC Safe Harbor should have the option of adopting risk retention under the Final Rule prior to the effective date of the Final Rule

We believe that bank securitizers should be given the option (but should not be obligated) to become early adopters of the Final Rule on a transaction-specific basis. Dodd-Frank § 941 provides that the Final Rule will take effect twelve months after enactment for residential mortgage backed securities (“RMBS”) and two years after enactment for all other asset classes.⁴ However, provisions of the recently enacted FDIC Safe Harbor for securitizations by banks indicate that the safe harbor in that provision will sunset in favor of the new risk retention rules “[u]pon the effective date” of those rules.⁵ It is unclear whether that phrase gives banks the option to use the new risk retention provisions during the intervening one to two years. Banks should not be obligated to become early adopters of the Final Rule, as it is difficult to determine ahead of time how long it will take for each asset class to put necessary systems and policies in place and to conduct necessary training. However, for some asset classes it may be helpful to

³ Motivation is an inherently subjective determination that should not be subject to securities law liability standards. Indeed, it can be difficult to determine why anyone takes a particular action. Further, large organizations may have many reasons for taking a particular action, and in fact one division of an organization may support a given conclusion for different reasons than another. A disclosure requirement for risk retention choices would be little more than an after the fact guessing game potentially imposing significant liability with no guarantee of a correct result.

⁴ Section 15G(i) of the Exchange Act, added by Dodd-Frank § 941.

⁵ 12 C.F.R. § 360.6(b)(5)(B).

give bank securitizers the option to elect to early adopt risk retention provisions on a transaction-by-transaction basis in lieu of interim compliance with the FDIC Safe Harbor.⁶

E. The Agencies should reissue the Proposed Rule for further comment

Finally, in light of the broad-reaching impact that the Proposed Rule is likely to have on the availability of credit for consumers, and by extension on the economy as a whole, we believe that it would be appropriate for the Agencies to re-release the Proposed Rule for further comment once they have considered the current round of comments. We believe that our letter suggests constructive ways that the Proposed Rule can be modified to avoid causing the significant economic disruptions that might otherwise result. It is critically important not only that those changes be made but also that parties be given the opportunity to provide further feedback to assist the Agencies in fine-tuning the Final Rule. The complexity of the processes being regulated and the extent of the rules and regulations proposed counsel in favor of a measured approach to ensure that the Final Rule, once adopted, will help foster a robust yet more stable securitization market as soon as possible. An opportunity for further comment after the Agencies have made initial changes to the Proposed Rule would facilitate a more effective rule overall and, thus, would assist in attaining the valuable goals of the Proposed Rule while minimizing unintended consequences. A measured pace that allows regulation to be implemented via a fully considered Final Rule is likely in the end to provide solutions more rapidly than implementing an initial rule rapidly and then responding to time-consuming requests for needed clarifications and asset- and situation-specific modifications.

⁶ Allowing the option of early adoption would create a more efficient and less disruptive transition to the new risk retention rules. Since a move to the new rules will occur within a year or two of adoption and since the FDIC has indicated that it is comfortable with replacing the old safe harbor with the new rules, no purpose is served by requiring time to elapse. Instead, securitizers should have the option to follow the new rules once they are in a position to do so.

III. Residential Mortgage Backed Securities Comments

A. Key RMBS Issues

From the perspective of the residential mortgage backed securities (“RMBS”) market, there are several critical problems with the Proposed Rule. Unless revised, the Proposed Rule is likely to cause substantial increases in consumers’ cost of borrowing that the current housing market can ill-afford. Indeed, housing prices continue to fall. According to the S&P/Case-Shiller home price index released on May 31, 2011, the residential housing market fell another 4.2% in the first quarter of 2011, to its lowest point since the economic recession began.⁷ Nationally, housing prices are now at 2002 levels. We believe revisions to the Proposed Rule are necessary in the following areas to avoid exacerbating any further serious decline, foster the return of a private RMBS market to support home prices, and promote proper accountability for the quality of securitized assets.

- The proposed Premium Capture Cash Reserve Account (“PCCRA”) rule must be eliminated, or in the alternative materially revised, to avoid unnecessarily increasing the cost of mortgage credit paid by consumers. A substantial increase in the cost of mortgage credit would be particularly undesirable at this time given the continued weakness in the housing market. In any event, the premium capture rule should not apply to transactions in which the retained risk represents a true pro rata participation in the assets and is paid *pari passu* from the mortgage loan pool, such as with the vertical slice and representative sample options and our requested participation interest option described below.

⁷ Nick Timiraos and S. Mitra Kalita, *Home Prices Hit Post-Bubble Low*, The Wall Street Journal, May 31, 2011, available at <http://online.wsj.com/article/SB10001424052702303657404576357170425058088.html>.

- Measuring the risk retention requirement solely at the securitization pool level, rather than at the loan level, artificially segments the RMBS market into two subgroups, Qualified Residential Mortgage (QRM) and non-QRM. That segmentation creates an unnecessary risk that low numbers of loans in one subgroup could make it uneconomical to generate loans of a particular type. To avoid the rising costs to consumers that could result from smaller, less efficient transactions, securitizers should be allowed to create securities backed by a combination of QRM and non-QRM loans that retain the required percentage of risk on a loan level basis. In addition, while not strictly necessary for commingling, a participation interest form of risk retention, in which securitizers would receive pro rata shares in the cashflows and losses of each underlying loan, should be offered to better facilitate such blended pools in a manner that is simpler and more transparent.
- The proposed QRM rule is far narrower than even current conservative mortgage underwriting criteria and will result in cost increases to many safe, well-qualified consumers if it is not expanded. The QRM standards should be widened to reflect the high credit quality of residential mortgage loans that will otherwise be excluded from QRM treatment. That approach would have the additional advantage of allowing private RMBS execution to better compete with Fannie Mae and Freddie Mac (collectively “GSEs”) and Ginnie Mae execution, allowing taxpayers to decrease their current support of the GSEs.
- If the QRM definition is not expanded, at a minimum residential mortgage loans meeting the current GSE underwriting standards should be subject to a lower risk

retention percentage to avoid denying affordable loans to a segment of the market that has excellent credit quality and to lessen the relative advantage of GSE execution over private label RMBS execution.⁸ Even aside from the Proposed Rule, a wind-down of the GSEs already would be a matter of years, not months, if severe market disturbances are to be avoided. If the Final Rule effectively prevents private capital from competing with the GSEs, that already lengthy process will only be extended. To avoid further market fragmentation and the resulting problems associated with fragmentation that are mentioned above, this modification should only be adopted if such loans can be commingled with QRM and non-QRM loans in the same securitization transaction, with risk retention determined at the loan level rather than the pool level.

- The QRM definition is not the proper place for adopting servicing standards. Because servicing standards included in individual loan documents will be a matter of private contract between individual borrowers and lenders, the Agencies will face grave difficulties in modifying servicing standards once loans are originated. Similarly, the Proposed Rule will result in state-by-state judicial interpretations of private mortgage contracts, undermining consistency and increasing costs. Rather than invite these problems, current interagency discussions aimed at adoption of universal servicing standards provide a superior method for adopting consistent rules applicable to all residential mortgage loans to consumers.

⁸ We recognize that GSE exemption only will exist while the GSEs are in conservatorship, but a vibrant private RMBS market is needed to allow the GSEs to reduce their exposure as they exit conservatorship. A private market is unlikely to return so long as the GSEs maintain competitive advantages.

- A letter submitted by the American Securitization Forum (“ASF”)⁹ indicates that risk retention requirements should sunset once they have served their purpose, releasing capital so that securitizers can provide new financing to borrowers and protecting bank balance sheets from large and unnecessary exposure to macroeconomic trends and illiquidity risks. We support this view.
- While we wholeheartedly support the inclusion of a representative sample risk retention option, the proposal as drafted is unnecessarily complicated, impractical to utilize for RMBS, and can be simplified while still aligning the interests of securitizers and investors.

We believe that these changes to the Proposed Rule are necessary to secure a robust private residential mortgage market while still ensuring that loans are underwritten to high quality standards. We also believe that these changes are essential to the restoration of an economically viable and robust private RMBS market, which would be consistent with the Congressional objective for the Proposed Rules. A robust private RMBS market would be a valuable source of additional capital for the residential housing market that could mitigate downward pressure on home prices and provide policymakers with additional flexibility to implement any desired GSE reforms.

B. Premium Capture Cash Reserve Account

As proposed, the Premium Capture Cash Reserve Account provision requires any security issuance proceeds (including proceeds from interest only securities that are not in first loss position) above par value of all asset-backed security (“ABS”) interests to be placed in cash in a reserve account with the trustee for the issuer’s benefit. This cash reserve must be retained in

⁹ As used herein, the term “ASF Letter” means the comment letter on the Proposed Rule submitted to the Agencies by the American Securitization Forum (the “ASF”) on June 10, 2011. Bank of America is a member of the ASF.

addition to risk retention, regardless of the form in which risk retention is held. PCCRA proceeds are then used to absorb the first losses or interest shortfalls on the related collateral, even before the most junior bond or any retained risk. There is no sunset date for the cash reserve. Except for payments to satisfy deal shortfalls as described above, cash placed in a PCCRA may not be distributed to the sponsor “[u]ntil all ABS interests in the issuing entity are paid in full or the issuing entity is dissolved.” As a result, the cash reserve account is the absolute first loss piece of a securitization and remains so as long as the securitization is in existence, unless the reserve account balance is reduced to zero through absorbing losses.

There are significant problems with the PCCRA provision.¹⁰ Initially, the PCCRA is based on a misconception of how the mortgage market operates because mortgage loans are not generated exclusively at par, and, thus, the entire securitization premium is not equal to profit that could be used to offset risk retention. In addition, the notion that sponsors could somehow earn enough through charging exorbitant prices that they would become indifferent to additional return is not grounded in reality. The proposed risk retention (or even a lesser amount of risk retention as proposed below in our discussion of Intermediate QRM) will represent a significant amount of money and thus will provide the substantial motivation needed to ensure origination of quality loans. No additional premium capture is required to generate the proper incentive. Given these economic realities, the proposal will not only cause substantial difficulties for mortgage originators and securitizers but ultimately will also raise costs to residential mortgage borrowers, without yielding the desired benefits for investors. The provision likely will significantly impede or prevent the return of the private RMBS market (a commonly stated goal), which will only occur if private RMBS execution is competitive with GSE securitizations. The

¹⁰ While the following discussion is specific to the private RMBS market, the concerns expressed in this section are equally applicable in many other asset classes addressed by the Proposed Rule.

PCCRA enhances the relative advantage of GSE structures by substantially increasing both the risk and the time periods for receipt of private RMBS securitization proceeds. Additionally, consumers will be impacted through (i) increased costs, (ii) loss of optionality to pay for any necessary incremental credit enhancement, closing costs, overhead, and compliance through an increased interest rate, (iii) restrictions on mobility, and (iv) difficulties in obtaining rate locks customarily offered by lenders. Finally, the PCCRA may threaten legal and accounting sale analysis, undermining the viability of most securitization transactions, which we do not believe to be an intended result of Dodd-Frank § 941. The PCCRA should be removed from the Proposed Rule or, at the very least, modified as proposed herein to avoid such negative consequences.

1. The PCCRA is based on fundamental misconceptions of the interaction between loan origination and securitization

We understand that the Agencies created the PCCRA rule with the goal of preventing “meaningful” risk retention from being circumvented. This misperceives a critical aspect of the residential mortgage market. The PCCRA appears to rely on the assumption that all residential mortgage loans are originated at par and that any proceeds from a private RMBS securitization that exceed par are profit to the securitizer. Those assumptions are incorrect. Residential mortgage lenders do not generally originate loans at par. Rather, premium is impacted by a number of variables that have nothing to do with profit, including closing costs, overhead, compliance, and credit support.¹¹ Market competition incentivizes participants to keep those costs as low as possible, and originators earn a relatively constant margin regardless of nominal dollar prices. As a result, the difference between par and premium securitization proceeds is not all gain to the sponsor and cannot be used by a sponsor to undermine meaningful risk retention.

¹¹ In Appendix B, we present an illustration of the mathematical problems with this assumption.

It is merely a reflection of then-current origination costs, the differential between current rates to borrowers and RMBS spreads, and the relative return available from alternate investments.

First, it is common for sponsors' costs in making loans to be above par. This is because a lender's cost to make a loan includes more than just the actual loan amount. Loan origination operations necessarily require overhead. There are also regulatory costs to lending, including costs of compliance and oversight, that must be absorbed in order to provide credit. In addition, the sale of junior securities at discounted prices as credit enhancement (or payment of GSE guarantee fees) can cause significant costs that are typically recovered through higher rates, as illustrated in Appendix B. All of these costs are typically spread across securitized loans in the form of an increase to the interest rate that would otherwise apply. This rate increase to compensate for incidental costs incurred in lending means that originators will generally originate loans at a premium.¹² As a result, the risk retention math for a securitization is not the amount of required risk retention minus premium. In other words, the risk retention calculation on a securitization with a premium price of 102 is not $5 - 2 = 3$.

Similarly, originators cannot unilaterally raise rates (and thus the premium received upon securitization) in a competitive residential mortgage market, because other market participants will undercut overpriced loan origination. Lenders are far from possessing unlimited pricing power. As anyone who has purchased a home, bought a car, or had a credit card recognizes, lenders compete based on rate. Because the cash loaned to consumers is fungible, it is difficult for lenders to differentiate loan offerings on any other basis than price. This fact makes it

¹² Indeed, recent residential mortgage loan origination has been selling into 4% and 4.5% agency pools, which are currently trading at premiums. According to market close prices as posted on Bloomberg on June 17, 2011, Fannie Mae 4% fixed rate pools were trading at 100-23+ (\$100 23.5/32), while Fannie Mae 4.5% fixed rate pools were trading at 103-27 (\$103 27/32). As explained below, a loan sold into a 4.5% pool is not more profitable than a loan sold into a 4% pool; rather, the difference in rate and price is a reflection of whether borrowers paid points and prevailing rates when the rate of the related loan was locked (and hedged).

impossible for a lender to unilaterally raise interest rates to generate extra profit in an effort to cancel out meaningful risk retention requirements. There will always be another lender down the street who will happily undercut above-market loans. Lenders compete by finding the lowest cost for funding loans. This is done within securitization by utilizing the most efficient structures to achieve maximum value for any given loan. Lenders pass these efficiencies on to borrowers via lower interest rates and reduced costs to borrowers. This market competition keeps costs in check.

In turn, the need to make loans to consumers at competitive rates controls the price at which lenders can sell those loans. The price of a security is a function of the present value of all the payments to be made in the future. The value of the securities that can be created from loans is similarly dependent on the rates that individual borrowers agree to pay. Securitizers cannot increase the price at which they sell securities without correspondingly raising the rates they charge borrowers. In turn, raising rates to borrowers decreases the competitiveness of originators' businesses putting them at risk of losing the ability to make loans altogether.

Nor do lenders first make loans to consumers and only later decide what to do with them. Like any business, the process of originating loans is part of a unified business model in which the costs and opportunities at each step of the process impact the outcome. In pricing loans (i.e., determining the rate to offer borrowers), originators must consider how they ultimately will utilize those loans. They consider whether to securitize loans, hold them on the balance sheet, or sell them as whole loans. Ultimately, they base loan pricing (or rate to borrowers) on the type of financing that can be achieved most efficiently with any given loan. That determination must be made before a loan can be offered, or an originator will not know what rate to give the borrower.

Once the originator determines the most efficient manner to utilize the loan, the loan's interest rate is set to reflect that execution. If the projected execution for a loan is less than the originator's cost to offer that loan, the rate to the borrower must be raised until the loan becomes profitable at the lowest acceptable margin. If a loan cannot be priced to this level, it cannot be offered to a borrower. The margins on loans sold at \$99, \$100, \$101, or \$105 will all be relatively constant.

If premiums are discounted by the PCCRA, a significant effect will be to increase the amount that the rate to borrowers must be raised before a loan can be made. Costs will still have to be covered for loans to be made; they will just be covered at far greater expense. Because these costs will now be the last proceeds received from a securitization, the time value of money and the discount due to the proceeds' first loss position will cause them to be worth significantly less than par. As a result, rates will have to increase dramatically to offset costs, ultimately harming consumers. Thus, the PCCRA effectively acts as a tax on loans that naturally price above par (currently virtually all non-GSE origination).

For all these reasons, premium received from securitization will not allow sponsors to cancel out their risk retention even without the PCCRA. However, there is an additional fundamental misconception with the PCCRA. Even if it were hypothetically possible to generate sufficient proceeds to fund the required risk retention, the apparent fear that sponsors will become indifferent to risk retention dollars if they receive sufficient premium is also based on a faulty assumption. Even if sponsors could somehow manufacture loans that would ensure that they would not lose money due to risk retention, they would still have a strong economic incentive to originate quality loans so that they could benefit from the required retained interest as well. The ninety-fifth dollar of a securitization has the same economic value as the hundred

and first. The receipt of one dollar of premium will not incentivize anyone to be indifferent to a dollar of risk retention. Argument to the contrary must assume that sponsors are indifferent to additional proceeds. Risk retention would still serve its goal regardless of the premium at which securitizations are sold. The PCCRA thus addresses an illusory problem.

In short, originators attempt to set rates to borrowers as low as possible in order to compete while still generating a reasonable return. Proceeds above par are not primarily profit but reflect the necessary costs of issuing a loan and of securitizing it. If the PCCRA is included in the Final Rule, the only alternative to avoid its tax on natural premiums will be to charge borrowers points and fees up front, unnaturally forcing the rate down to par. As explained below, that result is counter to borrowers' interests.

2. The PCCRA proposal undermines the return of the private RMBS markets

The PCCRA will make it more difficult for private mortgage backed securities to compete with GSE issuance. Private capital will only be able to provide significant liquidity when proceeds from private securitization of a loan pool are comparable to what could be obtained by selling the underlying loans to the GSEs or other available buyers. Unfortunately, securitization subject to the PCCRA provision will make it difficult to attract private capital because of the very high cost of the PCCRA and the resulting magnitude of disadvantage of private RMBS compared to GSE securitization. There are two aspects to this problem. First, proceeds that historically were received at the time of securitization will now be transformed into risky, future cashflows exposed to 100% of pool losses. Second, the PCCRA will capture not only all profits but also a portion of sponsors' cost basis in securitized loans. In combination, these factors will give GSE securitization an additional and powerful competitive advantage over private RMBS that may cause private capital to permanently cede the market to the government

and ultimately to the taxpayers. Private issuers will be unable to issue securities on a competitive basis with GSE securitization as long as GSE securitization delivers up front proceeds, and private label securitization requires these same proceeds to be received over time and subject to substantial credit risk. Merely removing the GSEs' exemption from the risk retention rules will not alter these facts but would instead result in a significant shock due to the market's loss of funding. As a result, the Proposed Rule is likely to prevent the withdrawal of the GSEs from the market for years to come. The only alternative would be to significantly increase the GSEs' guarantee fees to offset the competitive advantages GSE securitization will enjoy. Either way, the PCCRA proposal will increase borrowers' cost of credit with no apparent corresponding advantage to investors or borrowers.

First, the PCCRA will make private RMBS transactions uncompetitive due to the subordination of expected proceeds of issuance. In a typical private RMBS deal, the most junior tranches commonly trade at deep discounts to compensate investors for the increased risk they assume. In the simplest terms, the dollar price of a security is a reflection of the present value of the cashflows expected by an investor, so bonds from which little or no return of principal is expected are priced at deep discounts.¹³ The PCCRA turns this practice on its head by subordinating previously senior interests to the junior tranches. The result is that securitization proceeds will only be recovered upon the termination of the securitization transaction, which could be as long as the end of the thirty-year term of the typical residential mortgage, if at all. The effect is economically equivalent to forcing sponsors to purchase, at full price, securities subordinate to junior tranches traditionally traded at deep discounts. There is no express statutory

¹³ Indeed, the most junior tranches in a typical RMBS securitization are *expected* to be eventually written down to zero even in normal cases and are priced at deep discounts to reflect this fact. Such bonds are commonly referred to as "Credit IOs," because, even though they are entitled to principal, investors expect virtually all of the return on their investment to be attributable to the bond coupon.

mandate in § 941 for such a provision, which goes well beyond the regulatory goal of “skin in the game” already met by the risk retention requirement. Instead, it mandates transaction structures that would make private issuance uneconomical for the vast majority of residential mortgage pools. Securitizers will also be required to allocate balance sheet to these long-term, risky retained interests, further increasing the cost of providing private residential mortgage financing. This exposure could also raise safety and soundness concerns for banks. Without the ability to hedge, balance sheets will be exposed to the full effect of any adverse macroeconomic changes in the housing and employment markets and made less liquid.

Second, the PCCRA provision undermines the competitiveness of private securitization because it is also likely to capture a percentage of a sponsor’s out-of-pocket cost for a loan. As written, the rule requires premium capture without regard to the sponsor’s basis in the underlying loans. As already explained, it is common for a sponsor’s basis to be above par, reflecting costs of overhead, regulatory costs such as compliance and oversight, and the cost of junior securities sold at discount to provide credit support. These costs are usually recouped by securitizers upon sale, but under the PCCRA they will be placed in a cash reserve fund.¹⁴ Because of the time value of money and the extended periods that will typically elapse before these proceeds can be recovered, any premium portion of the sponsor’s out-of-pocket cost basis will be significantly discounted. In addition, it will only be recovered at all to the extent that there are funds available after the PCCRA has absorbed all losses on the mortgage loans in the RMBS pool. Further reducing proceeds for RMBS issuers, PCCRA proceeds can only be invested in Treasuries with maturities of less than one year or placed in FDIC-insured accounts. This creates a fundamental mismatch between a thirty-year asset—the funds deposited into the reserve account—and a low

¹⁴ Although closing costs paid to non-affiliated third parties are exempted from the premium capture calculation, § __.12(a)(1) of the Proposed Rule, all other costs will be included in the PCCRA calculation.

interest one-year investment. The PCCRA unnecessarily prevents private RMBS transactions from being competitive with either GSE or portfolio execution and from expanding the availability of credit that could assist in the recovery of the housing market.

In addition, the PCCRA will undermine the return of private RMBS transactions by limiting both the efficiencies of securitization and the ability to create cashflows that best suit investors' needs. The alternatives to the PCCRA suggested by the Federal Reserve Bank of New York—(1) using only overcollateralization (“OC”) structures that release excess interest on a monthly basis instead of traditional collateralized mortgage obligation (“CMO”) structures that monetize excess spread up front or (2) creating subordinate bonds with extreme interest rates—are not economically feasible. In CMO transactions, all cashflows, including the bottommost cashflows, are specifically allocated to identified tranches with no excess spread or overcollateralization being assigned to the most subordinated tranche. This differentiates CMOs from OC structures, where excess spread and overcollateralization are allocated to the most subordinated tranche. For a description of other important distinctions between OC and CMO structures that make CMO structures more predictable for investors, see Appendix C.

In a normal CMO structure, investors purchase different types of securities based on their specific goals and opinions of future loan performance. Buyers of senior interest only (“IO”) or premium bonds generally believe prepayments will be relatively slow, thereby increasing buyers' yields as they enjoy premium coupons for a longer period of time. In contrast, subordinate buyers tend to believe prepayments will be fast, allowing them to profit by accreting the difference between the purchase price of their deeply discounted bonds and the principal balance of their bonds.

Typical CMO structures can accommodate the opposing investment outlooks of both senior and subordinate buyers. As noted earlier,¹⁵ subordinate bonds trading at sometimes deep discounts to reflect their loss expectations provide credit support for the senior, premium securities that they protect. Both subordinate buyers and premium buyers benefit because they can match specific cashflows to their unique investment needs and economic outlooks. Further, the ability to separate cashflows in order to accommodate these divergent views and goals maximizes proceeds from the sale of loans and thus reduces costs for borrowers. The net result is that structuring allows loans to be turned into securities that are more attractive to investors than the unsecuritized loans. Thus securitization adds value to the economy by efficiently allocating capital and facilitating the provision of credit to borrowers at low cost.

The alternative structures suggested by the Federal Reserve Bank of New York eliminate these core efficiencies of securitization and instead substitute structures that are inconsistent with either senior or subordinate investors' needs. The practical effect of those suggestions is to convert what were senior securities into subordinated cashflows (i.e., convert the senior IO to an increased interest rate in subordinate bonds of an overcollateralization structure). In doing so, the Federal Reserve Bank of New York's suggestion would result in either overenhanced senior bonds (because this credit enhancement would be in addition to what was required by senior bond investors) or subordinate bonds with interest rates in excess of what subordinate bond buyers demand (subordinate bond buyers *like* discounts because better-than-expected loan performance results in payments at par).

Either way, the value of the excess interest to the sponsor is essentially lost because investors will not pay even close to a dollar-for-dollar amount to receive it. The proceeds that could be received from the sale of a senior IO security will not be recovered by converting the

¹⁵ See above note 13.

cashflow into credit support and thereby creating overenhanced senior securities. Senior security buyers will not pay the well above par prices required to compensate a sponsor for the loss of IO proceeds due to the negative yield implications caused by prepayments on premium mortgage securities. Even if a bond were created with a high coupon that theoretically justified a large premium, investors will be very reluctant to pay substantially more than par because every prepayment is received at par, instantly amortizing the premium and dramatically lowering yield. This aversion to premiums is commonly referred to as “par compression.” The greater the premium charged, the greater the risk to investors from prepayments. A likely way to partially mitigate this concern would be to charge borrowers prepayment penalties in an effort to assure premium buyers that prepayments will be slow.

Similarly, adding the interest that normally would be used to create a senior IO to the interest rate paid to a subordinate bond would create securities that are inconsistent with the investment goals of subordinate bond buyers. Even if a junior bond were created with cashflows that resulted in a par dollar price, it would be less desirable to subordinate bond investors because it would eliminate their potential upside investment benefit from accretion of discount, which would not be offset by the increase in interest rate if one hopes for a rapid prepayment speed, as subordinate buyers typically do.

Thus, under any form of the PCCRA, the capital efficiencies of securitization are diminished, and securitizers will be unable to create cashflows that best suit investors’ investment needs. If the ability to create senior IOs and premium senior bonds along with discounted subordinate bonds is eliminated by the PCCRA, the trade-off with alternate structures will not be a dollar-for-dollar exchange and, thus, will not maximize the underlying loans’ values. If originators are unable to sell each cashflow to the highest bidder, they will be unable to

pass efficient and inexpensive cost of capital to borrowers, as explained above.¹⁶ The PCCRA rule, thus, has the net effect of dictating an inefficient structure, rather than allowing investors themselves to determine what structures function most efficiently. This loss of efficiency does not come with any increased incentive to create more sustainable loans or to better align the interests of investors and originators. Instead, it creates incentives to originate loans for sale to the GSEs or with high enough interest rates to make them attractive to lenders and investors willing to hold them in whole loan form for the life of the loans.

3. Consumers will lose borrowing flexibility due to the PCCRA

All consumer loans, even those with the most stringent lending criteria, contain credit risk that lenders must reflect in their offered rates. Because private securitizations provide their own credit support (unlike GSE securitizations that rely on now-explicit government guarantee), some percentage of each loan's balance in a securitization must be sold as a subordinated and therefore discounted security to compensate investors for this credit risk. Even the best qualified borrowers must pay for this credit protection through either up-front points or rate, because every loan has some possibility of default. Borrowers have more long-term flexibility in arranging financing if they can choose to finance their related credit risk with an above-par product (i.e., a mortgage loan with a slightly greater spread over the benchmark rate). If such financing is eliminated or made less efficient and more risky, the only alternative for a borrower will be to pay up-front points to compensate the originator for the related incremental credit risk.

Borrowers who pay up-front points have less flexibility than borrowers who pay in rate because they must stay in a loan long enough to amortize the cost. Otherwise, the up-front points are lost when borrowers prepay, refinance, or move. The cost of credit enhancement paid in up-front points can be substantial, with a historical rule of thumb being that borrowers must pay an

¹⁶ See above at Section III.B.1.

entire point (1%) at closing to compensate for each quarter point (0.25%) of interest rate. In contrast, borrowers who pay for credit enhancement in the form of a higher rate essentially pay for this cost as they go and only pay for credit enhancement during the time period they are obligated to make payments on the loan. As a result, borrowers who pay in rate have the flexibility to refinance or move at any point in the future at no extra cost, while borrowers who pay up-front points sacrifice the sunk cost of points paid at closing. Unfortunately, the PCCRA limits borrowers' ability to pay these costs in rate, as much of the rate paid as credit enhancement will be captured by the PCCRA and deferred. The full impact of the PCCRA on borrowers and their resultant inability to pay for credit enhancement through a reasonably increased rate is extensively illustrated in Appendix B.

Because loss of the ability to pay for credit enhancement, closing costs, overhead, compliance, and other costs through rate will have the inevitable effect of pushing borrowers to pay up-front points instead, the PCCRA is especially likely to adversely impact anyone who will be in a loan for a short time or is struggling to save for a down payment. For instance, proverbial first-time homebuyers may be reluctant to lock themselves into a "starter home" that they may outgrow quickly, leading to greater stress on home prices. Similarly, if interest rates drop, a borrower who recently paid up-front points for credit enhancement will be unable to benefit from refinancing without losing the premium that was paid. The effect of the PCCRA is to increase the costs of putting borrowers into lower cost loans.

Additionally, the PCCRA provision will cause some borrowers to be unable to obtain a loan at all. In the currently tight private residential mortgage market, borrowers already must provide significant down payments. If the PCCRA provision prevents borrowers from compensating for incremental credit enhancement through rate, the cost of points on top of

already substantial down payments will further decrease the affordability of loans for many consumers.

Finally, the separately proposed Qualified Mortgage requirements¹⁷ may cause unintended consequences when combined with the PCCRA provision. The Qualified Mortgage requirements effectively prohibit the payment of points and fees exceeding 3% of the amount of a loan. Thus, to the extent that there is aversion to loans that are not Qualified Mortgages, even some borrowers who have the cash for a substantial down payment and credit enhancement points may be unable to secure financing or may only be able to obtain higher interest rate loans from lenders willing to hold a loan in their portfolios for substantial amounts of time (for instance, insurance companies or REITs).

4. It will be more difficult or more expensive for borrowers to obtain a rate commitment because lenders will be unable to hedge interest rate risk efficiently

The PCCRA also significantly increases the costs of providing borrowers with a mortgage rate commitment. At present, lenders are able to offer borrowers a rate commitment during the time it takes to underwrite a loan because lenders can hedge the resulting interest rate exposure until the loan is securitized. Losses on the loan due to rising rates are offset by gains on the hedge, and vice versa. However, under the PCCRA, it will be much more difficult to hedge effectively. In the event that rates rise, the loans will be sold at a reduced price by the sponsor, and those losses will be offset by gains on the related hedge. However, in the event that rates fall, the hedge will lose value, but gains monetized on the loan because of the locked loan rate that would normally offset this loss will be captured and placed in the most junior position in a securitization. The lender must use other funds to pay to terminate the related hedge, which again increases the cost of originating mortgage loans—a cost ultimately borne by consumers.

¹⁷ See 76 Fed. Reg. 27,390.

Faced with these hedging difficulties, lenders have two choices. They can either decline to offer a rate commitment, reducing certainty for borrowers and leaving them at risk if rates rise while the loan is being originated, or they can charge significantly higher prices to compensate for the additional risk. The first choice would have the additional disadvantage of making it very difficult to calculate debt-to-income (“DTI”) levels, as the final mortgage rate will not be determined until origination of the loan. If DTI cannot be calculated, the DTI cap under the QRM rules will cause some borrowers to initially qualify for a loan, only to lose their financing before closing as market movements result in higher rates, payments, and DTI ratios. From any perspective, consumers lose as a result of these unintended consequences of the PCCRA.¹⁸

5. Both legal and accounting sale treatment may be lost due to the PCCRA

Given the subordination of the sponsor’s proceeds (and in most instances a portion of the sponsor’s basis) in mortgage loans transferred to a securitization, the PCCRA proposal may impact the ability to secure the necessary legal true sale opinion for any securitization in which a significant portion of the net proceeds are retained in a premium capture cash reserve account. As a general matter, legal true sale occurs when a transferor sufficiently transfers the rights and rewards of ownership to the transferee. Any subordinated exposure to losses retained by the transferor will be a key factor to any true sale analysis. Under these rules, the amount of the first loss cash reserve and the risk retention requirements may be viewed as requiring the sponsor to absorb too large a portion of the risk of credit losses on the transferred portfolio. The effect would be to give the sponsor too large a stake to conclude that the risks of ownership of the loans have been transferred to the holders of the related ABS interests.

¹⁸ At the very least, hedging costs should be included in closing costs under § __.12(a)(1) of the Proposed Rule and excluded from the PCCRA calculation.

Unless such a true sale has occurred, the mortgage loans remain subject to a stay imposed upon the commencement of a bankruptcy or insolvency proceeding involving the transferor. The PCCRA rules give securitizers a significant, first loss interest in the performance of the securities they sell, making it difficult to obtain legal true sale in certain instances. The likelihood of this outcome is further increased due to the 5% risk retention requirement that is a centerpiece of the Proposed Rule.

Loss of legal sale treatment could be fatal for residential mortgage securitization. If legal sale treatment is not available, given the impact of a potential stay, it may not be possible for an issuer to acquire financing for assets in excess of corporate debt, which would eliminate one of the fundamental advantages of securitization. Even if true sale opinions could be delivered in these instances, such increased retained risks at the margin will increase the likelihood of legal challenge of the sale in the event of a transferor's bankruptcy as creditors seek to expand the bankruptcy estate. Unless they are compensated for the additional risk through higher rates, investors are unlikely to purchase securities if there is a perception that their proceeds could be delayed due to challenges to sale treatment—or even reached by transferors' creditors. Again, this undermines one of the key structural features of securitization and thus the market's ability to provide efficient, low cost financing to borrowers.

While it is true that a private RMBS transaction could be structured to meet the requirements of the FDIC rule, in order for sponsors to have such a transaction treated as a sale for GAAP, it is also necessary for sponsors to receive a legal true sale opinion with regard to such transactions. Because accounting sale depends on legal true sale, there could be an automatic loss of accounting sale, an economic incentive that is essential to the prospects for the return of a robust RMBS market as a viable alternative form of funding that diversifies risk and

allows securitizers to avoid having to maintain certain regulatory capital with respect to credit risk that has been effectively transferred to third parties. To the extent that their regulatory capital is tied up due to loans that have not obtained sale treatment, securitizers' ability to make additional loans to consumers is reduced.

The inability to diversify risk would require originators to make only loans they are willing to retain on their books. Those loans would be financed through deposits, secured and unsecured credit, and equity capital, all of which are more expensive forms of capital than securitization. That in itself would result in decreased availability of mortgage credit for non-government sponsored mortgage products and over time could cause further residential mortgage market tightening as borrowers compete for these limited sources of mortgage funding. Further, originators' balance sheets are far from unlimited, and once banks and other originators exhaust their balance sheet capacity for long-term residential mortgage debt (which is a risk based largely on the strength of the housing market and cannot be controlled through underwriting and individual loan decisions), lending will be further constricted, driving rates up and putting more downward pressure on housing prices.

We have heard from some representatives of the Agencies that they believe that a significant benefit of the Proposed Rule's PCCRA provision is that it provides "meaningful" risk retention that they believe needs to be in excess of the 5% base risk retention requirements. While we understand this concern over whether a 5% risk retention is sufficient to align the interests of securitizers with those of investors, we believe that the impact of the Proposed Rule's PCCRA provision on the economic viability of private RMBS transactions will be so severe as to defeat the purpose of Dodd-Frank § 941. Dodd-Frank § 941 was intended to promote the securitization market by addressing perceived conflicts of interest between securitizers and

investors, and the Agencies' release re-emphasizes that point.¹⁹ While it may be impossible to determine with certainty whether a 5% risk retention requirement is sufficient to align the interests of securitizers with those of investors, it is clear that the Proposed Rule's PCCRA provision will have such an adverse impact on the economic incentives for private RMBS transactions involving non-QRM loans that those provisions could only be fairly characterized as impeding rather than promoting such transactions. While "meaningful" risk retention designed to align the interests of investors and securitizers is necessary, it must be balanced in order to avoid reaching the point of impeding the regular use of the securitization markets.

Thus, there are significant problems with the Proposed Rule's PCCRA provision that will impact borrowers and lenders alike. The proposed provision, if enacted, could significantly decrease the availability of affordable residential mortgage loans backed by private capital for a broad range of borrowers. The full impact of the PCCRA is difficult to estimate, but, as described in Appendix B, we believe that the actual rate of *increase* to a borrower whose loan is included in a securitization transaction subject to the proposed PCCRA requirement would be approximately 2 to 5%. This extraordinary impact would essentially require that the GSEs continue to provide their current high levels of support to the residential mortgage market and that policymakers only diminish the current role of the GSEs at such time as they are convinced that the housing market could withstand a significant (40-100%) rise in rates.

6. The PCCRA should not apply to vertical slice or representative sample risk retention

Even if the PCCRA proposal is retained in some form, it should not apply to securitizations in which vertical slice or representative sample risk retention is used.²⁰ It is our

¹⁹ See Proposed Rule, 76 Fed. Reg. 24095-96.

²⁰ As explained below at page 38, we believe that a participation interest form of risk retention should be adopted, in which a securitizer would hold a *pari passu* interest in each underlying loan equal to the risk

understanding that the proposed PCCRA requirements were motivated by a concern that securitizers will structure deals to defeat risk retention by either taking cashflow up front or by owning discounted cashflows worth less than 5% of the assets' value, rendering them less sensitive to the performance of the securitization going forward. As explained, we believe this premise is flawed. However, even if it were correct, vertical slice and representative sample retention are, by definition, forms of retention that cannot be manipulated or avoided through structuring. This means it will be impossible for issuers who hold vertical or representative sample forms of risk retention to create structures that eliminate or reduce their exposure over time.

Unlike horizontal risk retention, in which the securitizer holds the bottommost 5% of a deal, a holder of vertical or representative sample interest risk retention owns an undifferentiated 5% of the credit risk for the entire deal, either as a percentage of each tranche or as a percentage of the underlying loans. As a result, it is impossible, even as a theoretical matter, to use financial engineering to eliminate the required risk retention.

A vertical slice is a true 5% *pari passu* interest in each tranche of a securitization and, therefore, must, by definition, begin as a full 5% interest and remain a full 5% interest for the life of the transaction. For so long as risk retention is required, the securitizer will share in the upside and downside of each issued security (and thus each underlying asset) equally with the unaffiliated investors in the transaction and will thus maintain alignment of incentives with each such investor. The securitizer cannot avoid taking a pro rata share of any losses with the

retention required on that loan. Because the same characteristics that make vertical slice and representative sample risk retention impossible to manipulate also apply to a participation interest, we believe that a participation interest, if adopted, should also be exempt from the PCCRA requirements. Additionally, as explained in our discussion of revolving asset master trusts, page 72, the seller's interest option is also a form of vertical risk retention and should not be subject to the PCCRA for the same reasons explained here.

unaffiliated investors. Any efforts to allocate trust collections or realized losses to any tranche will correspondingly reduce the amount of trust collections or realized losses allocated to other tranches in which the securitizer holds the same proportionate interest. The net result is economically equivalent to taking money from one of the securitizer's pockets and putting it into another.²¹ Because securitizers holding vertical risk retention will be economically indifferent to the form of individual tranches, they will structure solely to maximize the economic value of the securities sold to third-party investors and without incentives to allocate greater amounts of trust collections or realized losses to or from any particular tranche.

Similarly, an originator holding a representative sample cannot use structure to avoid risk retention.²² So long as the originator holds a random sample of similar loans, subject to the same random, luck-of-the draw performance differences as the securitized loans, the originators' risk exposure will mirror that of the securitization. Thus, both vertical and representative sample retention allow investors and securitizers to share precisely and ratably in the benefits and risks of the performance of a designated loan portfolio. At the absolute minimum, therefore, the PCCRA rule should be altered to indicate that it does not apply to securitizations in which vertical or representative sample risk retention is retained.

²¹ Consider the following example. An RMBS trust issues Class X and Class Y certificates that are collectively entitled to all of the distributions of that trust and subjected to all of the realized losses incurred by that trust. Now assume that there is \$1,000,000 available for distribution in a given month. If the securitizer holds 5% of each of the Class X and Class Y certificates, it will receive \$50,000 in total distributions, regardless of whether Class X receives \$50,000 and Class Y receives \$0, Class X and Class Y each receive \$25,000, or Class X receives \$0 and Class Y receives \$50,000. The securitizer would similarly be indifferent to the allocation of realized losses as any reallocation of realized losses would always result in a zero-sum game in which the securitizer gained and lost in equal and offsetting amounts.

²² We believe that the representative sample retention form included in the Proposed Rule is unnecessarily complicated and can easily be modified to attain the same goals in a less onerous manner. *See* Section III.I below. Regardless, an originator who holds a representative sample of loans should be exempted from the PCCRA rule because it is not possible to use structuring to eliminate required risk retention.

C. To mitigate liquidity concerns, securitizers should be given flexibility to commingle QRM and non-QRM assets while still meeting risk retention requirements

1. The Proposed Rule artificially segments the RMBS market at the risk of creating unnecessary inefficiencies

The regulation limiting the QRM risk retention exemption to securitization pools backed exclusively by QRM loans is likely to increase costs to borrowers unnecessarily. Under the Proposed Rule, QRMs are not subject to risk retention because they are expected to have very strong credit characteristics. However, the Proposed Rule only allows securitizers to use the QRM risk retention exemption if every loan underlying a securitization is a QRM. A single non-QRM loan defeats the exemption.²³

We are very concerned about this provision because it effectively isolates QRM loans from the rest of the RMBS market. Whenever a finite class of assets is split into artificial subgroups, there is a substantial risk that one of the subgroups will be too small to generate a critical mass of loans necessary for securitization. This is true even of very large loan groups, as GSE bond prices reflect. If an asset class is subdivided, the smaller asset subclass may become uneconomical because it is inefficient to securitize small numbers of loans and expensive to hedge them for a long time while waiting to aggregate sufficient numbers. In addition, securitizers who do not come to market frequently have difficulty commanding the best prices as they struggle to develop the necessary relationships with other market makers and investors. Any of these inefficiencies cause funding costs and the resulting costs to borrowers to rise.

Under the Proposed Rule as currently drafted, it is possible that either QRM or non-QRM loans, or even both QRM and non-QRM loans at various points over time, could have loan

²³ In certain circumstances, securitizers are required to repurchase non-QRM loans, but although that requirement would prevent a 100% QRM securitization from losing its QRM status, it does nothing to mitigate the overarching difficulties caused by the prohibition on commingling addressed here.

origination amounts too low to generate critical mass within the relatively short time periods necessary to be an active securitization product and to keep hedging costs down. Since the volume of loan origination varies dramatically depending on market conditions, these problems might make one market subgroup inefficient at one point in time, while the next year, under different economic circumstances, the other subgroup could suffer the same problem. Under present market conditions we are particularly worried that the very tight QRM loan definition (described below at Section III.D) may capture so small a segment of the market at any given time that QRM loans will be difficult to securitize due to insufficient volume to produce securitizations of sufficient size to justify the fixed costs associated with asset securitization. Indeed, at present origination levels, we believe it would take Bank of America some six to nine months to generate a sufficient number of loans to securitize an average prime, fixed rate RMBS deal comprised solely of loans satisfying the QRM credit characteristics.²⁴ Regardless of when, or in what subgroup of loans this problem occurs, the resulting lack of liquidity ultimately will raise costs to borrowers.

Fortunately, this potential liquidity problem can be mitigated without reducing investor protection or sponsors' incentives to originate quality loans. Issuers should be allowed to create securities backed by a mix of both QRM and non-QRM loans, so long as they retain the appropriate amount of risk for each underlying loan. Such commingling would not change the risk retention requirements or incentives of originators in any way, since the method by which loans are aggregated does not change underwriting standards or individual borrower characteristics. Thus, "meaningful" risk retention would still be determined at the only point where it matters—loan-level lending decisions. At one end of the spectrum, non-QRM loans

²⁴ The assumed QRM credit characteristics used for this estimated aggregation period do not include the servicing term requirements of the proposed QRM criteria.

would still be subject to the full 5% risk retention, while on the other end QRM loans would still be exempt. The total risk retention of a mortgage pool would have an overall retention amount between 5% and 0%, but that number would reflect the weighted average of the risk retention required for each loan.²⁵ While it thus would not alter the credit risk retention profile of the underlying loans in any way, commingling would eliminate the liquidity problems that could arise under the Proposed Rule if insufficient loans are originated for any subgroup of the residential mortgage loan market. Issuers can easily create structures within a securitization using established cashflow payment rules to reflect an exact participation in each loan, based on its QRM or non-QRM status and a rule requiring commingled transactions to use such a structure could readily be drafted. We urge the Agencies to revise the Proposed Rule to avoid unnecessary market inefficiencies that offer no corresponding benefit to any participant.²⁶

2. The Agencies have discretion under § 941 of Dodd-Frank to allow loans subject to different levels of risk retention to be commingled

The Agencies have the authority to adopt a provision allowing commingling of QRM and non-QRM loans under § 941. A risk retention rule of the type proposed in Section III.C.1. above for commingled residential mortgage pools would satisfy the 5% credit risk retention requirement for non-QRM RMBS loans. In addition, while the general rule is that 5% of the credit risk with respect to securitized assets must be retained (§ 15G(c)(1)(B)(i)), the Agencies also have broad authority to allow creation of securities subject to less than 5% of the credit risk required to be retained with respect to securitized assets under § 15G(c)(1)(B)(ii). The only criteria for exercising that authority is that the “terms, conditions, and characteristics of a loan

²⁵ Risk retention also would include any amounts retained on loans under an Intermediate QRM 1% risk retention standard, as discussed below in Section III.E.

²⁶ As explained below in Section III.C.4, we believe that a participation interest form of risk retention, while not strictly necessary in order to permit commingling, would make commingling of QRM and non-QRM loans more transparent and easier for investors to understand.

within the asset class [must] indicate a low credit risk with respect to the loan.” § 15G(c)(2)(B). In other words, the Agencies can allow securitization of assets subject to risk retention of less than 5% so long as any reduction is based on low credit risk of the underlying assets. In the case of a commingled RMBS pool including loans that meet QRM guidelines, there can be no question that the reason for the blended risk retention meets that standard, given the high quality of loans that meet QRM guidelines. The overall risk retention for a commingled residential mortgage pool would be directly tied to the weighted average of high quality loans that meet the exacting QRM credit standards. While § 15G(c)(1)(B)(i)(II) does state that QRM pools cannot be completely exempted from risk retention if they contain any non-QRM loans, a commingled pool would still require full risk retention on all loans that do not meet QRM criteria. It would meet the intent for protection of investors and would not allow securitizers to avoid risk retention for any non-QRM loans and would thus fall within the Agencies’ authority mentioned below.

Additionally, § 941 is very clear that the Agencies enjoy broad-ranging powers to fashion risk retention regulations and exceptions to make the Proposed Rule workable. The Agencies are directed to “jointly adopt or issue exemptions, exceptions, or adjustments to the rules issued under this section” so long as they “help ensure high quality underwriting standards,” “encourage appropriate risk management practices,” and “improve the access of consumers and businesses to credit on reasonable terms.” § 15G(e)(1), (2). Commingling of mortgage loan types will increase liquidity and, thus, improve “access ... to credit on reasonable terms” without having any negative impact on underwriting standards or risk management practices. Given these broad statutory powers, we believe it is appropriate for the Agencies to allow loans that are subject to

different risk retention requirements to be commingled in a securitization, with risk retained on loans as required under the Proposed Rule.²⁷

3. Blended pools will not harm investors

We do not believe that securities backed by blended pools of mortgage loans would negatively impact investors in any way. The characteristics of underlying loans have always been disclosed and will continue to be disclosed under the Proposed Rule. Percentages of QRM and non-QRM loans comprising a pool would merely be another asset characteristic like DTI, loan to value (“LTV”), or geography that residential mortgage investors consider. Further, if investors decide that they want a security backed solely by a particular loan subtype, it should be possible to accommodate their wishes, so long as they are willing to pay any potential premiums caused by the scarcity of the related loans. Permitting commingling simply makes loan subtypes, like QRM, more liquid (and thus less expensive) than they otherwise would be.

4. A participation interest risk retention form should be added to facilitate blended RMBS pools

To simplify the calculation of different amounts of risk retention in a commingled RMBS securitization, a participation interest form of risk retention should be added to the Proposed Rule.²⁸ In a participation interest, securitizers would retain an undivided interest in each individual underlying loan reflecting the amount of risk required on that loan. For instance, for every non-QRM loan, the securitizer would retain 5%. Each interest would entitle the securitizer

²⁷ As described below in Section III.E., if the Agencies are unwilling to expand the present, constricted QRM definition, we believe they should create standards for reduced risk retention on high-quality loans that just miss meeting the strict QRM standard. If created, such a “Intermediate QRM” class of assets at the absolute minimum must be allowed to be commingled with non-QRM loans, as described in this section. Any alternative approach would unnecessarily risk artificial market segregation resulting in increased costs due to illiquidity. *See* Section III.C.1.

²⁸ While we discuss participation interest in the context of facilitating commingled RMBS securitization, the participation interest form of risk retention has merit in its own right and should be incorporated into the Final Rule regardless of whether commingling is allowed.

to pro rata distributions of principal and interest. Similarly, if losses were incurred on a particular loan, the securitizer would share in those losses because he owns a percentage of the loan equal to the amount of risk retained. Because of this pro rata interest and *pari passu* sharing of both profits and losses with investors, the PCCRA provision also should not apply to a participation interest form of risk retention, for the reasons explained above in discussing the vertical and representative sample forms.

A participation interest would be beneficial because it would incorporate many of the advantages of representative sample risk retention without the technical difficulties of selecting representative loans addressed later in this letter. As securitizers under participation interest risk retention would own a percentage of every loan in a deal, there would be no concerns about guaranteeing a truly random sample or ensuring that the sample was representative of the entire loan pool. Instead, any loss on any loan would be shared by securitizers and investors alike. This form of risk retention would surely meet the statutory objective to create strong incentives for securitizers to ensure that each loan was creditworthy.

To be effective, a participation interest rule would have to be written to allow a pro rata interest in every loan and would also need to comply with FAS 166 to avoid sale problems under GAAP. Additionally, to make a participation interest a viable risk retention form, the Securities and Exchange Commission would need to clarify, in the limited context of risk retention pools, that the retained participation interest and the portion of the securitization sold to investors are not two separate securities. In the past, Securities and Exchange Commission comments have suggested that participation interests may be treated separately and, thus, be subject to separate

registration requirements.²⁹ Such requirements would increase costs prohibitively and are unnecessary in the limited context of a risk retention rule.

If securitizers are allowed to commingle QRM and non-QRM loans in a single securitization, liquidity problems as a result of an artificial subdivision of the mortgage loan market will be eliminated. Although not strictly necessary, a participation interest form of risk retention would greatly simplify the process of quantifying securitizers' obligations in a commingled loan pool. As explained, we do not foresee any adverse changes in the credit quality of the underlying loans, incentives for sponsors, or protections provided to investors as a result of this proposal. Rather, a rule allowing commingling of QRM and non-QRM loans would prevent any odd-lot liquidity problems that might otherwise arise, saving borrowers money at no cost to investor safety and no reduction in incentives to securitization sponsors.

D. The Qualified Residential Mortgage standards

1. The QRM standards are too narrow

The proposed QRM standards are tighter than necessary to meet the stated goals of supporting strong underwriting standards and protecting investors. Given the tighter underwriting guidelines and enhanced controls put in place in the wake of the financial crisis, current origination already achieves the high credit quality goals that risk retention is designed to promote. As a result, it is unlikely that significant further enhancement of credit quality will be achieved by requiring securitizers to retain risk from current production. The QRM rules should be broadened to reflect the already high quality levels of current loan production.

²⁹ See Asset Backed Securities, Securities Act Release No. 8518, 70 Fed. Reg. 1506, 1529, n. 173 (Dec. 5, 2005).

a) Current loan production is very high quality, yet it would be largely excluded from QRM treatment

Question 106 in the commentary to the Proposed Rule asks whether the overall approach taken by the Agencies in defining QRM standards is appropriate. Respectfully, we believe that the QRM criteria under Dodd-Frank § 941 were intended to focus more on product type and less on underwriting criteria. Only one of the five indicators discussed in § 941(e)(4)(B) even relates to credit criteria, and there is no indication that Congress intended the QRM definition to be a small percentage of the total volume of residential mortgage loans originated. Indeed, at the time that Dodd-Frank was enacted, most industry participants and many, if not most, members of Congress believed that the QRM definition would exempt the vast majority of thirty-year fixed rate mortgage loans so long as they were fully documented and underwritten based on reasonable assumptions regarding borrowers' ability to repay.³⁰ In contrast to this belief, the Proposed Rule's QRM definition will require risk retention on the vast majority of thirty-year fixed rate loans that are not eligible for sale to the GSEs.

Currently, jumbo loan origination standards at Bank of America are substantially similar to the conforming GSE criteria on every point except for loan size.³¹ In spite of this fact, we anticipate that over 70% of current loan origination would be excluded from QRM treatment under the Proposed Rule.³² This estimate does not even include the substantial impact that the Proposed Rule's servicing standard requirements will have. Indeed, for the reasons explained below in Section III.G, it is not even clear if originators will underwrite loans with servicing standards in the loan documentation. Therefore, analysis of the QRM loan criteria of necessity

³⁰ See, e.g., Letter from Senators Mary Landrieu (D-LA), Johnny Isakson (R-GA), and Kay R. Hagan (D-NC) to Risk Retention Agencies (May 27, 2011) (bipartisan letter signed by thirty-nine Senators indicating that the QRM definition is substantially narrower than expected in passing Dodd-Frank).

³¹ Excluding certain small origination channels that provide customized loans to retail customers and that are not statistically significant from a volume standpoint.

³² See Appendix D, Exhibit 4 (only 28.4% of already tight 2010 origination would qualify as QRM).

does not quantify the impact that inclusion of servicing standards will have. Even without servicing standards, however, the proposed QRM rule will unnecessarily exclude a large number of high quality loans.

Loans originated in the past two years are already high quality loans from a credit standpoint. Ninety-day delinquencies on all current (2009 and later) jumbo origination are substantially below the apparent goal of 1% shown in the normalized pool data released as part of the Proposed Rule notice. Indeed, current jumbo origination delinquencies are even lower than historically expected delinquencies due to uncontrollable factors like housing market trends, natural disasters, illness, death, divorce, factory closings, and the health of the employment market generally. The QRM rule was designed to exempt precisely such high-quality loans on the theory that there was no need to protect investors from assets that were already very low credit risks. Instead, the QRM rule disqualifies the vast majority of such production.

Part of the reason why the QRM rules exclude such a large percentage of current origination is that the loan performance characteristics the Agencies evaluated were primarily from a deep recession accompanied by home price depreciation not experienced since the Great Depression. We believe that the Agencies should consider loan performance data over a longer timeline rather than tying QRM eligibility to loan performance during the recent financial crisis.

In addition, the Proposed Rule compounds these stringent factors by unnecessarily demanding that *all* of them be met for a loan to qualify as a QRM. In developing the QRM rule, the Agencies appear to have evaluated each risk factor *individually*. For instance, the Agencies considered the impact of DTI on defaults independently from the impact of LTV and other factors. The required target for each variable was then set based on the level that would independently indicate strong credit. However, the QRM rules apply these individual factors

collectively. The result is to layer multiple variables that independently indicate high credit quality and require all of them to be present for a loan to qualify as a QRM. As such, the proposed QRM definition overcompensates for credit risk and does not reflect the way that loans are originated. Originators typically recognize that extremely high quality credit characteristics in one set of credit criteria may compensate for somewhat lower indicators in others. Thus, an independently wealthy individual might not meet the QRM front and back end DTI requirements or 80% LTV requirement and yet still be a very strong credit risk due to owning extensive assets. We fully recognize that the actual underwriting standards used by lenders to evaluate such compensating factors are too complicated to codify in the QRM rule. However, the slightly wider criteria for QRM loans that we propose below would have the net effect of permitting underwriters to allow for at least some limited compensating factors within what would remain historically tight underwriting standards. Rather than attempting to adopt a complicated set of conditional QRM rules, the Agencies should embrace the natural lending flexibility that a somewhat wider QRM definition would afford. While recognizing that regulators desire a black line rule for easy application, without room for these traditional compensating factors the QRM rule draws the wrong line.

As explained above in describing the need to commingle QRM and non-QRM loans,³³ if the QRM loan definition is not broadened, so few QRM loans will be originated that it may be difficult or take a considerable time period for sponsors to aggregate sufficient numbers to securitize them. At 17% of production from 2001 to 2010,³⁴ QRM loans actually are likely to be less liquid than other loans simply due to their scarcity. The result could be an actual increase in borrower cost to reflect originators' inability to generate sufficient numbers of QRM loans to

³³ See above Part III.C.1.

³⁴ See Appendix D, Exhibit 4.

create a critical mass. Last year there were concerns that the QRM definition could end up being so broad as to unfairly penalize all non-QRM loans; the irony is that the proposed QRM definition could have precisely the opposite effect. And insofar as the Agencies have concerns about the liquidity of either QRMs or non-QRMs, those concerns are best addressed by allowing commingling of asset subclasses, as described above, rather than adopting a definition of QRM that may be substantially narrower than envisioned by Congress.³⁵

b) The QRM standards would significantly impact low- to moderate-income lending

Question 108 of the Proposed Rule solicits comment on the effect the proposed QRM standards might have on pricing, terms, and availability of non-QRM residential mortgages, including to low- and moderate-income (“LMI”) borrowers. As outlined above, we believe an inappropriately narrow QRM definition is inadvisable because it could effectively result in an illiquid and, therefore, more costly QRM market coupled with a more costly non-QRM market given the additional costs of risk retention. A significant number of LMI borrowers would be impacted by the proposed QRM definition. We estimate that nearly 80% of LMI home purchase loans and nearly 90% of LMI rate/term refinance loans originated in 2010 would be non-QRM loans under the proposed definition. While it is difficult to quantify the precise financial impact the proposed definition would have on the loan terms available to LMI borrowers, it is axiomatic that prices would increase and the ability of such borrowers to qualify for financing would be reduced. Thus, we believe the current proposal would have a significant impact on a broad group of LMI borrowers.

³⁵ See above note 30.

2. The QRM definition should be broadened to become closer to the GSEs' conforming loan definition

Instead of ceding large segments of the market to the GSEs, the rules should encourage healthy private market competition. Taxpayers currently backstop the portfolios of Fannie Mae and Freddie Mac. Yet those portfolios purchase loans subject to lower underwriting standards than the QRM standards intended to be purchased by sophisticated investors with large amounts of capital. This is not to suggest that the GSEs are currently purchasing new origination that contains dangerous credit risks. Rather, the point is that assets that are safe enough for the taxpayer-backed GSEs are certainly safe enough that securitizers should be allowed to sell them to sophisticated investors without being subject to risk retention requirements. The QRM definition should be rewritten to become closer to the GSEs' current conforming loan definition, excluding applicable loan size limitations. As demonstrated in Appendix D, the QRM definition can be widened to allow substantial numbers of borrowers to enjoy low-cost QRM financing at the cost of very minimal changes to credit risk.

The most important criteria that should be modified to make QRM structures competitive with GSE securitization are DTI, LTV, and borrower credit history. By adopting the following criteria, private securitizations will be placed on a more equal playing field with the GSEs, encouraging the return of private capital to a broader segment of the RMBS marketplace.

First, LTV levels should be equal for purchase money and refinance transactions.³⁶ A borrower who buys a new home with 20% down should not be prohibited from lowering his

³⁶ We recognize that the Agencies have indicated a strong preference for an 80% LTV standard. Should this standard be adopted in the final rule, it is extremely important that liquidity be provided for loans with higher LTVs in order to avoid negatively impacting borrowers who cannot make the substantial down payments required by the QRM standards. Without such accommodation, the QRM rules will have a disparate impact on young people, first-time homebuyers, minorities, and others. Residential mortgage loans with LTVs as high as 95% can still provide excellent credit risks, and we strongly encourage the

interest rate through a rate term refinance just because he has not had enough time or excess savings to pay down 5% of his principal balance. If one of the goals of the QRM rule is to ensure that borrowers can afford the loans they receive, the rules should allow borrowers to refinance into more affordable products without penalizing them for having an existing loan. In addition, if a lower threshold for cash-out refinances is adopted, it will act as a disincentive to paydowns because cash used for partial prepayments could be locked away for up to thirty years or until borrowers move. If the Agencies believe that an 80% LTV is an appropriate level for new loans, then it should be equally appropriate for refinances.

Next, the front-end DTI requirement should be eliminated. Front-end DTI is not commonly relied upon in the residential mortgage industry because it is largely irrelevant. A borrower's back-end DTI is far more important because it reflects the portion of the borrower's income that will actually go to debt service. For instance, a borrower with a 30% front-end DTI and a 30% back-end DTI by definition has only a mortgage loan and presumably has the most favorable front-and back-end DTI combination, other factors held constant. However, the proposed QRM definition would deny that borrower QRM treatment while allowing a similar borrower with a 28% front-end DTI and 36% back-end DTI to qualify. The QRM rule should focus exclusively on back-end DTI.

Similarly, we believe that the Proposed Rule's back-end DTI of 36% unnecessarily excludes creditworthy borrowers for only negligible improvements in credit quality. Instead, borrowers with up to 45% DTI should qualify for QRM loans. The data in Appendix D illustrates that DTI can be safely expanded at a negligible increase in risk. This change would allow borrowers to avoid the additional costs described in Appendix B.

Agencies to consider methods to accommodate such borrowers, such as reduced risk retention with the inclusion of mortgage insurance.

Finally, we believe that references in the QRM rule to individual credit events such as thirty- or sixty-day delinquencies are imprecise (and sometimes inaccurate) predictors of creditworthiness and should be abandoned. A backward-looking analysis can appear to associate isolated payment experience with a particular credit score, but no single data point can provide a holistic credit measurement. While single credit events may be considered on rare occasions in unusual underwriting circumstances, even the commentary to the Proposed Rule admits that statistics equating delinquencies with credit risk simply do not exist. As a result, there is no way to know whether the proposed QRM delinquency standards (or any other single variable replacement, for that matter) are too tight, too narrow, or simply irrelevant.

Insofar as the Agencies wish to adopt factors to evaluate borrowers' credit history, credit bureau scores are already carefully calibrated to reflect a comprehensive view of an individual's past financial activities. Credit bureau scores are far more representative of borrowers' habits than any single credit variable can ever be. We note that credit bureaus are not Nationally Recognized Statistical Rating Organizations ("NRSROs") and, thus, are not prohibited from being referenced in the QRM rules by Dodd-Frank. Nor are credit bureaus subject to the same conflict of interest concerns that have been raised with regard to rating agencies. Credit bureau fees are ultimately (but indirectly) paid by borrowers. They thus give credit bureaus no incentive to inflate credit scores, in contrast with assertions that rating agencies curried favor with the issuers who paid their fees by inflating security ratings to obtain future business. Finally, the residential mortgage industry has long relied heavily on credit bureau scores for the simple reason that they work. Even the Agencies' comments to the Proposed Rule demonstrate this fact by repeatedly referencing credit bureau scores. Credit bureau scores have the additional

advantage of having been in wide use for decades, resulting in familiarity and extensive data that the Agencies can use to set standards appropriately.

The data provided in Appendix D demonstrates that these changes to the QRM rule would allow low-cost QRM loans to be offered to significantly larger numbers of borrowers with only minimal changes to credit quality.³⁷ Indeed, the widened QRM standard we propose would have allowed 26.7% of the market, on average, to receive QRM loans between 2001 and 2010, as opposed to only 17% under the Proposed Rule's definition.³⁸ Yet that substantial increase in availability of low-cost QRM financing to borrowers would only have resulted in an increase in defaults of less than one half of a percent, from 0.81% to 1.17%.³⁹

If adopted, these QRM criteria modifications will help to prevent penalizing private market securities backed by the very types of loans that are deemed safe for the taxpayer-supported GSEs. Indeed, a widened QRM standard would remain well below the default rates observed on Fannie Mae agency collateral. If the widened QRM definition had been applied to loans originated between 2001 and 2008, those loans would have experienced only some 40% of the defaults experienced by FNMA loans.⁴⁰ Even if a significantly wider QRM definition had been applied to such loans, the result would still be less than half as many defaults as agency collateral.⁴¹ As long as GSE guidelines are more expansive than QRM guidelines, private capital will not be able to compete for loans that are outside QRM but inside GSE criteria, and overreliance on the GSEs to support the housing market will continue. Modifying the QRM

³⁷ Again, it is important to note that this data does not take into account the impact of servicing standards in QRM loan documents currently required by the Proposed Rule. That requirement could only further reduce the number of borrowers who could receive QRM loans.

³⁸ See Appendix D, Exhibit 4 (comparison of Rule and BofA 3 columns).

³⁹ See Appendix D, Exhibit 2 (comparison of Rule and BofA 3 columns) (considering loans originated between 2001 to 2008).

⁴⁰ See Appendix D, Exhibits 2-3, Column 3.

⁴¹ See Appendix D, Exhibits 2-3, Column 4.

guidelines as suggested will lessen private securitization's competitive disadvantage and help private capital to return. Similarly, it will allow the private market to grow organically, potentially providing credit with little disruption to the already fragile housing market in the event that the GSEs reduce their footprints. That reduction is one of the central goals of the Agencies and market participants alike, as evinced by the Department of the Treasury and the Department of Housing and Urban Development's recent joint report titled *Reforming America's Housing Finance Market*.⁴² The QRM definition should correspond with the suggested criteria to encourage these results.

3. Responses to additional QRM-specific questions in the commentary to the Proposed Rule

As described above, the majority of our QRM-specific concerns can be addressed by allowing commingling of QRM and non-QRM loans or by bringing the QRM rule closer to the GSEs' conforming loan definition. Nevertheless, there are several related questions raised in the Agencies' commentary to the Proposed Rule that should also be considered.

First, in response to Question 109, we believe that the points and fees calculations for QRM loans should be calculated using the same criteria adopted for calculating points under the Qualified Mortgage (QM) rules. QRM requirements must be clear and unambiguous, and the same must be true for the calculation methodology adopted in the QM definition in order to promote greater clarity and certainty in determining whether loans qualify as QRMs. Additionally, the costs and complexity of data system upgrades required for lenders to comply with the new Dodd-Frank regulatory requirements will be significantly reduced if the QRM and

⁴² Department of the Treasury and Department of Housing and Urban Development, *Reforming America's Housing Finance Market: A Report to Congress* (Feb. 2011), available at <http://www.treasury.gov/initiatives/Documents/Reforming%20America's%20Housing%20Finance%20Market.pdf>.

QM points and fees criteria are uniform. Those savings will be passed on to consumers in the form of lower borrowing costs.

Similarly, Question 124 asks whether points and fees are calculated properly under the Proposed Rule. The proposed definition includes in the calculation of the 3% cap on total points and fees those settlement charges paid to a creditor's affiliate, but excludes similar charges if paid to an unaffiliated entity. The QRM definition, instead, should allow for equal treatment of settlement service providers, without regard to their ownership structure. The Proposed Rule's disparate treatment would reduce the ability of creditors to control the quality of ancillary settlement services and would negatively impact both consumers and the economy.

A large number of the nation's leading national lenders, real estate brokerage firms, and homebuilders offer both mortgage loans and other settlement services through wholly owned subsidiaries, affiliates, or joint ventures. These entities must comply with the affiliated business arrangement provisions of the Real Estate Settlement Procedures Act ("RESPA"). Under the proposed definition, these lenders would be subject to regulatory compliance and legal costs, and thus less able to sell their smaller loans when an affiliate provides settlement services on such loans. As a result, the availability of mortgage loans for lower-income and lower middle-income consumers would be reduced.

For many years RESPA has been based on a policy that permits creditors to require the use of a settlement service provider for core services (i.e., appraisal, credit reporting, and attorney services) used in the origination of mortgage loans. To the extent that originators can require the use of their affiliates for these and other settlement services, originators have significantly greater control over the quality and compliance standards to which loans are produced. This quality control benefits both originators and their mortgage customers and

investors. The proposed QRM definition would effectively overturn RESPA's well-established policy and weaken the ability to closely monitor the quality, efficiency, consistency, and legal/regulatory compliance of settlement services, as required under the OCC's long-standing guidance regarding the management of third parties. For these reasons, charges for settlement services provided by an affiliate should not be included in the calculation of points and fees.

We also do not believe that the QRM eligibility criteria should incorporate a "reason to know" standard for precluding loans with second liens, as Question 114 asks. The lack of specified criteria for knowledge of second liens would make it impossible for creditors to be sure, at the time of issuing asset-backed securities, whether the loans in that transaction qualified as QRMs. If the Agencies believe it is necessary to address the existence of second liens in the QRM criteria, they should establish specific verification procedures that creditors can rely upon in determining whether loans qualify as QRMs at the time of issuance. Further, if a "reason to know" standard is adopted, lenders should only be held accountable under the Proposed Rule when they own or service a second mortgage. Otherwise, it will be extremely difficult to verify QRM criteria.

Next, we strongly favor the concept raised in Question 142. That question asks whether the Agencies should permit sponsors to substitute replacement QRM loans if a loan is determined after closing not to be a QRM. Substitution in lieu of repurchase is a well-established and uncontroversial feature in RMBS for mortgage loans that have documentation deficiencies or do not meet loan-level representations and warranties. A substitution provision for loans that turn out not to meet the QRM requirements would be both consistent with market practice and beneficial to securitizers and investors. It would reduce prepayment risk for RMBS investors while adding flexibility for securitizers. The best way to implement a substitution provision

would be to follow the requirements under the IRS REMIC regulations for substituting qualifying mortgage assets for defective obligations. Specifically, the rules should provide that loan substitution must occur during the first two years after issuance and take place no later than ninety days after discovery that a loan does not qualify as a QRM.

Finally, we appreciate the Agencies' flexibility in publishing a possible alternative approach to the QRM definition and corresponding risk retention requirements, as discussed in Questions 143-149. However, the alternative does not provide enough information regarding the risk retention requirements for non-QRMs to be implemented into a final rule without a further release for comments. If the Agencies give further consideration to the alternative proposal, they should carefully evaluate its impact on the accounting treatment for RMBS. Any proposal to increase the base 5% risk retention requirement would likely have a devastating impact on the prospects for the future return of a robust private RMBS market. As described earlier in evaluating the likely impact of the PCCRA, any risk retention requirement in excess of 5% would put sale treatment, a fundamental structural and economic feature of private RMBS transactions, in jeopardy.

E. If the QRM definition is not expanded, an intermediate form of risk retention should be created to mitigate costs to borrowers

As explained, we believe that the QRM definition should be broadened to become closer to the GSEs' current conforming loan definition, reflecting the high credit quality of current origination and allowing private label securities to compete on a level playing field with taxpayer-backed GSE structures. However, if the Agencies retain the current, narrow QRM definition, at a minimum the Proposed Rule should include an intermediate class of residential mortgage loans to mitigate cost increases to consumers who are still excellent credit risks but do not quite meet the stringent QRM rules. As noted above, residential mortgage loans that meet the

GSEs' present conforming loan criteria (other than principal balance) are very high quality from a credit perspective, but over 70% of them are excluded from the proposed QRM definition.

1. A "Intermediate QRM" form of risk retention should be allowed if the proposed QRM guidelines are not changed

If the proposed QRM guidelines are not materially broadened in the final rule, we believe that a "Intermediate QRM" subclass should be defined to generally track the present criteria for GSE conforming loans. An intermediate Intermediate QRM class would allow the Agencies to take the high quality of current GSE conforming loans into account and would provide funding to those borrowers without the effect of likely price increases due to the full proposed 5% risk retention and the impact of the PCCRA. As described earlier in the QRM discussion, the most important changes would be allowing new origination LTV, refinancing LTV, and cash-out refinances of 80% CLTV or lower, defining back end DTI at 45% or less, and eliminating the largely meaningless front-end DTI requirement and references to specific delinquency events as a credit history proxy. If the Agencies decide to adopt the proposed QRM definition, borrowers who just miss qualifying for QRM loans will be subjected to the same price increases resulting from risk retention overhead (and in particular the PCCRA) as though they had the worst credit in the market. To close the gap between these borrowers and very similar QRM borrowers who are entirely exempt from risk retention, Intermediate QRM loans should be subject to a 1% risk retention rate instead of the 5% imposed on all private, non-QRM mortgage loans under the Proposed Rule. In addition, while we strongly believe that the PCCRA should be removed from the proposed rule entirely, at a minimum Intermediate QRM loans should not be subject to the PCCRA. We believe that 1% risk retention for Intermediate QRM loans would still give originators sufficient incentive to generate high-quality loans without unduly punishing

responsible, low-risk Intermediate QRM borrowers or excessively hampering the return of capital to the private RMBS market.

It is important to emphasize, however, that we only believe that an Intermediate QRM class of mortgage loans is advisable if the Agencies also allow commingling of QRM, Intermediate QRM, and non-QRM loans within a single pool to relieve any liquidity problems arising from insufficient issuance of a particular subclass of loans.⁴³ If an Intermediate QRM rule were adopted without a corresponding rule allowing commingling, the Intermediate QRM proposal would further fragment the residential mortgage loan market into subgroups. While we have significant concerns about a market artificially divided into QRM and non-QRM mortgage pools, that problem would increase considerably if a third subgroup were added. In that case, the private RMBS market would be divided into three subgroups, one, two, or all three of which could lack the necessary volume for efficient securitization. In short, adoption of a commingling rule is a necessary prerequisite to realizing the considerable benefits of our Intermediate QRM proposal.

An Intermediate QRM rule would provide a graduated set of risk retention requirements, enabling consumers and securitizers to avoid what otherwise will likely be steep increases in costs for non-QRM loans in the private market. Intermediate QRM would not entirely eliminate these rate increases (like expanding the QRM definition would), but it would substantially reduce the effect on borrowers who just miss qualifying for QRM loans. Because of this fact, we believe that adopting an Intermediate QRM definition would reduce the hurdles for securities backed by private capital to compete with GSE securitizations, helping to avoid the GSE domination of the non-QRM market that the Proposed Rule is otherwise likely to foster.

⁴³ See Section III.C.

For the same reasons, a tiered approach to residential mortgage risk retention using the Intermediate QRM proposal would facilitate the drawdown of the GSEs without risking prohibitively high costs to borrowers. In order to enable this drawdown, the Intermediate QRM definition should be static based on present GSE conforming guidelines rather than merely referencing them. A static Intermediate QRM definition would allow the GSEs to tighten their conforming loan criteria as they exit the market while leaving private securitizers able to step up to fill the void left by their departure.

2. Creation of an Intermediate QRM rule is within the Agencies' broad discretionary powers under § 941

Adoption of an Intermediate QRM standard is an appropriate exercise of the rulemaking authority delegated by Congress in § 941. As already explained in discussing the Agencies' power to allow commingling of different subclasses of mortgage loans, the Agencies have wide-ranging discretion to allow credit risk retention of less than 5% with respect to securitized assets, including the creation of securities with less than 5% risk retention. § 15G(c)(1)(B)(ii). They may do so as long as the "characteristics of a loan within the asset class indicate a low credit risk with respect to the loan." § 15G(c)(2)(B). Additionally, the Agencies have authority to "provide for a total or partial exemption of any securitization [from the risk retention rules], as may be appropriate." § 15G(c)(1)(G)(i). Those explicit grants of authority do not exclude any particular asset classes, but rather encompass all security types under the rule. In conjunction with the obvious presence of independent QRM rules, Congress must have contemplated that a third category of residential mortgage loans, subject to risk retention between zero and five percent could be necessary. Congress thus provided the Agencies with the authority to create such a category.

The authority to adopt Intermediate QRM rules is further strengthened by the Agencies' discretion to create risk retention exceptions intended to "improve the access of consumers and businesses to credit on reasonable terms," § 15G(e)(2)(B). A rule providing affordable credit to borrowers with unquestionably high credit, who barely miss qualifying under a QRM standard likely to be met only by the most financially secure members of society, can only be said to "improve the access of consumers" "to credit on reasonable terms." Not only that; an Intermediate QRM rule would affirmatively prevent potentially dramatic cost increases to borrowers. As an example, adopting a 1% Intermediate QRM retention option would reduce incremental costs to borrowers who just miss QRM treatment from the full 5% to 1%—an eighty percent savings to borrowers. We believe that the Agencies have the authority to adopt an Intermediate QRM rule as described and should do so to avoid the increased costs that will otherwise result for high-quality borrowers. These borrowers are the potential buyers needed to reduce the current inventory of unsold homes. By providing for an Intermediate QRM and related commingling rule, the Agencies can comply with both the letter and the spirit of § 941, and in particular satisfy its objective of allowing affordable credit to borrowers.

F. The Proposed Rule's negative impact on the return of private capital will be exacerbated by the currently necessary exemption of the GSEs

Although we understand and support that policy makers' ultimate goal is to return private capital to the residential mortgage market, we agree with temporarily exempting the GSEs from the Proposed Rule's risk retention requirements. At present the GSEs are necessary to minimize disruption to the already fragile housing market and should be retained to facilitate a measured transition back to a market backed by private capital. However, the Proposed Rule is likely to undercut the important goal of shrinking the GSEs' share of the market over time. In that

position, the GSEs' lending engines will be difficult to downshift without a dramatic and unpalatable impact on the housing market.

1. In combination, the Proposed Rule provisions will hamper the return of private capital to the RMBS markets

As noted above, there are serious stand-alone difficulties with the premium capture rules and a tight QRM definition. However, when combined with the necessary exemption of the GSEs from risk retention (and, thus, from both premium capture and QRM rules), the proposals create obstacles to the return of private capital that are even greater than the sum of their parts.

If the current combination of rules is retained in the final rulemaking, it is likely to result in a tiered residential mortgage market with increased interest rates for any consumers who have anything less than perfect credit or do not qualify for a GSE eligible loan. The small handful of borrowers who qualify for QRM loans will command the lowest rates, reflecting the fact that they are both the best credit risks and also the least costly for originators to finance because of their exemption from risk retention.⁴⁴ As noted, only a fraction of current, already stringent origination falls into this category.

Second, it will be very difficult for private capital to compete with the GSEs for conforming but non-QRM loans. Again, in the present market these borrowers are extremely good credit risks. But because of the GSEs' exemption from the risk retention and premium capture provisions as well as their taxpayer backing, the GSEs will always have a substantially more competitive bid for these loans than the private sector. Private capital simply will not be

⁴⁴ At present, we recognize that the GSEs enjoy a unique position in the residential mortgage market because of their government guarantee, such that there currently is little private residential mortgage securitization. However, as the intended goal seems to be to eventually reduce GSE involvement, likely by raising guarantee fees, the GSEs at some point will reach parity with the private market. The likely net result of parity will be to increase costs to borrowers as the costs of GSE financing are raised to match the impact of the Proposed Rule on the private market. When that occurs, we expect QRM borrowers to enjoy the lowest-cost financing available in the market, as described here.

able to compete. As a result, originators will sell a disproportionate amount of their conforming but non-QRM production to the GSEs. The effect will be continued exposure of the GSEs to non-QRM loans at a time when the stated goal is to decrease taxpayer involvement in the market.

Next, some borrowers who do not qualify under the QRM or conforming standards may obtain loans that originators are willing to hold on their books. Under the Proposed Rule, these borrowers will not necessarily have weaker credit than QRM or conforming borrowers. Rather, they are likely to be very strong borrowers whose characteristics make them ineligible for QRM or conforming loans but still attractive to portfolio holders. One likely example might be high net worth jumbo borrowers who want to borrow more than 80% LTV. Another example might be jumbo borrowers who meet QRM back-end DTI requirements but fail front-end DTI. As these high-quality loans will be removed from general non-QRM private label pools and placed in portfolios, there is a risk that the highest-quality non-QRM loans will not be sold into the market.

Even so, these non-QRM borrowers will potentially still pay a premium over QRM or GSE eligible loans because they will be financed as long-term balance sheet assets, will be less liquid than QRM or conforming loans, and will not be securitized. Portfolio loans also will be limited by the size of available lender balance sheet and, thus, are likely to remain a relatively small percentage of the market, increasing the borrowing costs of this segment of borrowers most critical to burning off the unprecedented inventory of unsold homes.

Lastly, anyone who cannot qualify for any of the options above will have to borrow in the private RMBS market, subject to all the expenses of increased risk retention and the premium capture rules. There is likely to be a substantial jump in interest rates between QRM, conforming, and portfolio loans and the remainder of the residential mortgage market. This large gap in rates will reflect the significant additional costs of issuing bonds backed by non-QRM

loans. It will also mean that these loans must be originated at premium note rates, further exacerbating the premium capture problem. In short, securitization will be the funding of last resort, contrary to the stated goals of restoring the private label RMBS market.

In addition, securities backed by these non-QRM or conforming loans will be difficult to market for reasons having nothing to do with credit. As an initial matter, the above market rates will cause multiple problems with the PCCRA rule, as discussed above. In addition, investors will know that the underlying borrowers are paying a substantially higher rate than QRM or conforming products and thus will be concerned about rapid prepayments. Borrowers will have a strong incentive to refinance as soon as they can improve their credit characteristics. As a result, investors looking to purchase senior cashflows will be justifiably concerned that any premium paid for bonds will be quickly repaid at par as borrowers refinance, which in turn will motivate them to demand prepayment penalties for non-QRM premium loans. All of these factors will make securitizing non-QRM assets even more difficult. Solving the problem with increased rates will be almost impossible (as discussed above in Section III.B.), thus reducing the availability of credit and securitization even further.

2. Reducing involvement of the GSEs will not by itself result in the return of private capital at affordable rates

These problems cannot be solved simply by removing the GSEs' risk retention exemptions or even by gradually drawing down the maximum conforming loan size or increasing the guarantee fee. Either course may shrink the GSEs but would not give private capital the needed incentives to return to the RMBS marketplace. Instead, it would create a vacuum of affordable financing in the market sectors previously served by the GSEs. Private capital will not return at the rates provided by the GSEs if the Proposed Rule is passed as written, even if the GSEs disappear or shrink. Instead, the competitive advantage of the GSEs will result

in artificially low conforming loan rates relative to the rates available in the private mortgage market. Without addressing that advantage, shrinking the GSEs will result only in increased costs to compensate for the market's collective loss of financing. And while increasing the GSEs' guarantee fee could potentially compensate for any pricing differences between QRM and GSE loans, increasing guarantee fees sufficiently to eliminate the competitive advantages of the GSEs in non-QRM loans due to the combined effects of premium capture and 5% risk retention would strangle credit to non-QRM borrowers. As a result, we expect that it would be very difficult practically and politically to reduce GSE market participation under the Proposed Rule.⁴⁵

G. Inclusion of servicing standards in the QRM rule

1. Servicing standards should be determined by industry-wide regulation rather than included in the QRM definition

Regardless of other aspects of the QRM rule, the QRM definition should not require servicing standards to be included in mortgage transaction documents. While we support the concept of uniform servicing standards for residential mortgage loans in principle, the note or mortgage is not an appropriate location for them. As the comments to the Proposed Rule recognize, numerous federal regulatory agencies are currently considering the adoption of national servicing standards on an industry-wide basis. We believe that efforts by proper regulatory authorities or Congress are the appropriate way to proceed on this important topic, rather than prematurely adopting rules limited to one segment of residential mortgage loans. The proposed QRM-specific servicing standards will create mortgage loan enforcement risks that

⁴⁵ The goal is not to return to pre-financial crisis GSE levels, but rather to reduce the GSE levels in order to meet the goals set forth in the Department of the Treasury and Department of Housing and Urban Development, *Reforming America's Housing Finance Market: A Report to Congress* (Feb. 2011), available at <http://www.treasury.gov/initiatives/Documents/Reforming%20America's%20Housing%20Finance%20Market.pdf>.

may prevent QRMs from being originated or securitized, will apply only to the small segment of the market least likely to need them while substantially increasing the complexity and costs—which will ultimately be borne by borrowers—of originating and servicing residential mortgage loans, and will impede efforts by the Agencies to develop consistent standards applicable nationwide to all residential mortgage loans.

2. Complexity and uncertainty surrounding servicing standards will discourage lenders from originating lower cost QRM loans

The biggest problem with the proposed servicing standards for QRMs is that they will be implemented by requiring servicing provisions to be included in mortgage loan documents. This feature of the proposed QRM definition will likely prevent, or at least significantly delay, the origination of residential mortgage loans that qualify for the QRM exemption from the risk retention requirements.

Bank of America, like substantially all mortgage lenders, originates mortgage loans on form loan documents that meet the requirements for delivery to the GSEs and federal housing agencies.⁴⁶ This standardization of loan documents makes loans more fungible and allows them to be placed into the most efficient form of securitization rather than locked into a single delivery option. Similar forms of loan documents are also customarily used for secondary market transactions with private parties. Those current industry standard forms of loan documents do not include agreements relating to the servicing of the loan that are proposed in the QRM definition, and neither the GSEs nor the federal housing agencies, which together constitute substantially all of the current secondary mortgage market purchasers, provide for such agreements to be included in loans eligible for their programs. Because there is no current market for residential

⁴⁶ Again excluding certain small origination channels that provide customized loans to retail customers and which are not statistically significant from a volume standpoint, as recognized above in note 31.

mortgage loans that include the proposed servicing terms, it is unclear whether loans with those terms would gain market acceptance.

Because the servicing agreements will be interpreted under the laws and in the courts of each state, there will likely be inconsistent and erratic state court interpretations of those agreements that will require lenders to implement state-specific loss mitigation procedures, which will significantly increase the complexity, cost, and risk of loan servicing.

The uncertain and untested impact that the inclusion of servicing requirements in loan documents will have on the behavior of borrowers and the consumer rights bar likely will have an adverse impact on the value and marketability of loans that include them. Because loans with the proposed servicing terms have not previously been originated, investors and rating agencies have no historical loan performance data for similar loans that could be used to predict the impact of the servicing agreements on loan performance. Investors may choose not to purchase, or demand higher yields for, RMBS transactions that include QRMs because of the additional uncertainty created by the servicing agreements.

3. The expense of originating and servicing to multiple standards will be borne by the borrowers least likely to need assistance

Creating and maintaining separate loan documents and servicing standards for QRMs will be very expensive for lenders if the proposed servicing standards are included in the final rule. That expense, as with all origination and servicing expenses, must ultimately be reflected in the cost of mortgage credit. Yet the servicing standards in the QRM definition will only apply to the small segment of the market least likely to need the loan modifications required by the Proposed Rule. QRMs are expected to be the most creditworthy loans in the RMBS marketplace, yet they will be the only ones subject to servicing standards under the Proposed Rule. This outcome is the opposite of what might be expected. The fact that § 941 does not explicitly give

the Agencies authority to adopt national servicing standards suggests that the legislature believed such standards should be reserved for a future rulemaking. A long delay is not likely. The Agencies and the Consumer Financial Protection Bureau are already exercising other rulemaking authority to enact national servicing requirements applicable to all mortgage loans. Therefore, there appears to be little benefit to the typical consumer from requiring servicing agreements to be included in QRM loan documents. Rather than incur substantially higher QRM origination and servicing costs that will be passed through in the form of higher mortgage credit costs, the Agencies should wait and adopt servicing standards on a comprehensive national basis.

4. Including servicing standards in loan documents will impede efforts by the Agencies to create uniform national servicing standards

Because the proposed QRM servicing standards would be implemented by means of private contracts between borrowers and lenders rather than a set of regulations that can be modified by the Agencies as necessary, the proposed QRM servicing standards will cause problems not only for lenders, but also for the Agencies themselves. As foreclosure cases and private litigation involving the QRM servicing standards are decided, there is a substantial likelihood that different courts across the country will adopt varying and erratic interpretations of the rights and duties of the parties under the loan documents. The result will be a patchwork of inconsistent servicing standards depending on the jurisdiction. If the goal of the servicing standards is indeed to standardize, this result will be counterproductive. Rather than adopting a rule that will result in piecemeal determinations by state courts with limited and varying levels of expertise with loan servicing standards, a single, generally applicable set of servicing standards drafted by expert regulators would be far more efficient and predictable.

The inclusion of servicing standards in loan documents would also impede efforts by the Agencies to make needed adjustments to servicing standards. Because each QRM loan with

servicing standards will be contractually agreed to at the time a loan is made, the rights and obligations of the parties will be fixed, regardless of whether the Agencies' views of servicing evolves over time. These results are undesirable and can easily be avoided by promulgating a generally applicable servicing standards rule rather than establishing standards as a matter of private QRM contract.

H. Risk retention obligations should end a reasonable time after origination

Sections __.12(b)(3) and __.14(a) of the Proposed Rule require securitizers (or consolidated affiliates) to hold PCCRA proceeds and risk retention for the life of all securities they issue. Because losses after the first thirty-six months of a loan generally are not the result of underwriting decisions, this rule potentially freezes capital for decades but will have little impact on the incentives to generate quality loans beyond the incentives provided by a much shorter time period. Consistent with the views expressed in the ASF Letter,⁴⁷ we believe that securitizers' risk retention obligations, including any PCCRA obligations, can safely sunset without undermining Congress's interest in encouraging strong underwriting. As a result, a risk retention sunset provision should be adopted.

Congress's goal in requiring risk retention was to encourage sound underwriting practices. The logic behind that goal posits that securitizers who share in losses will have added, direct incentive to ensure the quality of the loans they securitize. Risk retention is only responsive to that goal insofar as the losses it requires securitizers to bear are the result of poor underwriting and are thus avoidable.

Once a borrower has made timely payments for eighteen to thirty-six months after a mortgage is originated, subsequent credit events can be expected to result from macroeconomic factors or changes in the borrowers' circumstances, rather than from the underwriting practices

⁴⁷ See ASF Letter, at 69-70.

of originators. Therefore, retained interests should be able to be sold shortly thereafter. It is unusual for borrowers who faithfully make mortgage payments for thirty-six months before experiencing delinquencies to fall behind on payments due to conditions that the initial underwriting decision could have predicted. Instead, independent factors—overall housing market trends, health of the employment market, natural disasters, illness, death, divorce, and others—likely were to blame. Delinquencies and defaults after the initial thirty-six months of a loan are generally due to changed economic conditions or adverse life events experienced by borrowers, not underwriting decisions. By definition these risks cannot be controlled through underwriting and thus provide no incentives to undertake additional efforts to ensure quality at either the time of origination or the time of securitization. Risk retention beyond the first thirty-six months after loan origination provides no meaningful incentives to ensure quality underwriting because losses for seasoned loans cannot be effectively managed through improved underwriting. The Proposed Rule’s lack of a risk retention sunset provision will require securitizers to hold assets on their balance sheets for extended periods of time. Capital that otherwise could be used to provide new loans to borrowers will be tied up for years. Thus, without a sunset provision for risk retention, the resulting lack of liquidity will likely cause a decrease in the availability of credit, ultimately increasing costs to borrowers without creating meaningful incentives to improve the quality of loan underwriting.

Under a sunset provision, securitizers will still recognize losses for projected future defaults and delinquencies. Because potential purchasers will have years of loan experience at the point of risk retention sunset, they will be able to discount their bids to account for any projected future losses on the securities offered for sale by securitizers. In other words, market participants will have the data to value the retained bonds so that future expected losses on the

retained interests will be recognized when the bonds are sold. As a result, a sunset provision will not alter securitizers' economic incentives to securitize quality loans because the projected losses will be reflected in the price for their retained securities at the time of sale. A sunset provision along the timeframe endorsed in the ASF Letter will merely improve liquidity for the market, ultimately benefiting consumers.

I. Risk retention should not apply to non-economic residuals.

A technical correction to the Proposed Rule's definition of ABS interest is also needed to clarify that risk retention is not required for REMIC residual interests that receive no, or nominal, cashflows. We fully support the views expressed by the ASF Letter (at 69) and the SIFMA Letter (at 50)⁴⁸ on this topic. Non-economic residuals are often required to be created in residential mortgage securitizations under the applicable federal tax laws and do not alter the motivations of securitizers as they typically have no or only nominal (often \$100) value. As such, they should not be included in the interests on which securitizers are required to retain risk.

J. Representative sample risk retention

1. The goals of representative sample risk retention can be achieved without the unnecessarily complex procedures in the Proposed Rule

On a conceptual level, we wholeheartedly support allowing securitizers to meet the 5% risk retention requirement through a randomly selected sample of underlying loans. Such a procedure provides much-needed flexibility to securitizers while still aligning their interests with those of investors. The rule as drafted, however, is unnecessarily complex and should be modified to achieve its goals in a more efficient manner.

⁴⁸ Securities Industry and Financial Markets Association, Letter Regarding Credit Risk Retention Proposed Rule (June 10, 2011) ("SIFMA Letter")

a) Problems with the representative sample rule as written

As written, the Proposed Rule requires securitizers to use a recursive process of pool identification, random loan selection, and comparison with the pool average to select the 5% risk retention. If the randomly selected loans are not sufficiently similar to the average of the pool from which they were picked, the process must be repeated as often as necessary until the characteristics of the retained loans reflect the same pool averages.

The trouble with this rule is that it will be difficult to randomly (or for that matter even intentionally) choose a five percent selection whose characteristics match the whole. RMBS loans typically have balances in the hundreds of thousands of dollars. In industry terms, loans with sizeable individual balances are said to be “chunky,” meaning that a relatively small number of loans sum to a substantial percentage. In turn, this means that the pool average often will not reflect the characteristics of one, or even a number, of the underlying loans. As a result, it will be difficult to select a small number of “representative” loans. To take an oversimplified example, a pool with only two loans will have an average profile, but neither loan will reflect that average. This problem only increases as the homogeneity of the securitization pool decreases because individual loans stray farther from the center, making it all the more difficult to find the perfect handful of loans that mirror the pool average. While the difficulty does diminish as pool size grows, a pool of relatively “chunky” loans, such as an RMBS deal, can only grow to a certain point before the amount of capital involved becomes prohibitively large. Even with the current rule’s 1,000 loan limit, the five percent representative sample rule requires issuers to randomly select fifty loans (hypothetically assuming equal principal balance) that match (within a 95% two-tailed confidence interval) the pool average’s characteristics. In practice, this may prove impossible to do.

b) A true random sampling of multiple securitizations will achieve the same risk retention goals

Fortunately, the goals of the random sampling rule can be achieved with far less effort than the selection process outlined in the rule, at least in asset classes that involve relatively large numbers of loans. Risk retention is intended to align the interests of investors and issuers insofar as credit risk is concerned in order to promote strong loan underwriting. There is no need for an issuer to attempt randomly to select “average” loans on a pool-by-pool basis to meet that goal. A securitizer who retains a truly random portfolio of loans equal to five percent of its loan securitization will have the same incentives to ensure asset quality as one who engages in the selection process contained in the proposed representative sample rule.

The representative sample rule should be modified to allow securitizers to randomly select five percent of their loans underwritten or purchased in accordance with the same guidelines as those used for a securitization transaction at the aggregation stage of securitization, mark them as risk retention pools, and put them on their books as the true long-term assets they are. That course would still leave the securitizer holding five percent of their issuance, which will give them the incentives to maintain credit quality that the risk retention rules are intended to provide. To give regulators and the market confidence that a sampling is truly random, we fully support independent verification of random selection procedures. We believe that § __.8(d) of the Proposed Rule is correct in providing for an Agreed Upon Procedures Report from an independent public accounting firm to address this potential concern. As a result, we believe this provision should be retained, with the exception of § __.8(d)(2)(iii), which would be unnecessary under the truly random loan sampling we propose. Similarly, given the fact that the Proposed Rule requires disclosure of data for retained as well as securitized loans, any attempted gaming of the random selection process would manifest itself in the pool statistics and loan level data.

A truly random selection process need not be tied to the characteristics of a single securitization because such selection will naturally equalize over time to represent a true blended five percent of all the securitizer's deals. The easiest way to understand this fact is to think of the simplified example of a coin toss. A single toss may be either heads or tails, but over a series of many random tosses statistical aberrations are normalized. Thus, as the number of coin tosses (i.e., sample size) expands, the outcome of a single toss is diluted to the point of meaninglessness. Thus a repeat player will not change his behavior based on the outcome of a single toss. In the same way, repeat securitizers will not alter their behavior based on whether they believe a single random loan (or even a random group of loans) allocated to a given securitization is better or worse than the average. Some of the loans they hold may be worse than average, some may be better, but over time securitizers will still hold an average mix, just as a coin toss will yield half heads and half tails. As a result, the interests of any securitizers who hold a truly random five percent and engage in a sufficient number of market transactions will be aligned with the interests of investors. In other words, the proposed representative sample model's desired results can be achieved much more simply than the Proposed Rule suggests. Even a one-time issuer would have the proper incentives so long as the sample is truly random, because gambling in hopes of obtaining favorable loans is simply that and not a rational business strategy.

This change to the representative sample rule would also allow securitizers to hold the required five percent risk retention efficiently from a cash management, planning, and accounting perspective. If securitizers can retain their required risk at the point of production and aggregation, they can fund their obligations with appropriate capital, place them on the proper part of the balance sheet, and account for them consistently from the very beginning. From a risk

retention perspective, there will be no difference as a result of this method; securitizers will still hold the required risk. However, they will be able to avoid inefficiencies of mismatched funding, unnecessary balance sheet confusion, and complicated accounting that will only increase costs unnecessarily. As written, the representative sample rule increases complexity without any benefit in terms of protection for investors or better incentives for securitizers.

K. RMBS Conclusion

If the above suggestions to the Proposed Rule are adopted, we believe that the private RMBS market will be able to recover and provide much-needed additional capital to assist with the recovery of the housing market across the United States. Private securitization can be placed on a more equal footing with GSE financing while still providing ample protection for investors. Those positive outcomes would assist not only in the general recovery of the American economy but also would provide affordable financing to millions of American borrowers through sustainable mortgage loans.

IV. Commercial Mortgage Backed Securities Comments

While we anticipate providing comments to address the impact of the Proposed Rule on Commercial Mortgage Backed Securities (“CMBS”), those comments will be forthcoming in a supplemental letter.

V. Revolving Asset Master Trust Comments

A. Key Revolving Asset Master Trust comments

FIA Card Services, National Association (“FIA”), an indirect subsidiary of Bank of America Corporation, conducts nationwide consumer lending programs, principally comprised of activities related to credit cards. FIA formed BA Credit Card Master Trust II (“Master Trust II”) on August 4, 1994. As described in more detail below, Master Trust II has issued a collateral certificate representing an undivided interest in Master Trust II, to BA Credit Card Trust (“BACCT”), which is the primary ABS-issuing entity sponsored by FIA in connection with the securitization of credit card receivables.⁴⁹

As a longtime participant in the credit card ABS market, both as an issuer and an underwriter of credit card ABS, Bank of America applauds the efforts of the Agencies to craft a risk retention requirement for revolving asset master trusts that allows sponsors to satisfy their risk retention requirements through the holding of a seller’s interest. We fully agree that the sponsor of a revolving asset master trust should be permitted to satisfy its base risk retention requirement by retaining a seller’s interest in a manner consistent with market practice and that the traditional seller’s interest used in revolving asset master trust structures effectively aligns the interest of the securitizer with the interests of the investor. As noted in the Proposed Rule, the seller’s interest is a shared interest with all of the investors in the performance of the underlying assets and, thus, exposes the sponsor to the credit risk of the receivables.⁵⁰

However, we believe modifications to the Proposed Rule are needed in the following areas in order to accommodate the unique structural features of master trusts, and to make the

⁴⁹ The diagram in Appendix E illustrates the master trust structure utilized by FIA.

⁵⁰ See Proposed Rule, 76 Fed. Reg. 24104.

seller's interest option and the other proposed methods of risk retention workable for master trusts:

- The seller's interest method of risk retention should be better aligned with existing market practice. We support the stated intent of the Proposed Rule to define a seller's interest in a manner consistent with market practices. However, we are concerned that certain aspects of the definition of seller's interest described in more detail below are in fact inconsistent with market practice and will cause the seller's interest approach to be unavailable to nearly all master trust issuers.
- The risk retention rules should permit a consolidated affiliate of the sponsor to be the initial holder of the retained interest. Because the seller's interests for many master trusts are held by intermediate SPVs that act as depositors to those master trusts, rather than the sponsors of the master trusts, the seller's interest option in the Proposed Rule would be unavailable to all master trust transactions structured as multiple-step transactions, including those master trusts sponsored by FIA.
- The risk retention rules should be clarified to prevent the imposition of duplicative risk retention requirements on securitization platforms that use multiple-trust structures and should be revised to treat multiple master trusts used in any such structure as a single issuing entity. As a result of the evolution of master trust structures over the last twenty years, many of the largest securitizers in the credit card ABS market, including FIA, utilize multiple-trust structures. In such structures, a common law trust typically owns credit card receivables and issues an investor certificate (commonly called a collateral certificate),

representing an undivided interest in the receivables, to a statutory trust that issues ABS to investors. The Proposed Rule would not allow a sponsor that uses a multiple-trust structure to satisfy its risk retention requirement by holding a seller's interest in a master trust that holds credit card receivables and issues a collateral certificate to the issuing entity, and therefore the Proposed Rule prevents a significant segment of the credit card ABS market from taking advantage of the risk retention option specifically designed for revolving asset master trusts.

- The Proposed Rule should be revised to allow greater flexibility to combine the seller's interest method of risk retention with the other permitted forms of risk retention. In particular, the risk retention rules should be revised to permit a combination of the seller's interest approach with the horizontal residual interest and horizontal cash reserve account approaches, in effect allowing for an alternative "L-shaped" form of risk retention specific to master trusts. Like many credit card sponsors, FIA and its consolidated affiliates hold significant retained interests in the master trusts sponsored by FIA in the form of interests in the rights to subordinated tranches issued by both Master Trust II and BACCT, residual funds on deposit in cash collateral accounts remaining after payments to investors, and monthly excess spread on the receivables remaining after making required payments. A risk retention option for revolving asset master trusts that does not permit a sponsor to combine these various forms of retained credit risk effectively requires credit card issuers to retain credit risk greatly in excess of 5% of the overall credit risk of the securitized assets.

- In order for the horizontal residual interest approach to be a viable alternative for master trusts, the definition of eligible horizontal residual interest must be expanded to include an alternative definition specific to master trusts that takes into account the unique features of master trusts, as described in more detail below.
- All risk retention options available to revolving asset master trusts, including the seller's interest option, should apply only to ABS interests issued after the effective date of the risk retention rules.
- Finally, we believe the PCCRA provision should not apply to revolving asset master trusts. However, if the PCCRA provisions are retained in the final risk retention rules, such provisions should be revised to include a calculation that is specific to master trust transactions.

B. The Seller's Interest Option for Revolving Asset Master Trusts

1. Definition of seller's interest

We are encouraged by the statement in the Proposed Rule that the definition of seller's interest is intended to be consistent with market practice.⁵¹ Because we believe the seller's interest as traditionally used in master trust structures already provides a highly effective method of risk alignment between the securitizer and investors, we support the Agencies' effort to craft a definition of seller's interest that is consistent with existing market practice. We wish to note the following technical changes that we believe are necessary to align the definition of seller's interest in the Proposed Rule with current market practice:

⁵¹ See Proposed Rule, 76 Fed. Reg. 24104.

a) Clause (1) of seller's interest definition

Clause (1) defines a seller's interest as an ABS interest "(1) in all of the assets that (i) are owned or held by the issuing entity; and (ii) do not collateralize any other ABS interests issued by the issuing entity."⁵²

As an initial matter, it would not be consistent with the common usage of the term "seller's interest" in the securitization market to define the seller's interest as an interest in "all of the assets" of the issuing entity. The seller's interest represents a proportional retained interest in the pool of securitized assets. Leaving aside minor deviations among existing master trusts, a seller's interest in a master trust is typically calculated as the principal balance of receivables, plus cash in any excess funding account,⁵³ minus the aggregate investor interest.⁵⁴ Note that there may be assets of the issuing entity—for example, cash reserve accounts, prefunding accounts, and other forms of credit enhancement such as derivatives—that would not typically be included in the proportional retained interest that is commonly referred to as a seller's interest.

As noted above, it is common to include in the calculation of the seller's interest any cash set aside in an excess funding account. In a master trust structure, the function of the excess funding account is to hold collections that would otherwise be distributable to the holder of the seller's interest in trust for the benefit of investors, to the extent that the seller's interest is less than the minimum required seller's interest. The cash on deposit in the excess funding account typically would be used to cover shortfalls in required payments of principal to investors. Funds

⁵² See Proposed Rule § __.2, 76 Fed. Reg. 24157.

⁵³ The term "special funding account" is also frequently used and is synonymous with the term "excess funding account." For purposes of this letter, we refer to all trusts accounts that are used to trap collections to satisfy the minimum seller's interest requirement as "excess funding accounts."

⁵⁴ For purposes of such test, cash set aside in a principal accumulation account or principal funding account to pay the principal amount of any series on its expected payment date would be subtracted from the aggregate investor interest or otherwise given credit in calculating the seller's interest. In addition, proceeds of the issuance of ABS set aside in a prefunding account would also be subtracted from the aggregate investor interest or would be given credit in calculating the seller's interest.

set aside in the excess funding account would be included in calculating the amount of the seller's interest, and the deposit of such funds typically cures the shortfall in the minimum seller's interest for purposes of the securitization transaction documents.

Subclause (ii) of clause (1) further requires the seller's interest to be an ABS interest in the assets of the issuing entity that do "not collateralize any other ABS interests issued by the issuing entity." All of the receivables held by a master trust, including the interest in such receivables commonly called the seller's interest, typically collateralize all of the ABS interests issued by the master trust. We therefore request that subclause (ii) be deleted.

b) Clause (2) of seller's interest definition

Clause (2) further defines a seller's interest as an ABS interest "[t]hat is *pari passu* with all other ABS interests issued by the issuing entity with respect to allocation of all payments and losses prior to an early amortization event."⁵⁵ The seller's interest typically does receive a pro rata allocation of losses and finance charge collections as contemplated by the Proposed Rule. However, during any amortization period⁵⁶ during which principal collections are used to pay, or are set aside to make future payments of, principal for a series of ABS, a portion of the seller's interest in principal collections becomes subordinated to the amortizing series. This occurs through what is commonly called the "fixing" of principal allocations to an amortizing series, meaning any amortizing series continues to receive an allocation of principal collections based on the principal amount of the series at the time it begins amortizing, rather than on the current principal amount of the series, as reduced by prior payments of principal.

⁵⁵ See Proposed Rule § __.2, 76 Fed. Reg. 24157.

⁵⁶ We use the term "amortization period" in this section to refer to any amortization period, including any scheduled amortization period or early amortization period, during which principal payments are made to investors, as well as any scheduled accumulation period or early accumulation period, during which principal collections are set aside in trust accounts to make a "soft bullet" payment of principal on a targeted or expected payment date.

In certain securitization transactions, collections allocated to the seller's interest may also be made available to cover shortfalls in payments on investor interests. In such cases, the holder of the seller's interest is exposed to greater credit risk than if the seller's interest were *pari passu* with all other ABS interests in terms of allocations of payments on the securitized assets. We therefore support the recommendation made in the ASF Letter that clause (2) of the definition of seller's interest be revised to define the seller's interest as an ABS interest "(2) That exposes the holder to a proportional or greater share of the credit risk of the receivables as compared with the share borne by the aggregate investor interests."⁵⁷

c) Proposed definition of seller's interest

The seller's interest is one of the most prevalent and most effective means by which sponsors and/or their consolidated affiliates currently share in the credit risk of assets securitized using master trust structures. For the reasons set forth above, the definition of seller's interest in the Proposed Rule does not accomplish the stated intent of the Agencies to craft a definition of seller's interest that is consistent with existing market practice. We therefore recommend that the Agencies adopt the following alternative definition of seller's interest,⁵⁸ which we believe preserves the spirit of the definition proposed by the Agencies, while incorporating necessary technical adjustments to those aspects of the definition which would be problematic for existing master trusts:

Seller's interest means an ABS interest that:

(1) Represents a fractional undivided interest in the entire pool of securitized receivables;

⁵⁷ ASF Letter, at 110.

⁵⁸ We are suggesting the Agencies adopt a definition of seller's interest that is substantially similar to the definition of seller's interest proposed in the ASF Letter (with only minor wording variations).

(2) Exposes the holder to a proportional or greater share of the credit risk of the securitized receivables as compared with the share borne by the aggregate investor interests; and

(3) Adjusts for fluctuations in the outstanding principal balances of the securitized receivables.

2. Definition of revolving asset master trust

The Proposed Rule defines a revolving asset master trust as “an issuing entity that is (1) A master trust; and (2) Established to issue more than one series of asset-backed securities all of which are collateralized by a single pool of revolving assets that are expected to change in composition over time.”⁵⁹

a) Master trusts may issue multiple classes and/or tranches of a single series rather than series

With respect to the requirement that a revolving asset master trust be established to issue multiple series, we wish to suggest a technical clarification for master trusts that use delinked structures. In a delinked structure, each class of notes of a single series may consist of multiple tranches that are issued on different dates.⁶⁰ While they are structured with the flexibility to issue multiple series, delinked master trusts often issue only one series of ABS, comprised of multiple classes and multiple tranches issued from time to time. We therefore suggest that the phrase “established to issue more than one series of asset-backed securities” in clause (2) of the definition of revolving asset master trust be replaced with the phrase “established to issue more than one series, class or tranche of asset-backed securities.”

⁵⁹ See Proposed Rule § __.2, 76 Fed. Reg. 24157.

⁶⁰ In contrast, other master trusts may issue separate series, with all securities of any given series being issued on the same issuance date.

b) Master trust ABS may be secured by multiple collateral certificates representing interests in more than one pool of receivables

With respect to the requirement that the ABS issued by a revolving asset master trust be “collateralized by a single pool of revolving securitized assets that are expected to change in composition over time,” we wish to suggest two technical clarifications. First, we suggest that the definition be clarified to clearly permit ABS issued by a master trust to be secured by collateral certificates representing an interest in an underlying pool of revolving securitized assets. Second, as discussed above, in some cases separate pools of receivables may be held by different master trusts, each of which has transferred a collateral certificate representing an undivided interest in the related pool of receivables to one issuing entity. We therefore request that the reference to a “single pool” be deleted.

c) Flexibility to hold nonrevolving assets

The basic characteristics of a master trust are that it has the flexibility to issue multiple series and tranches of securities that have different terms (for example, different issuance dates, interest rates, and maturity dates) and that such securities are secured by a common pool of collateral that is expected to change over time. Master trust structures are particularly well-suited to short-term revolving assets such as credit card receivables and dealer floor plan receivables. However, master trusts may also hold assets such as cash collateral accounts and prefunding accounts that are not revolving assets. In addition, it would be unnecessarily limiting to restrict the seller’s interest method of risk retention to master trusts that solely hold revolving assets.⁶¹ We therefore recommend deletion of the “revolving” asset requirement for master trusts.

⁶¹ For example, it may be efficient for a sponsor to securitize a pool of similar receivables, some of which may be revolving assets and some of which may be closed accounts. One example might be a mixed pool of receivables arising in both closed-end consumer credit accounts and revolving consumer credit accounts.

To summarize our comments in this section, we suggest clause (2) of the definition of revolving asset master trust incorporate these comments as follows:

“(2) Established to issue more than one series, class or tranche of asset-backed securities, which are collateralized by a pool of securitized assets (or an undivided interest therein) that are expected to change in composition over time.”

3. Revolving asset master trust risk retention option in § __.7

a) Calculation of general risk requirement for revolving asset master trusts

The Proposed Rule would require a sponsor to retain a seller’s interest of not less than five percent of the unpaid principal balance of all the assets owned or held by the issuing entity. As noted above, we do not believe any seller’s interest test used in the market is currently based on a percentage of the principal balance of “all the assets” held by the master trust. In particular, cash reserve accounts, prefunding accounts, and other forms of credit enhancement, such as derivatives, would not typically be included in the calculation of the minimum required seller’s interest for purposes of securitization transaction documents.

There are minor variations among the minimum seller’s interest tests used in the market, but securitization transaction documents most commonly require the holder of the seller’s interest to maintain a minimum seller’s interest equal to a specified percentage of either (i) the principal amount of receivables in the master trust or (ii) the outstanding aggregate investor interests issued by the master trust.⁶² We recommend that the risk retention requirement for

⁶² As noted in the ASF Letter, “an increase in the investor interests (e.g., in connection with the issuance of additional ABS) results in a corresponding decrease in the amount of the seller’s interest and conversely, a decrease in the investor interests (e.g., as a result of the payment of maturing ABS) results in a corresponding increase in the amount of the seller’s interest. Given this inverse, binary relationship between the investor interests and the seller’s interest, the program documents for some credit and charge card securitization platforms establish the minimum required seller’s interest by reference to the unpaid

revolving asset master trusts be revised to require a seller's interest equal to five percent of the aggregate investor interests (as defined in the transaction documents). We believe such requirement would remove any ambiguity as to the relevant pool of assets to be used for purposes of such calculation.⁶³

b) Timing of calculation of risk retention requirement

Section __.7 of the Proposed Rule requires that “at the closing of the securitization transaction and until all ABS interests are paid in full, the sponsor to retain a seller's interest of not less than five percent of the unpaid principal balance of all the assets owned or held by the issuing entity.” We believe the intent of such provision is to require the sponsor to retain a seller's interest equal to 5% of the trust principal balance as of the closing, with the amount of the required seller's interest adjusting on any future date of determination based on the then-current trust principal balance. However, we are concerned that the current wording of this requirement could be misinterpreted to require that the amount of the required risk retention, as calculated on the closing date for the ABS issuance, be maintained in a static amount until the related ABS are paid in full. The balance of receivables in a master trust, as well as the principal amount of ABS interests, is subject to fluctuations that will cause the amount of the seller's interest to change on a daily basis. Therefore, we request that the Agencies confirm that the required seller's interest for a master trust will be based on the then-current trust principal

principal balance of the outstanding investors interests, rather than the unpaid principal balance of the assets of the issuing entity.”

⁶³ As discussed in more detail in Section V.B.3.d below under “Transition issues for seller's interest option,” by requiring a sponsor to retain credit risk relating to all assets in the master trust, the risk retention rules effectively apply the risk retention requirements to investor interests issued prior to effectiveness of the risk retention rules on a retroactive bases. We therefore urge the Agencies to consider a general risk requirement for revolving asset master trusts that is based on the principal amount of outstanding investor interests issued after the effectiveness of the risk retention rules, rather than on the principal balance of all assets owned by the master trust.

balance (or, as we recommend above, the then-current investor interest), on any relevant date of determination.

We recommend that compliance with such risk requirement be determined on a periodic basis, not more frequently than once per month, as provided in the related transaction documents.

c) Duration of risk retention requirement

Section __.7 of the Proposed Rule would require the risk retention requirement for master trusts to be satisfied until all ABS interests are paid in the full. We request that § __.7 be revised to provide that a sponsor only be required to satisfy the risk retention requirements for so long as there are outstanding ABS interests that are not owned solely by the sponsor or its consolidated affiliates.

d) Transition issues for seller's interest opinion

As noted above, we are recommending that the seller's interest risk retention requirement be calculated as five percent of the aggregate investor interests. We request that only investor interests issued after the effective date of the final regulations be included for purposes of determining the risk retention requirement.

The risk retention requirement will become effective for credit card securitizations two years after publication of the final rules in the Federal Register, and do not apply retroactively to ABS issued prior to effectiveness of the final rules. The Proposed Rule would require a sponsor to retain a seller's interest equal to 5% of the "unpaid principal balance of all the assets owned or held by the issuing entity." By requiring a sponsor to retain credit risk relating to the assets collateralizing investor interests issued prior to effectiveness of the final regulations, the Agencies are effectively applying the risk retention requirements to revolving asset master trusts on a retroactive basis.

e) Proposal for § __.7 revolving asset master trust risk retention requirement

To summarize the above comments and requests to the Agencies, we propose the following general risk retention for revolving asset master trusts.⁶⁴

“(a) General requirement. At the closing of the securitization transaction and until all ABS interests, other than any ABS interests held by the sponsor and/or its consolidated affiliates, are paid in full, the sponsor retains a seller’s interest, determined as of each measurement date, that is not less than five percent of the aggregate investor interest⁶⁵ at such time, excluding any investor interest issued prior to the effective date of [these regulations].”

For purposes of the above definition, “measurement date” means (i) with respect to the closing date of a securitization transaction, the most recent date as of which the seller’s interest is to be measured in accordance with the transaction documents for purposes of the above risk retention requirement and (ii) each subsequent date as of which the seller’s interest is to be measured in accordance with the transaction documents for purposes of the above risk retention requirement.

f) Ability to cure shortfall in risk retention requirement

As noted throughout these comments, the amount of the seller’s interest changes on a daily basis as the value of the principal receivables in the trust changes (for example, as a result of new credit card transactions, payments by obligors, returns, and losses) and the outstanding amount of securities changes. To the extent the amount of the seller’s interest falls below the

⁶⁴ We are proposing a general risk requirement and related definition of “measurement date” substantially similar to the proposals discussed under the heading “Measuring the Amount and Duration of the Required Risk Retention” in the ASF Letter.

⁶⁵ As noted earlier in our comments, cash set aside in a principal accumulation account or principal funding account to pay the principal amount of any series on its expected payment date would be subtracted from the aggregate investor interest or otherwise given credit in calculating the seller’s interest. In addition, proceeds of the issuance of ABS set aside in a prefunding account would also be subtracted from the aggregate investor interest or would be given credit in calculating the seller’s interest.

minimum seller's interest, a sponsor would typically add additional assets to the master trust or reduce the amount of outstanding securities. In order to provide the sponsor with sufficient time to add assets or reduce the outstanding amount of ABS, transaction documents usually allow a cure period before a shortfall in the minimum seller's interest would cause an early amortization of outstanding ABS. We request that, consistent with market practice, sponsors have the flexibility to cure deficiencies in the minimum risk retention requirement.

4. Flexibility to retain risk by depositors and other consolidated affiliates

Many existing master trusts are structured as multiple-step securitizations, in which a sponsor first transfers receivables to an intermediate SPV (the "depositor"), which in turn transfers the receivables to a master trust. For such master trusts, the seller's interest is held by the depositor of the issuing entity rather than the sponsor. In addition, it is extremely common for credit card securitizers to use structures that involve multiple master trusts. In such structures, credit card receivables are held in a master trust or multiple master trusts (which, for purposes of this comment letter, we will refer to as "receivables trusts"), each of which issues an investor certificate, commonly called a collateral certificate, directly or indirectly through an intermediate SPV, to an issuing entity. The asset-backed securities held by the issuing entity are secured by one or more collateral certificates. These structures represent an overwhelming portion of the credit card ABS market. In such cases, the seller's interest may be retained by multiple sponsors, or, in structures that use intermediate SPVs as depositors, multiple depositors.

We note that the Proposed Rule permits a sponsor to transfer retained risk to an entity that is and remains a consolidated affiliate. The Proposed Rule acknowledges that transfers to consolidated affiliates are consistent with the statutory directive because the required retained risk "would remain with the consolidated organization and, thus, would not reduce the

organization's financial exposure to the credit risk of the securitized assets."⁶⁶ However, the Proposed Rule would not permit a depositor or other consolidated affiliate of the sponsor to be the initial holder of the retained risk.

For existing master trusts that use multiple-step structures, it would not be possible to restructure such trusts to enable them to utilize the seller's interest method of risk retention as currently proposed. Restructuring an existing master trust to accommodate the requirement that the seller's interest initially be held by the sponsor would require investor consent for most, if not all, master trusts and, therefore would not be a feasible alternative. Further, for many multiple-step structures that utilize intermediate depositors to achieve a "true sale" of the securitized assets, requiring the seller's interest to be held by the sponsor of the master trust would not be consistent with structuring the sale from the sponsor to the depositor as a true sale.⁶⁷

We therefore recommend that the Proposed Rule be revised to permit a sponsor to offset its risk retention requirement by the amount of credit risk retained by its consolidated affiliates, and that such consolidated affiliates be permitted to either hold the credit risk upon initial issuance or as a result of a transfer from the sponsor.

C. Additional forms of risk retention for revolving asset master trusts

1. "Eligible horizontal residual interest" method requires clarification for master trusts

Many, if not all, master trust issuers have issued subordinated classes or tranches of securities that are held by the related sponsor and/or its consolidated affiliates. Such retained subordinated securities provide credit enhancement to more senior securities through

⁶⁶ See Proposed Rule, 76 Fed. Reg. 24116

⁶⁷ The ability to obtain a legal opinion that the transfers of receivables would be legal true sales is a necessary condition for some master trusts to achieve sale accounting treatment.

subordination—both by absorbing losses before senior securities and through the subordination of interest and principal payments on the subordinated securities to payments on more senior securities. As described throughout our comments in this section, the allocation of losses and collections in a master trust structure is more complicated than in an amortizing structure. As a result, it is unlikely that subordinated securities currently retained by sponsors of credit card master trusts and their consolidated affiliates would satisfy the definition of eligible horizontal residual interest as currently proposed. We discuss each of the three clauses of the definition of eligible horizontal residual interest below to highlight why the subordinated securities issued by existing master trusts are unable to satisfy the requirements of such definition, and will recommend that the Agencies adopt an alternative definition of eligible horizontal residual interest specifically designed for revolving asset master trusts.

a) “Allocated all losses” requirement

Clause (1) of the definition of eligible horizontal residual interest requires the ABS interest to be “allocated all losses on the securitized assets ... until the par value of the ABS interest is reduced to zero.”⁶⁸ This standard is problematic for master trusts for four primary reasons:

- First, the seller’s interest will be allocated a proportional share of losses, so no ABS interest, even the most subordinated of all ABS interests, could ever satisfy the definition of eligible horizontal residual interest.
- Second, the holder of the seller’s interest in a master trust also retains the right to receive “excess spread” on the securitized assets (i.e., finance charge collections allocated to each series of ABS remaining after paying interest and other expenses

⁶⁸ See Proposed Rule § __.2, 76 Fed. Reg. 24157.

allocated to such series, including the coverage of losses⁶⁹ allocated to the ABS of the series). As a result, the residual interest in excess spread also represents an exposure to credit losses and therefore might be read to prevent all subordinated securities from satisfying clause (1) of the definition of eligible horizontal residual interest.

- Third, investors in credit card ABS often have the benefit of cash collateral accounts and spread accounts, the funds in which may be used to make interest and/or principal payments on the ABS issued by the master trust, and may in some cases be used to cover losses that would otherwise be allocated to investors. As a result, such trust accounts are also exposed to the credit losses on the securitized assets and therefore might arguably prevent all subordinated securities from satisfying clause (1) of the definition of eligible horizontal residual interest. The holder of the seller's interest typically would have a residual interest in any funds released from such accounts, either when the amount of funds in any such account exceeds the amount required to be on deposit therein or upon payment in full of the related ABS benefitting from any such account.

⁶⁹ Transaction documents generally provide that a share of the series finance charge collections equal to the lesser of (a) the amount of monthly credit losses allocated to the series and (b) the amount of series finance charge collections remaining after covering higher priority expenses (generally servicing fees and interest on some or all of the securities in the series) will be "treated as principal collections." In other words, to the extent that a series has finance charge collections available for this purpose, those finance charge collections are substituted for the collections that should ultimately have been received on the principal receivables that were charged off. If the series is in an amortization period, those substituted finance charge collections can be used to make principal payment on the securities. If the series is still in its revolving period, then those substituted principal receivables in effect are paid to the depositor to purchase new interests in non-defaulted principal receivables to take the place of the principal receivables that were charged off. If the amount of finance charge collections available to cover credit losses is less than the amount of credit losses allocated to a series, then the investor interest will be reduced by the amount of the deficit.

- Fourth, losses are allocated proportionally to each series of ABS issued by a master trust, and subordinated classes of a series will absorb losses before more senior securities of the same series are affected. However, the most subordinated class of securities within a series will only provide credit enhancement for more senior classes of securities within the same series and would not absorb losses allocated to all other series of ABS issued by the master trust.

The subordination features of delinked master trusts are more complex. Losses are initially allocated to each tranche, pro rata, and then will be reallocated from tranches in senior classes to tranches in the subordinated tranches to the extent the credit enhancement in the form of subordination is still available to such senior tranches. The amount of subordination available to provide credit enhancement to any tranche of a series at any time is limited to its available subordination amount, which is a function of the required subordination amount⁷⁰ for the tranche and any prior usage of subordination.

We therefore suggest that the definition of eligible horizontal interest be revised, as suggested in the ASF Letter, to provide that an ABS interest will qualify “if (i) the sponsor or its consolidated affiliates hold the seller’s interest, including the rights to receive excess spread on the securitized assets and (ii) there are no other ABS interests that absorb losses allocated to the related series prior to such ABS interest that are not held by the sponsor or its consolidated affiliates.”⁷¹ The retention by the sponsor and/or its consolidated affiliates of the seller’s interest and other residual interests in the securitized assets (i.e., excess spread and residual interests in various trust accounts) provide an additional incentive for the sponsor to act in a manner that is

⁷⁰ Generally, the required subordination amount for a tranche of senior notes is an amount equal to a specified percentage of the outstanding principal amount of such notes (as reduced by any funds set aside in a principal funding account).

⁷¹ ASF Letter, at 116.

aligned with the interests of investors. Therefore, so long as all such residual interests are held by the sponsor and/or its consolidated affiliates, such residual interests should not prevent subordinated classes and tranches of ABS from qualifying as eligible horizontal residual interests. Further, the definition that we propose below would permit an ABS interest to qualify as an eligible horizontal residual interest even if it is not the most subordinate ABS interest issued by the issuing entity, provided such ABS interest does not itself benefit from credit enhancement designed to protect such ABS interest from credit losses on the securitized assets, other than any credit enhancement in the form of an ABS interest held solely by the sponsor and/or its consolidated affiliates, including any cash collateral account or other trust account, the residual interest in which is held solely by the sponsor and/or its consolidated affiliates. We strongly believe that an ABS interest should not be prevented from qualifying as eligible horizontal residual interest solely because such ABS interest benefits from one or more forms of “first-loss” protection provided by the sponsor or its consolidated affiliates, as such interests increase rather than diminish the exposure of the sponsor and its consolidated affiliates to the credit risk of the securitized assets and further align the interests of the sponsor with those of investors by creating an incentive to reduce credit losses.⁷²

b) “Most subordinated claim to payments of both principal and interest” requirement

Clause (2) of the definition of eligible horizontal residual interest requires the ABS interest to “have the most subordinated claim to payments of both principal and interest by the issuing entity.”⁷³ As noted above, in master trust structures, subordinated securities of a

⁷² As noted in the ASF Letter, “[a]s the contingent recipient of these cash flows and deposited funds, the seller has considerable incentives to optimize excess spread by establishing a level of portfolio yield commensurate with the level of credit exposure, which directly aligns with the interests of investors.”

⁷³ See Proposed Rule § __.2, 76 Fed. Reg. 24157.

particular series typically only provide credit enhancement for the senior securities of the same series. Therefore, principal payments on the subordinated securities of a particular series would only be subordinated to principal payments on senior securities of the same series, but not subordinated to principal payments on securities of other series. Similarly, interest payments on subordinated securities of a particular series would only be subordinated to interest payments on senior securities of the same series, but not subordinated to interest payments on securities of other series.

Notwithstanding the subordination of payments described in the preceding paragraph, the most subordinated class of a series often has the benefit of a reserve account to cover shortfalls in interest payments and principal payments of such subordinated class. In many cases, this type of reserve account is one of the credit enhancement features that allows the most subordinated class of securities to achieve a desired investment grade credit rating. For the reasons discussed above, we do not believe this type of “first-loss” protection provided by sponsors and their consolidated affiliates should prevent a subordinated class of securities from qualifying as an eligible horizontal residual interest.

Finally, we note that a sponsor and/or its consolidated affiliates may hold more than one subordinate class of securities of a particular series (for example, the two most junior classes in the capital structure for a series). We request that a tranche or class of securities not be prevented from meeting the requirements of clause (2) of the definition of eligible horizontal residual interest solely because one or more ABS interests held by the sponsor and/or its consolidated affiliates have a claim to interest or principal payments that is subordinate to such tranche or class of securities.

c) Limitation on principal payments requirement

Clause (3) of the definition of eligible horizontal residual interest requires that until all other ABS interests in the issuing entity are paid in full, such ABS interest must not be “entitled to receive any payments of principal made on a securitized asset; *provided, however*, an eligible horizontal residual interest may receive its current proportionate share of scheduled payments of principal received on the securitized asset in accordance with the transaction documents.” For credit card receivables and other assets traditionally securitized using master trust structures, there are no “scheduled payments” associated with the assets, so there would be no way to apply this requirement to master trusts.

In addition, as described above, principal payments on subordinated securities of a particular series are typically only subordinated to principal payments on senior securities of the same series, and are not subordinated to principal payments on securities of other series. Further, in the case of delinked master trusts, tranches of the most subordinated class may be issued that have different expected payments dates and legal final maturity dates than senior tranches of the same series, and the expected payment dates and legal final maturity dates for certain subordinated tranches may occur prior to the expected payment dates or legal final maturity dates for one or more senior tranches. A subordinated tranche may therefore receive principal payments before senior tranches; however principal payments on subordinated tranches are generally restricted to the extent the payment of principal on a subordinated tranche would cause a shortfall in the required subordination for any senior tranche. If a subordinated tranche cannot be paid because of the subordination provisions, transaction documents typically provide that principal collections will begin to be set aside in trust accounts—often called principal funding accounts—for future payments of principal for senior securities. After that time, the subordinated tranches typically may be paid to the extent that:

- The principal funding accounts for senior classes of notes are prefunded in an amount such that the subordinated notes that have reached their expected principal payment dates are no longer necessary to provide the required subordination;
- New tranches of subordinated notes of the same series are issued so that the subordinated notes that have reached their expected principal payment date are no longer necessary to provide the required subordination;
- Enough notes of senior classes are repaid so that the subordinated notes that have reached their expected principal payment date are no longer necessary to provide the required subordination; or
- The subordinated notes reach their legal maturity date.

Given the ability of delinked master trusts to issue tranches of subordinated classes that provide credit enhancement for later maturing tranches of senior classes, we believe it would be inappropriate for the definition of eligible horizontal residual interest to restrict the timing of principal payments, and such a restriction would not provide a workable form of horizontal risk retention for master trusts. We therefore support the recommendation in the ASF Letter that the definition of eligible horizontal residual interest be revised to make clause (3) inapplicable to revolving asset master trusts.⁷⁴

⁷⁴ See ASF Letter, at 117-118.

d) Proposed definition of eligible horizontal residual interest

To summarize the above comments and requests to the Agencies, we propose the following definition of eligible horizontal residual interest for revolving asset master trusts that utilize the eligible horizontal residual interest method of risk retention:⁷⁵

Eligible horizontal residual interest means, with respect to any revolving asset master trust, an ABS interest in the issuing entity that has the most subordinated claim to payments of both principal and interest payable by the issuing entity on any payment date from collections on the securitized receivables (other than any payments on ABS interests held by the sponsor or its consolidated affiliates); provided, however, with respect to any ABS interest issued as part of a separate series, such requirement shall be met if the ABS interest has the most subordinated claim to both principal and interest payable by the issuing entity from collections on the securitized receivables on any payment date to ABS interests of such series (other than payments on ABS interests held by the sponsor or its consolidated affiliates), or is a tranche of the class that has the most subordinated claim to both principal and interest payable by the issuing entity from collections on the securitized receivables on any payment date to ABS interests of such series (other than ABS interests held by the sponsor or its consolidated affiliates); provided that an ABS interest may not be an eligible horizontal residual interest unless: (i) the sponsor or its consolidated affiliates hold the seller's interest, including the right to receive excess spread on the securitized receivables and (ii) there are no other ABS interests that absorb losses allocated to the related series prior to such ABS interest, other than any ABS interests held by the sponsor or its consolidated affiliates.

⁷⁵ The definition we propose incorporates the recommendations proposed in the ASF Letter for revisions to the definition of eligible horizontal residual interest.

2. Combining seller's interest approach with other risk retention provisions

The Proposed Rule should be revised to allow greater flexibility to combine different forms of risk retention for revolving asset master trusts. As noted in the October 2010 Board of Governors of the Federal Reserve System Report to Congress on Risk Retention, investors in credit card ABS are protected by a variety of mechanisms, including excess spread, subordinated tranches of securities, and various forms of cash collateral accounts, in addition to the seller's interest. Many master trusts have issued subordinate securities that are held by sponsors and/or their consolidated affiliates, and in some cases also have established cash reserve accounts that are used to fund shortfalls in payments to investors. As a result, many securitizers are holding substantial subordinated interests and "first-loss" residual interests in addition to seller's interests generally ranging from 4% to 7%, for a combined risk retention that is considerably higher than five percent of the securitized assets.

In particular, master trust issuers should be permitted to combine the seller's interest approach with the eligible horizontal residual interest and horizontal cash reserve account approaches. One way in which an "L-shaped"⁷⁶ method of risk retention could be formulated for master trusts with very little complexity would be to allow sponsors to include in the seller's interest, for purposes of satisfying the seller's interest method of risk retention on any measurement date, the amount of ABS interests held by the sponsor or its consolidated affiliates that qualify as eligible horizontal residual interests and/or the amount on deposit in any horizontal cash reserve account.

⁷⁶ As noted by the Board of Governors of the Federal Reserve System in their Report to the Congress on Risk Retention, "[t]he seller's interest is a vertical slice of all the receivables in the master trust and receives principal and interest payments in proportion to the share it represents of the master trust." Board of Governors of the Federal Reserve System, *Report to the Congress on Risk Retention* (October 2010), at 19, available at <http://www.federalreserve.gov/boarddocs/rptcongress/securitization/riskretention.pdf> (hereinafter Federal Reserve Study).

3. Flexibility to change form of risk retention

In addition to the ability to combine risk retention options, a sponsor also should have the flexibility to change its method of satisfying the risk retention requirements at any time. For example, if on the closing date for a securitization, a sponsor chooses to satisfy its risk retention requirement by holding a subordinated security that qualifies as an eligible horizontal residual interest, such sponsor should have the flexibility to later sell such subordinated security to the extent market conditions permit, so long as the sponsor otherwise satisfies its risk retention requirement through another method of risk retention, for example by increasing the amount of the seller's interest. As discussed in this letter, particularly during the recent credit crisis, credit card securitizers have retained significant amounts of subordinated securities, and in many cases continue to seek to sell such retained securities to unaffiliated purchasers. At a time that a sponsor already holds a substantial amount of subordinated securities that qualify as eligible horizontal residual interests, it would be unfair, and contrary to an efficient ABS market, to require that sponsor to increase its seller's interest to five percent on the closing date for a new issuance in order to preserve its ability to later sell its retained subordinated securities. In addition, investors in credit card ABS should be indifferent as to the method used by a credit card securitizer to satisfy its risk retention requirement.

D. Multiple trust structures

As a result of the evolution of master trust structures over the last twenty years, many of the largest securitizers in the credit card ABS market, including FIA, utilize multiple-trust structures.⁷⁷ In such structures, a receivables trust, typically organized as a common law trust,

⁷⁷ Master trusts established during the 1990s were formed as common law trusts that issued asset-backed certificates. Over time, in order to achieve more favorable tax and ERISA treatment, sponsors began to structure master trusts as statutory trusts that issued asset-backed notes under indentures. Sponsors desired to transition to note-issuing trusts that could issue notes secured by the assets in their existing

owns credit card receivables and issues a collateral certificate, representing an undivided interest in the assets of the receivables trust, to a statutory trust that issues ABS to investors. In some cases, multiple receivables trusts will each issue collateral certificates to the same issuing entity, which will issue ABS secured by the multiple collateral certificates. As we have previously noted, the seller's interest in such structures may be an ABS interest issued by the receivables trust rather than the issuing entity. Likewise, an ABS interest issued by a receivables trust may provide credit enhancement for all or a portion of the ABS interests issued by an issuing entity, and such ABS interests should qualify as eligible horizontal residual interests to the extent such ABS interests otherwise meet the requirements of the Proposed Rule, notwithstanding that such ABS interests are issued by an intermediate receivables trust rather than the issuing entity.

E. Premium Capture Cash Reserve Account

As discussed in the portion of this comment letter pertaining to Residential Mortgage Comments, we believe there are significant problems with the PCCRA provision. Further, as discussed in Section III.B. of our Residential Mortgage Comments, in the event that the PCCRA provisions are retained in the final rules in a revised form, we request that such provisions be made inapplicable to securitizations in which vertical slice, representative sample, and seller's interest forms of risk retention are used. The seller's interest option is in essence a vertical form of risk retention in which the holder of the seller's interest retains an interest in the entire structure of the securitization transaction, and therefore we refer you to the discussion of why the PCCRA provisions as a general matter should not be applicable to any form of vertical risk retention in our Residential Mortgage Comments.

common law trusts, without having to wait until the previously issued series of asset-backed certificates were retired. Therefore, it became common for a certificate-issuing common law trust to issue a collateral certificate to a statutory trust, representing a pro rata undivided interest in the pool of receivables, which interest would secure the asset-backed notes issued by the statutory trust.

In addition, we ask that the PCCRA provisions be made inapplicable to all revolving asset master trust securitizations, regardless of whether such securitizations utilize the seller's interest method of risk retention or other forms of risk retention. As a general matter, credit card securitizers have not historically issued premium or interest-only tranches and have not otherwise sought to monetize excess spread. In fact, as discussed above, the retention of the right to excess spread by credit card securitizers is one of the significant forms of risk retention that already exist in credit card securitizations. As noted earlier in our comments, the right to excess spread provides a highly effective method of aligning the interests of the sponsor with those of investors, because the value of the excess spread is directly tied to portfolio yield and credit losses. Under the Proposed Rule, a sponsor of a revolving asset master trust would not be permitted to use its residual interest in excess spread to satisfy its risk retention requirement. Leaving aside the issue of whether excess spread is an interest that should be given credit in satisfying the required risk retention, we strongly urge the Agencies not to penalize securitizers for retaining excess spread as additional form of exposure to credit risk, on top of the five percent risk retention otherwise required under the Proposed Rule.

Finally, although § __.12(a)(2) applies to revolving asset master trusts for which the sponsor relies on the seller's interest option, this section appears to have been drafted with no regard to revolving asset master trusts. In particular, we note that the seller's interest is not an ABS Interest issued as part of each securitization transaction. Rather the seller's interest is issued in connection with the creation of the master trust, and the seller's interest changes in value as new assets are added to the master trust, collections are received on the securitized assets and the outstanding principal amount of ABS issued by the master trust changes. In addition, in a delinked structure, a subordinated tranche of ABS may be issued on a different date than any

related senior ABS interests. As a result, there will not be a single “closing” for the securitization transaction and it is unclear which ABS interests would be considered issued “as part of the securitization transaction.”

F. Disclosure requirements for seller’s interest risk retention

Paragraph (b) of § __.7 of the Proposed Rule requires a sponsor to disclose to investors the amount (expressed as a percentage and dollar amount) of the seller’s interest that the sponsor will retain at the closing of the securitization transaction. As noted above, the seller’s interest changes on a daily basis as the value of the principal receivables in the trust changes, reflecting daily purchases and payments on credit card accounts, as well as the issuance of new securities. As a result, the disclosure provided to investors prior to the closing date cannot include a calculation of the seller’s interest as of the closing date. We request that that paragraph (b)(1) of § __.7 of the Proposed Rule be revised to require the sponsor to disclose the amount of the seller’s interest as of the date most recently calculated⁷⁸ in accordance with the related transaction documents for the securitization.

⁷⁸ See Section V.B.3.e for a proposed definition of “measurement date.” We propose that the seller’s interest be disclosed as of the most recent measurement date.

VI. Auto Loan Comments

A. Key Auto Loan Issues

Securitization has been and continues to be a critical source of funding for auto loans. A vibrant auto loan securitization market is essential to the well-being of a significant portion of the U.S. economy; namely, the millions of consumers who seek affordable loans to purchase automobiles and the automobile manufacturers, suppliers, and dealers whose respective businesses depend on the ability of consumers to obtain those loans.

We agree that risk retention serves to align the interests of securitization sponsors and investors. In fact, this principle is already embodied in a substantial majority of existing auto loan securitizations in the form of a significant residual interest retained by an affiliate of the sponsor (typically the depositor). As a result, sponsors of auto loan ABS transactions have a strong interest in the quality of the securitized assets, as any residual interest that they hold through their affiliates is the first ABS interest to absorb credit losses.

Regulation aimed at ensuring alignment of sponsor and investor interests through risk retention necessarily requires a significant degree of flexibility in order to accommodate the wide variety of securitized assets and securitization structures. Accordingly, we strongly support § __.3(a) of the Proposed Rules, which permits the sponsor to select the form of required risk retention from a variety of options, thereby permitting the sponsor to retain risk in a form that satisfies funding, accounting, structural, and other considerations of the sponsor and its affiliates. We also support the intent of the Proposed Rules to permit an exception to the risk retention requirements for securitization transactions collateralized by automobile loans satisfying the underwriting and other requirements of § __.20 of the Proposed Rules (“Qualifying Auto Loans”).

We believe that modification of the Proposed Rules is necessary in order for them to be workable in a manner that is compatible with the sound structural characteristics of auto loan securitizations and the sound underwriting standards for auto loans that have prevailed in the marketplace for years. Furthermore, we believe that the following modifications will achieve the goals of Congress and the Agencies in implementing a risk retention requirement, while also helping to ensure that consumers continue to have access to credit for purchasing automobiles by preventing a costly interruption of the auto loan securitization and origination markets:

- The eligible horizontal residual interest option should be simplified and aligned with existing market practice. The allocation of loss and scheduled principal requirements in the Proposed Rule make the eligible horizontal residual interest option incompatible with the existing sound securitization structures currently used for auto loan ABS.
- The risk retention rules should permit a blend of risk retention options.
- The Qualifying Auto Loan exemption should be revised to better reflect existing underwriting practices.
- The risk retention rules should permit a consolidated affiliate of the sponsor to be the initial holder of the retained interest.

B. The eligible horizontal residual interest option should be simplified and aligned with existing market practice

As noted in the Report to the Congress on Risk Retention, the originator, securitizer, and servicer in auto loan ABS transactions are usually affiliated with the same parent entity.⁷⁹ Unlike transactions in some other asset classes, in an auto loan ABS transaction, the sponsor or its affiliate typically retains risk by holding the residual interest. In addition, the size of this retained

⁷⁹ See Federal Reserve Study, above note 76, at 20.

risk as compared to the aggregate amount of outstanding receivables in an auto loan ABS transaction generally increases during the life of the transaction because most auto loan ABS transactions are structured to “deleverage” over time.⁸⁰ Consequently, not only are the sponsor’s interests squarely aligned with the investors’ interests in a substantial majority of auto loan ABS transactions, but also that alignment is maintained, and typically increased, throughout the life of the transaction.

As a result of this alignment of incentives and the deleveraging nature of auto loan ABS, “few, if any, triple-A tranches of auto ABS have experienced a principal write-down in the nearly 25 years of issuance,”⁸¹ and no payment defaults have occurred on any prime auto loan ABS rated by Standard & Poor’s since it began rating auto loan ABS in 1985. Given the strong performance of auto loan ABS even during the recent recession, we respectfully request that the eligible horizontal residual interest option be simplified and better aligned with existing market practice for auto loan ABS transactions as follows:

1. Allocation of losses

Under the Proposed Rules, to qualify as an “eligible horizontal residual interest,” an ABS interest must be allocated all losses on the securitized assets until the par value of the ABS interest is reduced to zero. However, losses generally are not “allocated” in an auto loan ABS transaction as they may be in RMBS or other asset class structures. Instead, collections on the securitized auto loans are used to make payments on each monthly payment date in the priority set forth in the transaction documents (the “payment waterfall”), and credit losses on the auto loans simply result in less money being available to pay the various payment waterfall priorities,

⁸⁰ This deleveraging and resulting increase in the relative size of the retained interest occur as collections on the underlying securitized auto loans are used to pay down senior tranches more quickly than subordinate tranches, including the residual interest.

⁸¹ See Federal Reserve Study, above note 76, at 57.

including payments to the holder of the residual interest (who, as described above, is usually an affiliate of the sponsor acting as the depositor⁸²). Therefore, while losses in auto loan ABS transactions are not formally allocated to the residual interest, the residual interest automatically absorbs losses because payments are made first to the senior interests, including the investors, before any distributions are made to the residual interest. Consequently, any credit losses on the securitized assets result in reduced distributions to the holder of the residual interest.

If the Proposed Rules were implemented as written, most auto loan ABS transactions would have to be restructured to include a formal allocation of loss mechanism (such as multiple waterfalls), the addition of which would unnecessarily increase the complexity of auto loan ABS transaction structures and reporting. Therefore, we agree with the comment and related discussion in the ASF Letter, supported by Auto Sponsors as well as investors,⁸³ concluding that the final rules should only require a formal allocation of losses to securitization transactions that have a loss allocation feature.

2. Principal prepayments

To qualify as an eligible horizontal residual interest under the Proposed Rules, an ABS interest may not receive any payments of principal made on a securitized asset other than its “current proportionate share of scheduled payments of principal.” Calculation of the proportionate share of scheduled principal payments requires servicers to, among other things, track and report scheduled and unscheduled payments of principal and requires inclusion of related requirements, including corresponding reporting and allocation provisions, in transaction documents. However, most securitized auto loans are simple interest receivables and, therefore,

⁸² In a typical auto loan ABS transaction, the depositor is a special purpose entity structured to be bankruptcy remote from the sponsor.

⁸³ As used herein, the term “Auto Sponsors” means the motor vehicle sponsor members of ASF. Bank of America is a member of the ASF and an Auto Sponsor.

the amount financed under the auto loan is amortized through the payment of fixed, monthly amounts consisting of both principal and interest. The monthly amount is applied first to pay interest and then to reduce the amount of principal outstanding under the loan. Consequently, in most auto loan ABS transactions, the servicer is not required to distinguish which portion of aggregate collections consists of scheduled principal, prepaid principal, and interest. Rather, the aggregate monthly payments received from the obligors are treated as “collections,” which are aggregated with the monthly payments of other obligors and then distributed down the payment waterfall set forth in the transaction documents.

We agree with the observations and comments of the Auto Sponsors in the ASF Letter with respect to the “scheduled payments of principal only” requirement for eligible horizontal residual interests. In their current form, the Proposed Rules would require the program documents for virtually every auto loan ABS securitization to be rewritten and the underlying accounting and servicing systems reprogrammed. These extensive revisions to existing structures and systems would unnecessarily increase the complexity and transaction costs of auto loan ABS transactions.

C. The risk retention rules should permit a blend of risk retention options

As noted by the Auto Sponsors in the ASF Letter, in proposing an “L” shaped risk retention option, the Agencies have implicitly acknowledged that the use of a single risk retention option should not be required in order to satisfy the risk retention requirement. We agree with the comment of the Auto Sponsors in the ASF Letter that the final rules should permit greater flexibility to “mix and match” risk retention options. This greater flexibility should include the ability to utilize multiple risk retention options in any percentage combination so long as the aggregate percentage of risk retained is at least five percent.

D. The Qualifying Auto Loan exemption should be revised to better reflect existing underwriting practices

Section 15G(c)(2)(A) and (B) of the Exchange Act require that the implementing regulations establish exemptions for pools of certain asset classes, including auto loans, that meet specified criteria and include underwriting standards that specify the terms, conditions, and characteristics of a loan within that asset class that indicate a low credit risk with respect to the loan.

Pursuant to this statutory directive, § __.17 of the Proposed Rules establishes an exemption from the risk retention requirement for securitization transactions collateralized solely by Qualifying Auto Loans. In developing the criteria for Qualifying Auto Loans, the Agencies stated that they “sought to establish conservative requirements that are consistent with underwriting standards commonly used by the industry for unsecured installment credits.”⁸⁴

We agree with the proposition that conservative underwriting standards should be required in order for an asset class to qualify for an exemption under § __.17 of the Proposed Rules. However, the underwriting criteria for Qualifying Auto Loans set out in § __.20(b) of the Proposed Rules are not consistent with even the most conservative auto loan underwriting practices currently utilized in the market. As a result, we understand that, unless the standards for Qualifying Auto Loans are substantially revised, the exemption for Qualifying Auto Loans will remain wholly unused by sponsors of securitization transactions collateralized by auto loans. We note that the Auto Sponsors and auto investor members of ASF are continuing to develop comments to the Proposed Rules regarding Qualifying Auto Loans. We support the development

⁸⁴ See Proposed Rule, 76 Fed. Reg. 24134. Although the Agencies noted that an auto loan is secured by the financed automobile, the Agencies concluded that standards for unsecured installment credits were warranted because an automobile is a “highly depreciable asset.” *Id.* This view is generally consistent with the conservative underwriting standards currently used in the origination of “prime” auto loans. The underwriting standards for such loans generally emphasize the borrower’s ability to repay, rather than the collateral value of the financed automobile upon repossession.

of a meaningful Qualifying Auto Loan exemption that will ensure high quality underwriting standards and, among other things, encourage appropriate risk management practices and improve access to credit on reasonable terms as contemplated by § 15G(e)(2) of the Exchange Act.

E. The risk retention rules should permit a consolidated affiliate of the sponsor to be the initial holder of the retained risk

Section __.3(a) of the Proposed Rules requires the sponsor of a securitization transaction to retain the risk of the securitized assets, but § __.14(a) permits the retaining sponsor to transfer the retained risk to a consolidated affiliate. As the Agencies noted, “[t]he rule permits a transfer to one or more consolidated affiliates because the required risk exposure would remain with the consolidated organization and, thus, would not reduce the organization’s financial exposure to the credit risk of the securitized assets.”⁸⁵

We strongly support the principle that the sponsor should be able to transfer the retained risk to a consolidated affiliate. We believe that this flexibility balances the legal, regulatory, and funding concerns of the sponsor and its affiliates with the intent of the Proposed Rules to align the interests of the parties.

We request a technical correction to clarify that the risk may be retained initially by a consolidated affiliate, and need not be first held by the sponsor and then transferred to a consolidated affiliate. In a typical auto loan ABS transaction, the sponsor transfers a portfolio of receivables to a depositor in a “true sale” for commercial law purposes, and the depositor transfers the portfolio of receivables to the issuing entity in return for notes issued by the issuing entity and the residual interest in the issuing entity in a transaction that may not be a true sale. The depositor will then sell the notes directly to investors or indirectly to investors through an

⁸⁵ See Proposed Rule, 76 Fed. Reg. 24116.

underwriter and will retain the residual interest, which represents a “horizontal loss” position in the issuing entity. If the retained residual interest satisfies the requirements for an eligible horizontal residual interest, so long as the sponsor and depositor are consolidated affiliates, the intent of the Proposed Rules will be satisfied through the retention at the depositor. Requiring the sponsor to initially hold the residual interest in the issuing entity prior to transferring it to the depositor or another consolidated affiliate serves no discernible purpose but adds unnecessary complexity to the transaction and may negatively impact the ability of the sponsor and its counsel to conclude that the assets have been sold by the sponsor in a true sale for commercial law purposes.

VII. Student Loan Comments

Bank of America agrees with the comments and discussion in the ASF Letter regarding the application of the Proposed Rule to Student Loan ABS. In particular, Bank of America supports an exemption for securitizations of loans originated under the Federal Family Education Loan Program under Title IV of the Higher Education Act (“FFELP Loans”) from the risk retention requirements.

A. FFELP loans pose negligible credit risk

FFELP Loans benefit from a federal government guaranty of 97% to 100% of the outstanding principal amount of the loan (plus accrued interest) depending upon the year of origination and other factors.⁸⁶ Because of this guaranty by the federal government, FFELP Loans pose virtually no credit risk. Absent an exemption for FFELP Loans, the Proposed Rule would require a sponsor to retain ABS interests or other exposures representing five percent of the “credit risk” when securitizing a portfolio of FFELP Loans, even though the true credit exposure to the underlying borrowers totals only 0-3% of the principal balance of such loans.

The Proposed Rule contains a number of exemptions for securitization transactions in which the securitized assets are guaranteed by the federal government. Those exemptions include both full guarantees⁸⁷ and partial guarantees.⁸⁸ The federal government’s near full guaranty of

⁸⁶ This guaranty is provided under a guaranty program administered by the Department of Education.

⁸⁷ The Proposed Rule exempts asset-backed securities that are “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 by obligations issued by the United States.” *See* § __.21(b)(2) of the Proposing Release.

⁸⁸ The Proposed Rule exempts asset-backed securities collateralized solely (excluding cash and cash equivalents) by residential, multifamily, or health care facility mortgage loan assets that are insured or guaranteed as to the payment of principal and interest by the United States or any agency of the United States.” *See* § __.21(a)(1)(i) of the Proposing Release. Examples provided by the Agencies of assets eligible for this exemption are (a) loans under a Department of Veterans Administration Program in which the federal government guarantees between 25% and 50% of lender losses in the event that the residential borrower defaults and (b) loans under a United States Department of Agriculture Rural

FFELP Loans is more extensive than the federal government's partial guaranty of other assets that qualify for a full exemption under the Proposed Rule. As noted by the Agencies in the Proposing Release, the particular exemptions described in the preceding footnote are required by new § 15G(e)(3)(B) of the Exchange Act, and, although § 15G does not similarly require an exemption for FFELP loans, new § 15G(c)(1)(G)(ii) requires the Agencies to create exemptions for certain securitizations of assets issued or guaranteed by the United States. Given the comparable (if not superior) credit profile of FFELP loans relative to other exempt assets, the creation of an exemption for FFELP loans under § 15G(c)(1)(G)(ii) would be entirely consistent with the exceptions proposed in the Proposed Rule, and with Congressional intent.⁸⁹

B. Risk retention would have no effect on underwriting standards for FFELP loans

The Federal Family Education Loan Program was ended in 2010 as a result of the Health Care and Education Reconciliation Act of 2010 (the "HCERA"). As a result of the HCERA, no new FFELP Loans have been made or will be made since June 30, 2010. As the ASF Letter points out, the application of a risk retention requirement to securitizations collateralized by FFELP Loans would have no effect on the underwriting standards for FFELP Loans. Moreover, the FFELP Loans that remain outstanding were required to be underwritten and serviced in accordance with the requirements of the Federal Family Education Loan Program.

Development program in which the federal government guarantees a sliding amount against loss up to 90% of the original loan amount for single family loans.

⁸⁹ The only apparent alternative would be to conclude that an exemption for FFELP Loans somehow fails to be in the public interest or undercuts investor protection, and Bank of America expects that neither conclusion is warranted.

VIII. Resecuritization Comments

We strongly support the Proposed Rule's recognition that resecuritization transactions should be exempted from the general risk retention requirements. As the Agencies' comments correctly note, resecuritization does not increase credit risk on underlying loans since those loans have already been originated, typically long before resecuritization. Similarly, resecuritization does not change the original ABS sponsors' incentives to create high-quality assets under the Proposed Rule. By definition, all resecuritized assets are already in the market, whether or not they were subject to risk retention when originated. As a result, there is no need for risk retention on any resecuritization transactions.⁹⁰

However, as drafted, the resecuritization exemption will be of little use because it only allows a single class of resecuritized ABS interests. Even the Agency comments recognize that holders of resecuritized ABS under the Proposed Rule will receive payments "identical (less any fees associated with the resecuritization) to those that would occur if that holder were to hold individual securities representing the same fractional interest in each of the underlying ABS." As retransferring is prohibited, there is no material benefit from resecuritization and thus no reason to incur its expense.⁹¹

There is no reason for this limitation. Resecuritization, as recognized, provides no credit underwriting incentives because the underlying loans already exist. Therefore, there is no reason to require risk retention on resecuritizations. Sponsors of resecuritization transactions should be

⁹⁰ We do not believe that the resecuritization rule should apply to non-CLO CDO transactions. Non-CLO CDOs have been subject to much criticism. They should not be included in the resecuritization rule. The exclusion of non-CLO CDOs from the exemption could be accomplished by excluding resecuritization transactions that have the ability to purchase and dispose of securities after closing.

⁹¹ We recognize that there will be possible improvements in liquidity for odd-lot ABS interests resecuritized into pools of more marketable size. However, as explained below, that relatively minor benefit is not the primary reason for resecuritization transactions and is unlikely to provide significant benefit to investors.

allowed to allocate risks among different tranches as they do in any securitization, and investors, regulators, and the general marketplace can be confident that the existing incentives of the original, underlying originators and securitizers will not be altered. For the same reasons, resecuritization should be exempted from risk retention regardless of whether the loans were issued under the Proposed Rule or not; at the point of resecuritization, the incentives for any originator have already been set.

Retranching of resecuritized ABS should also be allowed because it provides investors with the flexibility to reconfigure old assets into new forms that better match the investors' goals. If investors can only create a single class from their ABS interests, they will lose the ability to take assets they may no longer want and turn them into cashflows they can hold for their own accounts or market to others. Resecuritization thus gives investors flexibility to recycle securities and turn them back into valuable assets. That ability, in turn, allows investors to clean and refresh their portfolios and, one might expect, free up capital to invest in newly issued securities. Investors should be able to resecuritize their ABS interests, secure in the knowledge that their actions will not alter the incentives of issuers of the underlying securities.

IX. Municipal Bond Repackaging/Tender Option Bond Comments

Another type of securitization that should be exempt from risk retention requirements is the repackaging of municipal bonds—namely, a securitization where the underlying assets are obligations of states, political subdivisions thereof, or other local governmental entities.

Proposed Rule § __.21(a)(3) provides an exemption from the risk retention requirements for any asset-backed security that is a security that is issued or guaranteed by any state of the United States, by any political subdivision of a state or territory, or by any public instrumentality of a state or territory that is exempt from the registration requirements of the Securities Act by reason of § 3(a)(2). We strongly urge the Agencies to expand this provision to provide an exemption from the risk retention requirements for any securitization that is collateralized solely (excluding cash and cash equivalents) by a security or securities issued or guaranteed by any of such entities.

We believe that this expansion would be appropriate and in the public interest as contemplated by § 15G(c)(1)(G)(i) for reasons that include the following:

First, municipal bond repackaging transactions are not the type of transactions that prompted Congress to enact § 15G, and we believe they were inadvertently included in the broad definition of asset-backed securities. Most participants in the municipal markets do not consider municipal bond repackagings to be “securitizations” or asset-backed securities whose fundamental aim is to achieve a higher rating or lower yield by pooling, tranching, or otherwise reengineering a broader, more diverse pool of assets. We have previously made this point in our

August 2, 2010 comment letter to the Securities and Exchange Commission regarding its proposed revisions to Regulation AB.⁹²

Second, as mentioned above, proposed § __.21(a)(3) already provides an exemption from the risk retention requirements for any asset-backed security issued by or guaranteed by any state or any political subdivision or public instrumentality of a state or territory. The repackaging of these obligations does not affect the quality of the underlying assets and should, therefore, be afforded the same exemption as the underlying obligations.

Third, the connection between municipal bond repackagings and the broader municipal finance markets is important. As described in more detail below, municipal bond repackagings provide substantial additional funding and liquidity for municipal debt markets by making a larger investor base available to municipal issuers. Any inability of these investors to continue to participate in the municipal finance markets will likely increase funding costs for municipal issuers and borrowers and reduce liquidity for municipal bonds, further reducing investor interest therein.

The most common form of municipal bond repackaging is known as “tender option bonds” or “TOBs.” The TOB markets have existed since the early 1990s and have become a significant aspect of the municipal market for short-term, tax-exempt securities. The TOB market brings together longer-term municipal investors and short-term money market mutual funds (for whom the underlying municipal bonds would not otherwise be eligible assets due to their longer duration) and other short-term investors to play an important role in providing funding and liquidity for the municipal bond markets.

⁹² Available at <http://www.sec.gov/comments/s7-08-10/s70810-108.pdf>. JPMorgan Chase & Co. made a similar comment in its corresponding letter, *available* at <http://www.sec.gov/comments/s7-08-10/s70810-110.pdf>.

In a typical TOB transaction, a single series of highly-rated, long-term municipal bonds (typically one) is deposited into a trust, which issues two classes of securities: one, a floating rate, puttable security (the “floater”), and the other, an inverse floating rate security (the “residual”). Since no tranching is involved for the purpose of getting a higher credit rating, arguably the transaction does not constitute a “securitization,” and the proposed risk retention requirements do not apply. However, since the trust issues two classes of securities, some may argue that a TOB transaction is a “securitization” and subject to risk retention.

In a TOB transaction, the holders of the floaters have the right, generally on a daily or weekly basis, to require that the trust repurchase their floaters at par, and this put right is usually supported by a liquidity facility provided by a highly rated provider. The put effectively makes the floater a short-term instrument and is usually sold to money market mutual funds. The floaters are subject to well-defined default and insolvency risks, which are the same as if the underlying municipal bonds were owned. The investors in the TOB residuals are usually longer term institutional investors, who bear almost all of the market and structural risks related to the TOBs.

X. Corporate Debt Repackaging Comments

A. Under the Dodd-Frank Act, there is no evident authority to require risk retention for corporate debt packagings

There is no reference to corporate debt repackaging in Dodd-Frank § 941, and there is no basis to subject corporate debt repackagings to risk retention requirements, especially when there is no risk retention required for the underlying corporate debt. As described below, corporate debt packagings usually source the underlying corporate debt in secondary markets, and, as a result, imposing risk retention would be unlikely to have any effect on underwriting standards. Notably, the Financial Stability Oversight Counsel’s *Macroeconomic Effects of Risk Retention Requirements* study⁹³ makes no mention of corporate debt repackagings—presumably reflecting a view that corporate debt repackagings are not an appropriate class for risk retention requirements.

B. The Proposed Rule should exempt corporate debt repackaging

Like municipal bond repackagings, corporate debt repackagings are created by the deposit of corporate debt securities into a trust or other similar entity or other arrangement in order to issue securities with different attributes (e.g., shortened maturity, change in currency of payment, change in the basis of interest, reduction in minimum denominations, and so on). As a result, these transactions tend generally to involve only a small number of investors and are tailored to the particular investment preferences of the particular investors.

However, unlike municipal debt repackagings, corporate debt repackagings are generally considered to be asset-backed securities and, as a result, are swept into the definition of “asset-

⁹³ Financial Stability Oversight Council, *Macroeconomic Effects of Risk Retention Requirements* (January 2011), available at [http://www.treasury.gov/initiatives/wsr/Documents/Section%20946%20Risk%20Retention%20Study%20%20\(FINAL\).pdf](http://www.treasury.gov/initiatives/wsr/Documents/Section%20946%20Risk%20Retention%20Study%20%20(FINAL).pdf).

backed security” in the Exchange Act added by the Dodd-Frank Act and, thereby, would be made subject to the proposed risk retention requirements.

Corporate debt repackagings are not transactions of the type that prompted Congress to enact § 15G. As noted, corporate debt repackagings generally are consummated to permit tailored repackaged securities for particular investors.

Section 15G(c)(1)(G) permits the Agencies to provide a total or partial exemption, as appropriate, in the public interest. Similarly, § 15G(e)(2)(B) provides that any exemption, exception, or adjustment shall improve the access of consumers and businesses to credit on reasonable terms or otherwise be in the public interest and for the protection of investors.

Corporate debt repackagings, as noted, permit investors to invest in tailored repackaged securities and, thereby, provide additional funding and liquidity for issuers of the underlying corporate debt securities. Reducing the ability of such investors to continue to participate in this way will likewise reduce such funding and liquidity to the detriment of access of businesses to credit on reasonable terms.

XI. ABCP Conduit Comments

Bank of America agrees with the comments in the ASF Letter and the SIFMA Letter regarding the provisions of the Proposed Rule applicable to clause (3) of the definition of “eligible ABCP conduits” set forth in § __.2 of the Proposed Rule. Specifically, we strongly believe that a revision to the definition of “eligible ABCP conduit” is necessary to avoid inadvertently disrupting the availability of credit under common financing facilities structured as multi-lender or “club” deals, in which funding is provided by both ABCP conduits and banks or other financial institutions, such as Bank of America. Clause (3) the Proposed Rule’s definition of “eligible ABCP conduit” requires that “all of the interests issued by an intermediate SPV [be] transferred to one or more ABCP conduits or retained by the originator-seller.” Due to this requirement, if an intermediate SPV transfers interests to a bank or other financial institution, any ABCP conduit that also purchases an interest from such intermediate SPV would be excluded from the definition of “eligible ABCP conduit” and could not take advantage of the special risk retention option set forth in § __.9 of the Proposed Rule.

Businesses in the U.S. and abroad commonly obtain financing through multi-lender or “club” transactions in which the intermediate SPV(s) transfer interests in one or more issuances to one or more ABCP conduits, as well as to one or more banks or other financial institutions. Such transactions provide businesses with many benefits as compared to single-source structures. For example, a transaction funded by both banks and ABCP conduits may provide a business with (i) more flexible and efficient funding options in circumstances where, as compared to ABCP conduits, banks can offer funding on shorter notice, fund smaller denominations or finance different tranches, (ii) greater liquidity in the event of a bank’s or an ABCP conduit’s inability to fund or a general market disruption affecting the ABCP or LIBOR markets and (iii) pricing advantages available through bank-funding or ABCP-funding from time to time. Bank of

America encourages the Agencies to ensure that businesses, ABCP conduits, banks and other financial institutions can continue to utilize, and benefit from, such transactions under the Proposed Rule.

We expect that many (perhaps an overwhelming majority) of ABCP conduits and their sponsors will seek to comply with the Proposed Rule as eligible ABCP conduits under § __.9, and, as drafted, clause (3) of “eligible ABCP conduit” could result in such ABCP conduits being required to exit any transaction involving non-ABCP conduit lenders/purchasers. Businesses that currently obtain financing through such transactions may be required to restructure their existing financing facilities while giving up some or all of the benefits described above and incurring substantial expense. In addition, the general credit markets could be adversely affected due to the inefficiencies inherent in restructuring existing financing facilities and administering duplicative structures to accommodate the “siloeing” of ABCP-funded assets, and businesses could face challenges in syndicating large financings. Finally, we note that the foregoing expenses and inefficiencies could adversely affect not only ABCP conduits and their customers, but also non-ABCP conduit participants, including Bank of America.

We have been unable to identify a policy reason that supports prohibiting eligible ABCP conduits from joining banks and other non-ABCP conduit lenders/purchasers in financing transactions. Such a prohibition neither increases originator-sellers’ “skin-in-the-game” nor improves the creditworthiness of ABCP conduits or their customers. Bank of America therefore urges the Agencies to eliminate or revise clause (3) of the definition of “eligible ABCP conduit” in § __.2 of the Proposed Rule in order to prevent what we believe to be the foregoing unintended consequences.

XII. Conclusion

Securitization provides much-needed liquidity for all aspects of the market. If properly conducted, subject to prudent regulation and oversight, securitization provides benefits to borrowers, investors, and securitizers alike. Subject to the considerations addressed above, we believe that the proper balance between careful lending and returning economic growth can be achieved.

* * * * *

We are grateful for the chance to provide these comments to the Proposed Rule. If there are any questions arising from our comments or any other aspect of this topic, we welcome the opportunity to provide assistance in any way helpful. Please feel free to contact Isvara Wilson (isvara.wilson@bankofamerica.com, 980-387-3597) or the undersigned (kenneth.l.miller@bankofamerica.com, 980-386-6669) at any time.

Respectfully Submitted,



Kenneth L. Miller

Deputy General Counsel

Appendix A

Table of Contents

I.	Executive Summary.....	4
II.	General Comments	6
	A. The Agencies should establish a mechanism for providing interpretive guidance after the Final Rule is adopted	6
	B. The Final Rule should permit a consolidated affiliate of the sponsor to be the initial holder of retained risk.....	7
	C. Sponsors should not be required to disclose their reasons for choosing a particular form of risk retention	7
	D. Banks that utilize the FDIC Safe Harbor should have the option of adopting risk retention under the Final Rule prior to the effective date of the Final Rule	8
	E. The Agencies should reissue the Proposed Rule for further comment.....	9
III.	Residential Mortgage Backed Securities Comments.....	10
	A. Key RMBS Issues	10
	B. Premium Capture Cash Reserve Account.....	13
	C. To mitigate liquidity concerns, securitizers should be given flexibility to commingle QRM and non-QRM assets while still meeting risk retention requirements	34
	D. The Qualified Residential Mortgage standards	40
	E. If the QRM definition is not expanded, an intermediate form of risk retention should be created to mitigate costs to borrowers	52
	F. The Proposed Rule’s negative impact on the return of private capital will be exacerbated by the currently necessary exemption of the GSEs.....	56
	G. Inclusion of servicing standards in the QRM rule.....	60
	H. Risk retention obligations should end a reasonable time after origination ...	64
	I. Risk retention should not apply to non-economic residuals.....	66
	J. Representative sample risk retention	66
	K. RMBS Conclusion	70
IV.	Commercial Mortgage Backed Securities Comments.....	71
V.	Revolving Asset Master Trust Comments.....	72
	A. Key Revolving Asset Master Trust comments	72
	B. The Seller’s Interest Option for Revolving Asset Master Trusts	75
	C. Additional forms of risk retention for revolving asset master trusts.....	86

D.	Multiple trust structures	96
E.	Premium Capture Cash Reserve Account.....	97
F.	Disclosure requirements for seller’s interest risk retention	99
VI.	Auto Loan Comments	100
A.	Key Auto Loan Issues.....	100
B.	The eligible horizontal residual interest option should be simplified and aligned with existing market practice.....	101
C.	The risk retention rules should permit a blend of risk retention options	104
D.	The Qualifying Auto Loan exemption should be revised to better reflect existing underwriting practices	105
E.	The risk retention rules should permit a consolidated affiliate of the sponsor to be the initial holder of the retained risk.....	106
VII.	Student Loan Comments	108
A.	FFELP loans pose negligible credit risk.....	108
B.	Risk retention would have no effect on underwriting standards for FFELP loans	109
VIII.	Resecuritization Comments	110
IX.	Municipal Bond Repackaging/Tender Option Bond Comments	112
X.	Corporate Debt Repackaging Comments.....	115
A.	Under the Dodd-Frank Act, there is no evident authority to require risk retention for corporate debt packagings	115
B.	The Proposed Rule should exempt corporate debt repackaging	115
XI.	ABCP Conduit Comments	117
XII.	Conclusion	119

Appendix B

Premium Capture Cash Reserve Account Example

Consider an individual who takes out a \$200,000 loan at a note rate at which par bonds are currently created. In addition to closing costs, the lender's assumed overhead, compliance, and other expenses per loan are approximately \$2,000. A reasonable structure backed by such loans might be 90% senior bonds trading at par and 10% subordinate bonds trading around 60 cents on the dollar to compensate investors for credit risk. As a result, proceeds from the loan will be 90% x \$200,000 at par (\$1.00), or \$180,000; and 10% x \$200,000 at \$0.60, or \$12,000. Taking the \$2,000 in closing costs into account, the issuer loaned \$200,000 and netted \$190,000 ($\$180,000 + \$12,000 - \$2,000$).⁹⁴

Obviously a lender will not make loans at a \$10,000 loss. There are two ways for the lender to recoup its basis. One possibility is to charge points to make up the difference. In this case, \$10,000 would be five points ($5\% \times \$200,000 = \$10,000$).⁹⁵ The alternative is to increase the interest rate by approximately 1.25% per year (assuming one basis point in rate trades at a multiple of 4, each 0.25% in rate would be valued at 1.00% in price).⁹⁶ On a 30-year fixed rate

⁹⁴ This illustration also demonstrates why the majority of loan premium is not profit for securitizers. All securitized loans, regardless of the strength of their credit, require credit enhancement since investors know there will always be at least some losses and price their bids for subordinate bonds accordingly. In addition, all loans generated must incur their share of overhead, compliance, and other costs. As illustrated, these facts mean that it is impossible to originate loans at the same rates as par bonds without charging borrowers large up front fees. Barring such up-front fees, the costs of credit enhancement and securitization will always require loans to have rates above those of par bonds, even if the issuer merely recoups its costs without making any profit at all.

⁹⁵ As described above at 27, the Qualified Mortgage rules effectively prohibit loans with more than three points, further limiting the ability of borrowers to pay for credit enhancement under the PCCRA regime and perhaps eliminating the existence of mortgage loans with up-front points in excess of three points.

⁹⁶ This conversion between rate and price is an approximation of the present value of future cashflows used as a shorthand for detailed calculations and complicated market conditions. While a multiple of four clearly is not intended as a substitute for in-depth cashflow analysis, in the absence of specific collateral from which to derive a more precise calculation, a multiple of four is a useful tool for illustrative purposes. In the marketplace, IO prices are commonly quoted as a multiple of their rate. Higher rates

loan, assuming a par rate of 5%, increasing the rate by 1.25% would cause monthly payments to go from \$1,073.64 to \$1,231.43 per month. In other words, a borrower who is allowed to pay for credit enhancement and other costs through rate pays an additional \$157.79 per month rather than \$10,000 up front. Based on these assumptions, even without considering the time value of money, the borrower who pays \$10,000 at closing could not move, sell, or refinance for five years and three months without losing a portion of the up-front payment. The time value of money would only make the time longer. The result is economically similar to a prepayment penalty, as borrowers who pay up-front points at closing pay for credit enhancement throughout the life of the loan, whether or not they remain in it long term.

Unfortunately, the PCCRA rule effectively prevents offering borrowers the alternative of paying for credit enhancement with rate or with a combination of rate and up-front points. If securitized, the extra 1.25% in rate in the above example would create approximately five points of premium at the time securities were sold (again, assuming a multiple of 4). In turn, the PCCRA would capture this premium, forcing the lender to subordinate the entire five points of cash to every offered security. The market value of such a first loss premium capture account might be approximately \$0.30.⁹⁷ Using that value, the subordinated PCCRA amount would actually be worth only one and one-half points ($5 \text{ points} \times \$0.30 = 1.5 \text{ points}$), again ignoring the time value of money. In order for lenders to break even under the PCCRA by paying for credit enhancement in rate, the three and one-half points lost due to premium capture must be made up to avoid taking a loss on the loan. To compensate for the premium lost due to the PCCRA,

result in lower multiples to reflect greater prepayment exposure, while lower rates trade at higher multiples because of correspondingly lesser exposure to prepayments.

⁹⁷ We acknowledge that investors and rating agencies would give a securitization some amount of credit for the increased enhancement provided by the PCCRA. The problem is that the amount of such credit is nearly impossible to predict and will be iterative to derive. For the sake of simplicity, we have not taken this speculative valuation into account in our PCCRA analysis.

borrowers would have to be charged approximately 2.92% in *additional* premium rate (2.92% (additional rate) x 4 (rate to points conversion) x 100 (par) x 0.30 (discount) = 3.5 points). The result would be a total rate of 4.17% *above* the theoretical par rate (1.25% + 2.92% = 4.17%).

In other words, assuming 5% par bonds, a borrower subject to the PCCRA who wanted to pay for credit enhancement and costs using the rate in the above example would have to take out a mortgage with a rate in excess of 9% just to enable the lender to make the loan without losing money.⁹⁸ That rate illustrates the dramatic problems the PCCRA will cause for borrowers. The PCCRA effectively prevents the use of securitization as a capital market tool to reduce the cost of borrowing for non-QRM loans.

⁹⁸ As noted above, this rate ignores the credit that the market would likely ascribe to the increased credit enhancement of the PCCRA. Without this simplifying assumption, it is difficult to estimate the likely rate increase that borrowers will bear. This difficulty is caused in large part by the current lack of a new issuance market on which to base assumptions. It also reflects the difficulties of quantifying the impact on pricing of multiple investor concerns (including prepayment concerns, credit concerns, etc.) as explained in this letter. Recognizing the variability of these considerations, our best estimates indicate that the PCCRA would result in an actual increase in the price of mortgage loans between four and eight points if paid by borrowers in points at the time of closing. If borrowers instead chose to finance the additional cost due to the PCCRA via increases in the rates on their mortgage loans, the resulting substantial price increase would be subject to significant prepayment risk in the eyes of investors. Thus, any interest, only security based on the premium rate generated by this loan would result in a far lower multiple than the multiple of four noted above. As a result, we believe the actual rate *increase* to borrowers as a result of the PCCRA would be approximately 2% to 5%.

Appendix C

Comparison of CMO and OC Structures

It is critically important to emphasize that the private RMBS securitization market has traditionally employed structures that do not rely on excess spread. OC structures are a relatively new structural innovation predominately used for securitizations that require high levels of credit enhancement such as subprime collateral, as well as option ARM, Alt-A, and second liens. In contrast, securitizations of higher quality mortgages such as prime jumbo collateral almost never use OC structures. As illustrated in the following table, between 2005 and 2007 fully 99% of prime jumbo securitizations brought to market used traditional CMO structures (also known as “shifting interest”), while subprime securitizations utilized OC structures for virtually 100% of securitizations:

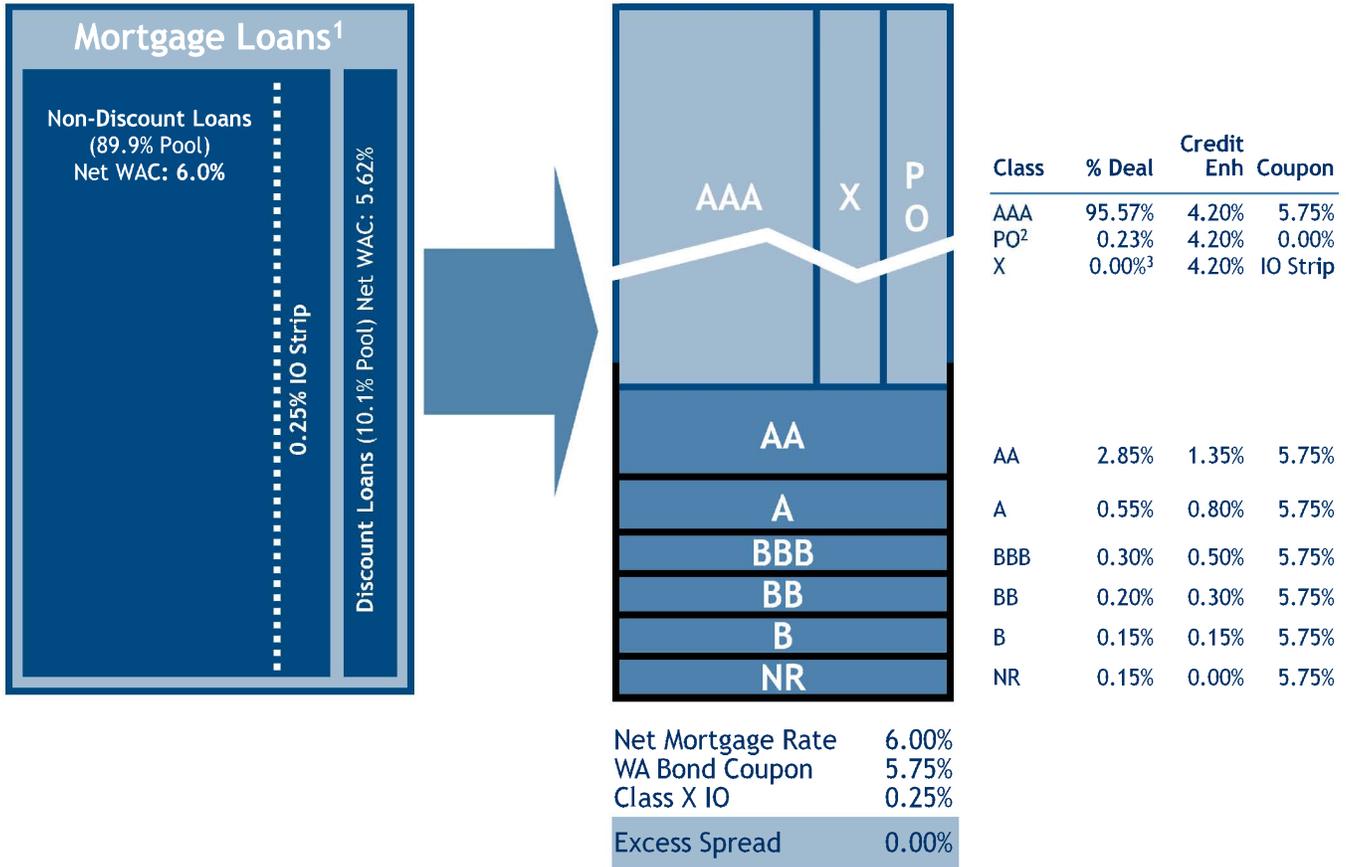
OC vs Shifting Interest (CMO)
Breakdown of Structure by Collateral Type
2005-2007 Originations (\$ Millions)

Sector	OC	SI	Total	% OC
Alt-A	249,854	495,137	744,992	34%
Subprime	1,114,725	2,842	1,117,567	100%
Jumbo	5,974	453,351	459,325	1%
Option ARM	187,003	194,565	381,568	49%

Source: Intex

The impact of the difference between the two types of structures is most clearly explained by beginning with a description of a typical CMO structure, as illustrated in the diagram on the following page:

Sample 2007 Vintage CMO Structure
Prime Jumbo Fixed Rate Collateral



¹ The interest rates on the underlying loans are “stripped” to get to the pass-through rate of 5.75%. For non-discourt loans with net mortgage rates > 5.75%, an IO is created that pays the difference between the net mortgage rate and 5.75%. For discount loans with net mortgage rate < 5.75%, a PO bond is created that strips principal payments to gross up the effective mortgage rates on these loans to 5.75%.

² PO amount is based on the stated principal balance of loans with net mortgage rates < 5.75% times the PO percentage equal to 1-(net mortgage rate/5.75%).
 $1 - (5.62\% / 5.75\%) * 10.1\% \text{ discount loans} = 0.23\% \text{ PO}$.

³ IO notional is the stated principal balance of the non-discouted loans.

A typical fixed rate CMO deal is created by aggregating a pool of mortgage loans with various fixed rates. As the diagram shows, the loans in this example have a weighted average coupon (or “WAC”) of 6.0%.⁹⁹ Because the mortgage loans underlying a CMO deal will bear different interest rates, the interest rate on mortgage loans is “stripped” down to a common coupon (the “passthrough rate” or “weighted average bond coupon”). In the diagrammed example, the passthrough rate is 5.75%. The interest “stripped” from each non-discourt mortgage loan in order to create a single passthrough rate is placed into an IO tranche (here

⁹⁹ For simplification, we omit consideration of servicing fees. The omission does not effect the analysis.

labeled “X”) that has a rate equal to the difference between the WAC of the non-discount mortgage loans and the passthrough rate (here $6\% - 5.75\% = 0.25\%$). Similarly, if there are any underlying mortgage loans with rates below the passthrough rate, a principal only (or “PO”) bond will be created by “stripping” a portion of the principal payments from the discount loans to raise the effective rate passed through.¹⁰⁰ The net result is that the differing rates paid by the underlying individual mortgage borrowers are mathematically equalized to create a cashflow in which all principal bearing bonds (except the PO) pay a single, fixed coupon.¹⁰¹ The IO is never used to cover losses or to reimburse the CMO Trust for anything. Rather, it is primarily a structure used to normalize the interest rate passed through, as described. The IO has traditionally been a senior security and sold to institutional investors.

In the same way, there is no “excess spread” or “overcollateralization” used to cover losses in a CMO securitization. Instead, bonds are created from the cashflow represented by the single passthrough rate (again, 5.75% in the diagram). The amount of subordination (the NR, B, BB, BBB, A, and AA tranches in the diagram) necessary to create the desired ratings for the senior bonds (the AAA, X, and PO tranches in the diagram) is set on the closing date and only changes in respect of principal paid or writedowns absorbed by a given bond. It can never grow above its initial balance (because there are no “excess cashflows”), and all bonds will pay one for

¹⁰⁰ To further explain how a PO bond works, consider a \$100,000 loan with a 5.6% coupon securitized in a structure with a 5.75% passthrough rate. Obviously 5.6% interest on \$100,000 is only \$5,600 ($5.6\% \times \$100,000$), less than the \$5,750 that would be generated by a \$100,000 loan with a 5.75% coupon. In fact, a loan with a 5.75% coupon would only need approximately \$97,400 in principal to generate the same \$5,600 of interest ($5.75\% \times \$97,400 = \$5,600$). This difference can be approximated by taking the interest paid on the extra \$2,600 of the 5.6% loan ($\$100,000 - \$97,400 = \$2,600$) and treating it as though it were received on the \$97,400 balance ($\$97,400 \times 5.6\% = \$5,454$ plus $\$2,600 \times 5.60\% = \146 , which equals the needed \$5,600). The remaining \$2,600 is placed in a PO bond with a coupon of 0.0%. The underlying loans do not change, but the creation of a PO bond allows the securitizer to accommodate coupons below the passthrough rate within the securitization as if each loan had a common interest rate.

¹⁰¹ While not all senior bonds are required to have a rate equal to the passthrough rate, in aggregate the rate on all the bonds in a CMO securitization must equal the passthrough rate. For simplification here we consider only bonds with coupons equal to the passthrough rate.

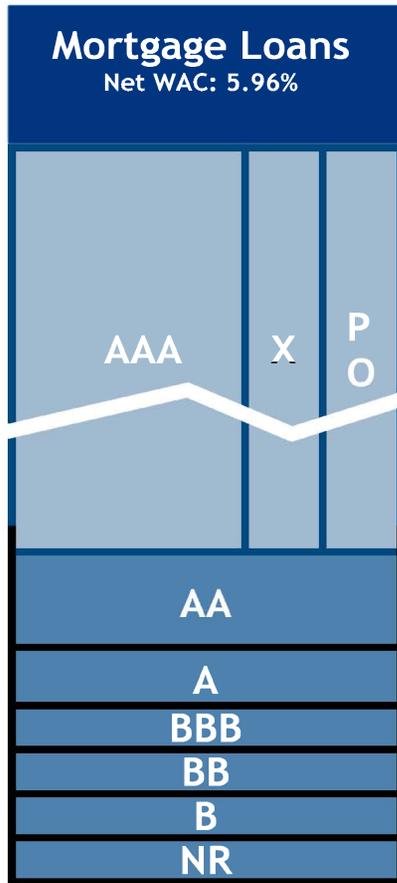
one relative to principal payments and losses on the mortgage loans. Losses are handled in a strict, reverse sequential order, starting with the bottommost tier of bonds (here labeled NR) and proceeding upward. A tranche will not take a loss until every penny of every bond subordinate to it has absorbed sufficient losses to completely extinguish its balance. Nor is it common for the issuer to retain the bottommost cashflow (the NR tranche here); issuers have historically sold all tranches in CMO deals, including non-rated tranches, to independent third parties.

Principal payments are handled in a slightly different but no less predictable manner. Principal is allocated according to schedules strictly set forth in the deal documents so that the subordinate bonds pay in a “shifting interest” fashion that allocates a majority of principal prepayments to senior bonds in early periods and a “shifting” pro rata share later on, with the residual being “non-economic,” reflecting the fact that CMO residuals are not entitled to receipt of any principal or interest.¹⁰²

In contrast, the diagram on the following page compares the CMO deal just considered with a typical OC structure:

¹⁰² As noted above, the residual may be assigned a notional amount, for instance \$100, for purposes of securing a rating. We agree with the position expressed in the ASF Letter, at 69, and the SIFMA Letter, at 50, that non-economic residuals are not appropriate subjects for risk retention.

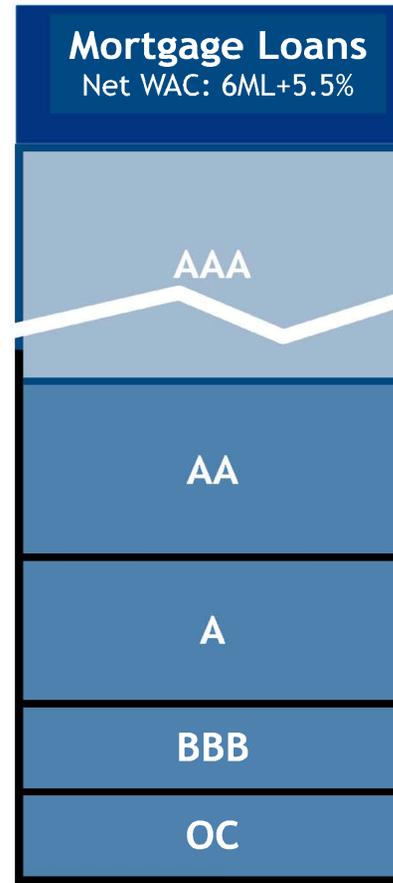
Sample 2007 Vintage CMO Structure
Prime Jumbo Fixed Rate Collateral



Class	% Deal	Credit Enh	Coupon
AAA	95.57%	4.20%	5.75%
PO ¹	0.23%	4.20%	0.00%
X	0.00% ²	4.20%	IO Strip ³
AA	2.85%	1.35%	5.75%
A	0.55%	0.80%	5.75%
BBB	0.30%	0.50%	5.75%
BB	0.20%	0.30%	5.75%
B	0.15%	0.15%	5.75%
NR	0.15%	0.00%	5.75%

Net Mortgage Rate	6.00%
WA Bond Coupon	5.75%
Class X IO	0.25%
Excess Spread	0.00%

Sample 2007 Vintage Overcollateralization Structure
Subprime ARM Collateral



Class	% Deal	Credit Enh	Coupon
AAA	77.60%	22.40%	L+20
AA	9.45%	12.95%	L+50
A	5.15%	7.80%	L+135
BBB	3.60%	4.20%	L+500
OC	4.20%	0.00%	0.00%

Net Mortgage Rate	L+5.50%
WA Bond Coupon ⁴	L+0.55%
Excess Spread	4.95%

¹ PO amount is based on the stated principal balance of loans with net mortgage rates < 5.75% times the PO percentage equal to 1-(net mortgage rate/5.75%). 1-(5.62%/5.75%)*10.1% discount loans = 0.23% PO.

² IO notional is the stated principal balance of the non-discounted loans.

³ IO pass through rate equals weighted average net mortgage rate of the non-discounted loans - 5.75%.

⁴ Bond coupon weighted based on principal balance and WAL.

Unlike the prime jumbo collateral underlying the CMO structure, the sample OC structure above is backed by subprime collateral.¹⁰³ Also unlike the CMO structure, the entire net WAC of the collateral underlying the OC structure is not passed through to the offered certificates as their interest entitlement. Instead, the bond coupons are set so that their weighted average will be well below the net WAC of the collateral.¹⁰⁴

Under normal conditions, the difference between the interest paid on loans and the interest promised on the OC bonds is used to cover any losses before the bonds experience them as well as to repay prior shortfalls or losses. As a result of this anticipated excess spread, the total principal amount of the subordinate bonds (here the OC, BBB, A, and AA bonds) on the closing date is less than the total amount of credit enhancement that would be required for the ratings given on the senior bonds (here the AAA bonds) and any subordinates above the OC bonds. The remainder of the credit support is expected to come from excess spread, to the extent available.

If the rating agencies do not correctly estimate the amount of future excess spread, either because prepayment speeds are faster on higher coupon collateral or because the deal sustains excess losses, it is possible that the deal will only have the credit enhancement provided by subordinate bonds. If this occurs, holders of those bonds may experience losses more quickly than expected, and senior bondholders may also experience losses.

However, if more excess spread is available than is necessary to absorb losses (in other words, if the underlying loans prepay more slowly or experience lower losses than anticipated), OC structures typically are structured with “performance triggers” that release cash to the

¹⁰³ The differences discussed here are inherent in the CMO and OC structures and do not depend on the collateral underlying the securitizations. Thus, while the comparison illustrates a prime jumbo CMO deal and a subprime ARM OC deal, the operation of the structures will be similar regardless of what collateral was used.

¹⁰⁴ Subject to the caveat that if all loans above the rate due on a particular bond pay off or default, the bond cannot pay more than the present WAC of the deal and will experience “coupon deterioration.”

subordinate bonds and the residual interest or OC when the deal is performing well. In the case of payments to the residual, excess interest is released from the transaction. As a result, the residual (the OC piece in the diagram) traditionally has significant value because the owner of this bond typically believes that the excess spread owed the OC bond is more valuable than the losses it is required to absorb.

In conclusion, CMO structures have historically been collateralized by higher quality mortgage loans and have performed materially better than OC structures. Many RMBS investors tend to prefer CMO structures because they do not have to rely on estimates of the amount of credit support in the form of subordinated IO that will be provided to the bonds that they purchase. Because the credit support for a CMO structure is set at the time the securitization is created instead of being estimated as in an OC structure, investors know precisely what credit enhancement is available when they make their investment decisions. However, the PCCRA will have the effect of pushing securitization to less desirable OC structures, as even the commentary to the Proposed Rule acknowledges and introducing increased uncertainty as to the value of excess spread and the benefits the PCCRA may confer.

Appendix D

QRM Impact On Borrower Qualifications

Because borrowers who qualify for QRM loans under the Proposed Rule are expected to enjoy the least expensive financing available in the residential mortgage marketplace, it is critically important to ensure that QRM criteria are set at appropriate levels. As explained, we believe that the QRM definition can be widened to provide lowest cost funding to a substantially larger number of borrowers without meaningfully increasing corresponding credit risk to investors. The following data quantifies the definitional widening we believe to be proper, with explanations regarding each scenario.

We have analyzed the impact that various combinations of QRM criteria would have on default rates, using historical market data for the years 2001 to 2010. Exhibit 1 details the loan level criteria applied for each hypothetical QRM definition. Exhibits 2 through 5 illustrate the impact that those different QRM definitions would have on the historical data. The definitions used are as follows:

In each scenario, the base comparison is the proposed QRM rule. Because industry data is not readily available for individual credit events (such as 30 or 60 day delinquencies), we have used a credit score of 690 to approximate the Proposed Rule's criteria in that regard. It is also important to note that the following analysis of the Proposed Rule does not account for the requirement that servicing standards be included in loan documents. That requirement introduces an additional level of complexity into the QRM analysis, as explained above in Section III.G, that is impossible to quantify. If it were possible to model the servicing standard requirement, however, it is likely the analysis would cause the proposed QRM definition to capture an even smaller portion of the market.

Scenario 1 (“BofA 1”) starts with the base QRM definition and eliminates the 28% front end DTI constraint while relaxing back end DTI to 45%. It also relaxes the refinance LTV constraint to 80%, removes the constraint that purchase loans must be stand-alone, and relaxes credit score to 680.

Scenario 2 (“BofA 2”) is the same as BofA 1 except that it widens the LTV constraint for purchase and refinance loans to 90%.

Scenario 3 (“BofA 3”) is the same as BofA 1 except that it widens the LTV constraint for cash out refinance loans to 80%. BofA 3 represents Bank of America’s proposed QRM rule, as discussed in Section III.D.2.

Scenario 4 (“BofA 4”) is the same as BofA 1 except that it widens the LTV constraint for purchase and all refinance loans to 90%.

Scenario 5 (“BofA 5”) is the same as BofA 1 except that it widens LTV for purchase and all refinance loans to 97%.

Scenario 6 (“BofA 6”) represents current Fannie Mae origination standards.

Finally, Exhibit 6 illustrates on a percentage basis the reasons why different loans would not qualify for QRM treatment, while Exhibit 7 shows the percentage of loans that would only be able to secure financing from sources such as the FHA or the VA, again on an annualized basis and under each of the different QRM definitions described above.

Expanded QRM Guideline Definitions (Exhibit 1)

Definition	Rule	Alt Appr	BofA 1	BofA 2	BofA 3	BofA 4	BofA 5	BofA 6
Back DTI	36	38Arm/4 1 Fix	45	45	45	45	45	45
Purch CLTV/pig	80%/No	90%/Yes	80%/Yes	90%/Yes	80%/Yes	90%/Yes	97%/Yes	FNMA
Refi CLTV/pig	75%/Yes	90%/Yes	80%/Yes	90%/Yes	80%/Yes	90%/Yes	97%/Yes	FNMA
Cash CLTV/pig	70%/Yes	75%/Yes	70%/Yes	70%/Yes	80%/Yes	90%/Yes	97%/Yes	FNMA
Neg Am	No	No	No	No	No	No	No	No
I/O	No	No	No	No	No	No	No	No
Balloons	No	No	No	No	No	No	No	Yes
Prepay Pen	No	No	No	No	No	No	No	Yes
ARM Margins	2/2/6	2/2/6	All	All	All	All	All	All
ARM Product	ALL	ALL	All	All	All	All	All	All
Credit	690	690	680	680	680	680	680	FNMA
Max Term	30yr	30yr	30yr	30yr	30yr	30yr	30yr	40yr
Occupancy	Primary	Primary	Primary	Primary	Primary	Primary	Primary	FNMA
Documentation	Full	Full	Full	Full	Full	Full	Full	Full
Fee Limits	3%	3%	3%	3%	3%	3%	3%	3%
MI Req >80 LTV	n/a	No	No	No	No	No	No	No

Source: Results aggregated by a third party provider from analysis of CoreLogic servicing dataset. Performance data as of March 31, 2011.

Historical Defaults, Proposed Rule vs. Expanded QRM Definitions (Exhibit 2)

Defaulted QRM loans / Total Loans Evaluated

QRM Default Rates:	Rule	Alt Appr	BofA 1	BofA 2	BofA 3	BofA 4	BofA 5	BofA 6	FNMA*
2001	0.48%	0.66%	0.64%	0.82%	0.70%	0.88%	1.09%	1.27%	1.2%
2002	0.36%	0.48%	0.47%	0.59%	0.51%	0.64%	0.76%	0.85%	1.1%
2003	0.39%	0.50%	0.51%	0.60%	0.56%	0.65%	0.74%	0.80%	1.2%
2004	0.72%	0.88%	0.89%	1.03%	0.95%	1.11%	1.24%	1.34%	2.2%
2005	1.49%	1.73%	1.79%	2.01%	1.91%	2.16%	2.34%	2.67%	4.1%
2006	2.11%	2.47%	2.76%	3.03%	2.99%	3.32%	3.55%	4.41%	6.9%
2007	1.94%	2.52%	2.68%	3.07%	2.94%	3.39%	3.79%	4.39%	6.9%
2008	0.64%	1.00%	0.91%	1.24%	1.01%	1.36%	1.54%	1.86%	1.7%
Grand Total	0.81%	1.02%	1.08%	1.26%	1.17%	1.37%	1.53%	1.78%	2.8%

Source: Results aggregated by a third party provider from analysis of CoreLogic servicing dataset. Performance data as of March 31, 2011.

* FNMA Default Rates by Origination Year as per "Fannie Mae 2011 First-Quarter Credit Supplement"

Expanded QRM Definitions as Percentage of FNMA Defaults (Exhibit 3)

Defaulted QRM loans / Defaulted FNMA loans

Percentage of FNMA Defaults:	BofA 1	BofA 2	BofA 3	BofA 4	BofA 5	BofA 6
2001	53.7%	68.1%	58.1%	73.7%	91.1%	106.2%
2002	42.3%	53.3%	46.3%	58.4%	68.9%	77.1%
2003	44.6%	51.9%	48.3%	56.8%	64.0%	69.7%
2004	40.5%	46.8%	43.3%	50.6%	56.6%	60.8%
2005	43.6%	48.9%	46.5%	52.4%	56.9%	64.9%
2006	40.3%	44.2%	43.7%	48.4%	51.8%	64.4%
2007	39.1%	44.8%	42.9%	49.5%	55.3%	64.1%
2008	53.6%	72.8%	59.7%	79.9%	90.4%	109.7%
Grand Total	38.2%	44.4%	41.3%	48.4%	54.1%	62.9%

Source: Results aggregated by a third party provider from analysis of CoreLogic servicing dataset. Performance data as of March 31, 2011.

QRM Market Share (Exhibit 4)

QRM Loans / Total Loans Evaluated

QRM Market Share:	Rule	Alt Appr	BofA 1	BofA 2	BofA 3	BofA 4	BofA 5	BofA 6
2001	15.3%	21.1%	20.4%	22.8%	23.6%	26.8%	29.3%	33.2%
2002	20.8%	27.2%	28.1%	30.2%	32.0%	34.9%	37.0%	40.4%
2003	21.3%	27.8%	29.2%	31.0%	32.9%	35.6%	37.1%	40.8%
2004	12.9%	16.7%	20.0%	21.5%	22.2%	24.4%	25.9%	29.3%
2005	10.6%	13.5%	16.4%	17.6%	18.6%	20.5%	21.6%	24.8%
2006	9.6%	12.3%	14.4%	15.5%	16.1%	17.6%	18.6%	21.8%
2007	10.5%	14.1%	14.8%	16.4%	16.5%	18.6%	20.3%	22.3%
2008	17.7%	26.1%	25.5%	29.5%	27.9%	32.6%	35.4%	36.1%
2009	31.3%	43.4%	41.7%	45.5%	45.6%	49.6%	51.3%	50.5%
2010	28.4%	38.5%	37.9%	42.0%	40.7%	45.1%	47.5%	48.6%
Grand Total	17.0%	22.6%	23.9%	26.0%	26.7%	29.4%	31.0%	34.1%

Source: Results aggregated by a third party provider from analysis of CoreLogic servicing dataset. Performance data as of March 31, 2011.

QRM Market Share Adjusted for QM (Exhibit 5)

Total QRM Loans / (Total Loans Evaluated - NegAm - Low/No Doc - I/O - >30yr)

Market Share Adj. for QM:	Rule	Alt Appr	BofA 1	BofA 2	BofA 3	BofA 4	BofA 5	BofA 6
2001	21.2%	29.1%	28.1%	31.5%	32.6%	37.1%	40.6%	46.0%
2002	27.7%	36.3%	37.4%	40.3%	42.7%	46.6%	49.3%	53.8%
2003	28.8%	37.6%	39.5%	42.0%	44.5%	48.1%	50.2%	55.2%
2004	18.6%	23.9%	28.7%	30.9%	31.9%	35.1%	37.2%	42.2%
2005	17.2%	22.0%	26.6%	28.6%	30.2%	33.2%	35.0%	40.2%
2006	17.7%	22.7%	26.5%	28.6%	29.6%	32.4%	34.2%	40.1%
2007	18.8%	25.3%	26.5%	29.4%	29.6%	33.4%	36.4%	40.1%
2008	25.4%	37.5%	36.5%	42.3%	40.0%	46.8%	50.8%	51.9%
2009	39.8%	55.2%	53.1%	57.9%	58.0%	63.1%	65.3%	64.3%
2010	39.4%	53.5%	52.8%	58.4%	56.6%	62.6%	65.9%	67.5%
Grand Total	25.1%	33.3%	35.2%	38.2%	39.3%	43.3%	45.7%	50.2%

Source: Results aggregated by a third party provider from analysis of CoreLogic servicing dataset. Performance data as of March 31, 2011.

Percentage of Non-Qualification by Reason (Exhibit 6)

Non-QRM Loans for Each Reason / Total Non-QRM Loans

% Non-Qual. by Reason:	Rule	Alt Appr	BofA 1	BofA 2	BofA 3	BofA 4	BofA 5	BofA 6
LTV	52.5%	28.2%	47.7%	35.5%	35.4%	16.3%	6.5%	in FNMA
fico	42.7%	46.2%	41.6%	43.2%	43.8%	46.2%	47.8%	in FNMA
dti	22.9%	18.0%	11.7%	12.2%	12.3%	13.0%	13.4%	14.9%
term	5.0%	5.5%	5.7%	5.9%	6.0%	6.3%	6.5%	0.0%
io	5.5%	6.0%	6.2%	6.4%	6.5%	6.9%	7.1%	7.9%
negam	3.2%	3.5%	3.6%	3.7%	3.8%	4.0%	4.1%	4.6%
doc	34.1%	36.9%	38.3%	39.8%	40.3%	42.5%	43.9%	48.7%
occ	12.5%	13.5%	14.0%	14.6%	14.8%	15.6%	16.1%	in FNMA
FNMA Combos								48.6%

Source: Results aggregated by a third party provider from analysis of CoreLogic servicing dataset. Performance data as of March 31, 2011.

FHA/VA Impact, Adjusted for QM (Exhibit 7)

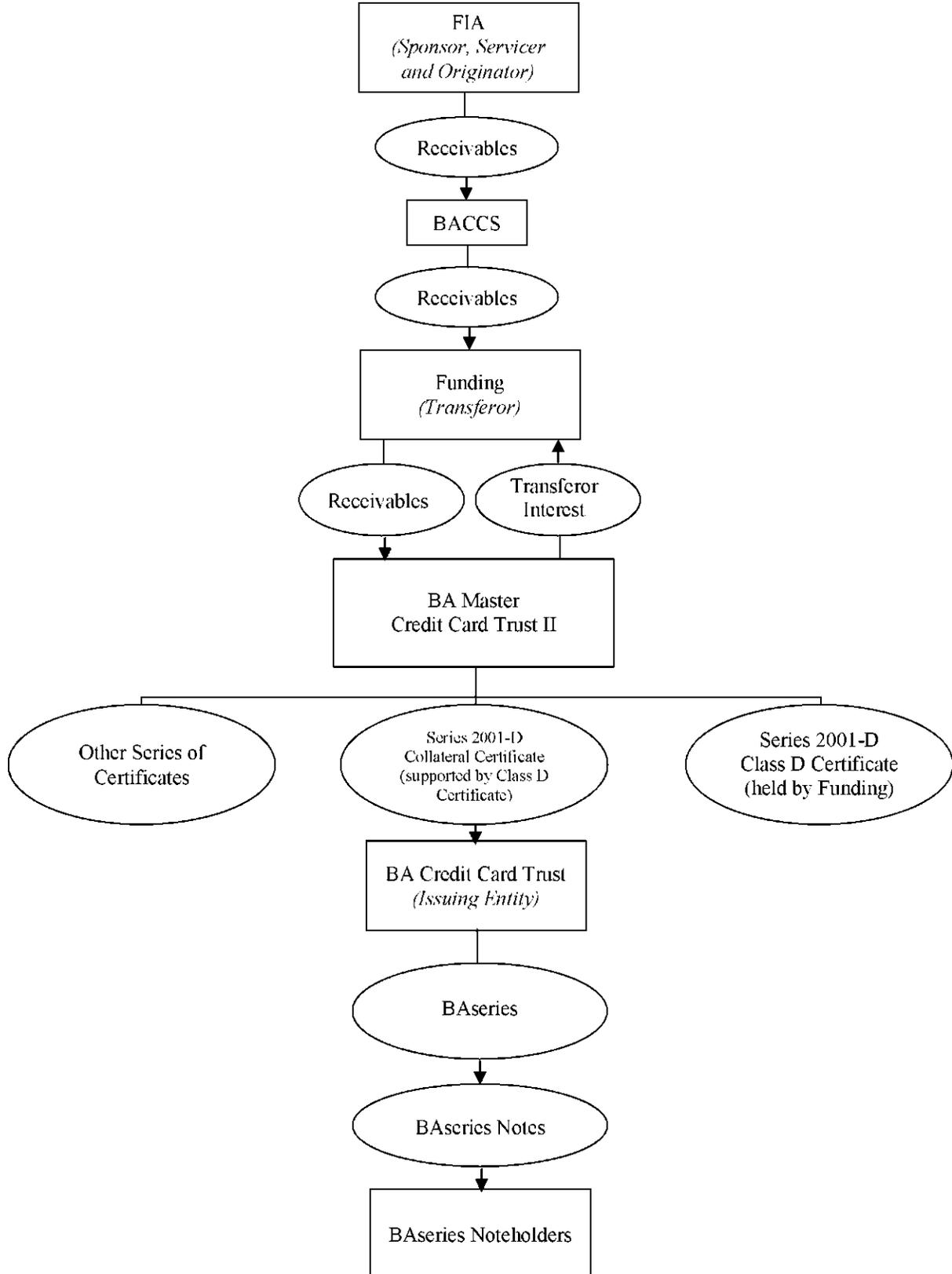
Non-QRM Loans with Less Than 20% Down /
(Total Originations – NegAm – Low or No Doc – IO – Greater Than 30 Year)

FHA/VA Impact Adj for QM:	Rule	Alt Appr	BofA 1	BofA 2	BofA 3	BofA 4	BofA 5	BofA 6
2001	22.3%	19.8%	22.3%	19.2%	22.3%	18.2%	15.0%	6.5%
2002	16.1%	14.0%	16.1%	13.4%	16.1%	12.5%	10.0%	4.9%
2003	14.1%	12.3%	14.1%	11.8%	14.1%	10.8%	8.8%	3.8%
2004	20.3%	18.8%	20.3%	18.2%	20.3%	17.3%	15.3%	4.9%
2005	19.9%	18.6%	19.9%	18.0%	19.9%	17.0%	15.3%	4.8%
2006	21.0%	19.6%	21.0%	19.1%	21.0%	18.3%	16.5%	7.0%
2007	24.5%	22.4%	24.5%	21.8%	24.5%	20.9%	18.1%	12.4%
2008	14.9%	11.1%	14.9%	10.4%	14.9%	9.6%	6.4%	4.4%
2009	6.9%	3.6%	6.9%	3.3%	6.9%	3.1%	1.5%	0.4%
2010	9.4%	5.5%	9.4%	5.1%	9.4%	4.8%	2.3%	0.5%
Grand Total	16.7%	14.5%	16.7%	13.9%	16.7%	13.1%	10.9%	4.8%

Source: Results aggregated by a third party provider from analysis of CoreLogic servicing dataset. Performance data as of March 31, 2011.

Appendix E

Bank of America Credit Card Structure



Appendix F

Index of Defined Terms

<u>Term</u>	<u>Page</u>
ABS	13
Agencies	2
ASF	13
ASF Letter	13
BACCT	72
Bank of America	1
BofA 1	xiv
BofA 2	xiv
BofA 3	xiv
BofA 4	xiv
BofA 5	xiv
BofA 6	xiv
CMBS	71
CMO	22
depositor	85
FFELP Loans	108
FIA	72
Final Rule	6
floater	114
GSEs	11
HCERA	109
IO	22
LMI	44
Master Trust II	72
NRSROs	47
OC	22
passthrough rate	vii
payment waterfall	102
PCCRA	10
PO	viii
Proposed Rule	2
Qualifying Auto Loans	100
receivables trusts	85
residual	114
RESPA	50
RMBS	8
shifting interest	vi
SIFMA Letter	66
WAC	vii
weighted average bond coupon	vii
X	viii