Communication Between Federal Reserve Board Staff
and Representatives of Ford Motor Credit Company (Ford Credit)
October 7, 2010

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Summary: Representatives of Ford Credit provided Federal Reserve staff with follow-up questions from the August 18, 2010, meeting on Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act and risk retention requirements on auto securitizers. A copy of the questions provided by Ford Credit is attached below.

RISK RETENTION AND MORTGAGE COMPARISONS

October 7, 2010

Follow-up Issues from August 18, 2010 Meeting

1. What happens to servicing incentives in the auto industry and for Ford Credit if there is no vertical slice risk retention (in rated notes) and all of today's retained risk (our horizontal slice) has been consumed by losses?
2. Comparison of ABS and business models between mortgage and auto financing industries.

Follow-up #1 – Risk Retention, Losses, and Servicing Incentives

A scenario where the auto ABS industry's present approach to risk retention is inadequate to continue incentivizing effective servicing is improbable. It is highly unlikely that a meaningful portion, let alone all, of our retained interest will be used to cover losses in an auto ABS transaction. Because we absorb losses first, we have strong incentives as a sponsor and servicer to prevent these losses. The history of auto ABS bears this out: Every matured term ABS issued by the major 16 auto finance company signatories of the "Vehicle ABS Sponsors Comment Letter to the SEC, Aug. 2, 2010" has repaid all principal and interest in full. None have missed any payment.

In addition, effective servicing is a competitive advantage of Ford Credit. Losses can be significantly mitigated, as cars and light trucks are reliable and highly liquid collateral. Even if losses are realized on some of the retail loans or leases in an ABS transaction, continued collections, including any "excess spread," from the remaining contracts would also help mitigate losses.

Retail Loan

- In accordance with rating agency requirements, the BBB rated notes (the lowest rated subordinated note that we have sold) in our ABS transactions are structured to withstand two times expected losses on the receivables. (Please note that many issuers sell only AAA rated notes. Ford Credit's AAA rated notes are structured to withstand 5 times expected losses.) In addition, the rating agencies use very conservative expected loss estimates before they apply this loss multiple. For example, in our most recent ABS transaction (FORDO 2010-B), Fitch, Inc. used an expected loss estimate of about 3% and, as a result, the BBB rated notes were structured to withstand 6% losses. Ford Credit's actual cumulative losses on its retail loan ABS transactions over the past decade (30 transactions backed by over $88 billion of retail loans) have never exceeded 3%, and most have been below 2% (please see graph on page #24 of Ford Credit's August 18, 2010 presentation on the Federal Reserve Board website).
- The consistency of Ford Credit's originations and the large data set created by over 20 years of public ABS issuance have made our transactions and the receivables backing them very predictable.
- The typical auto ABS transaction (including all Ford Credit retail loan transactions) are structured to build credit enhancement over time (i.e., de-lever). In all of our retail loan ABS transactions, there has been sufficient excess spread to cover realized losses. We have never had to use the reserve account or overcollateralization to cover losses in a transaction. As a result of the conservative structure we use, our retained interest has never been close to being reduced to zero.

Auto Lease

- The AAA rated notes (the only notes we have sold in our Rule 144A transactions) are structured to withstand five times expected credit losses.
- The AAA rated notes are also structured to withstand 35-40% residual value decline (residual value of the vehicle – i.e., its value as a used car – is a significant source of cash in lease ABS transactions). Ford Credit's worst year of residual losses was 2008, when residual values realized at auction were 19% lower than originally estimated.
- Because our structures build enhancement over time, all of our lease ABS transactions increased enhancement during 2008, despite the fact that residual losses were the worst in the 14 year history of the Manheim Index.

Floorplan (Dealer Inventory)

- Present enhancement levels for Ford Credit's floorplan ABS program is about 26% of total collateral for the AAA-rated notes and 13% for the lowest rates notes we sell (BBB-rated). This means our floorplan ABS transaction could absorb losses equal to 35% of the notes issued before the losses would affect the AAA rated notes. Ford Credit's annual portfolio losses have been about 9 basis points over the past five years.
- It is hard to even imagine the extreme circumstances that would cause losses of 26% on the collateral. For example, it would require 100% of dealers to default and collateral recovery values to be 74% or less.
- Floorplan financing is a revolving asset and this allows the notes to repay quickly if necessary. The transactions have multiple amortization triggers that when combined with rapidly turning assets provide repayment of the notes at the onset of adverse events.

Other Incentives Beyond Catastrophic Losses (Assuming the Improbable)

There are other incentives that will keep the sponsor/servicer motivated to prudently originate, conservatively select and effectively service assets in an auto ABS transaction, even if its entire retained interest has been used to cover losses. These other incentives include:

- The need for continued access to the ABS market. ABS is an important source of funding for Ford Credit and all auto finance companies. In fact, securitization represents about 60% of Ford Credit's present funding. Without access to the ABS market, the long term business viability of Ford Credit, and with it Ford Motor Company, would be in doubt. There is no greater incentive.
- We have 16 public/Rule 144A retail and lease ABS transactions presently outstanding that are at various stages of de-leveraging. Even if our retained interest were completely wiped out in one or more of these transactions, we would continue to have strong incentives to effectively service our transactions because we would still have retained interests in our other transactions. It would be impossible for us to change our servicing for the transactions in which our retained interest had been eliminated without also changing the servicing of all of our other outstanding transactions. Our servicing personnel are not aware of which loans have been retained or sold, let alone of which loans are in which transactions. As a result, our retained interest in the remaining ABS transactions would continue to provide incentives for effective servicing of all of our ABS transactions.
- Ford Credit does not securitize its entire retail loan or lease portfolio. As discussed in the SEC's Reg AB commentary, a sponsor's non-securitized assets can be considered a form of risk retention.
- The sponsor/servicer has a contractual obligation to service the assets and transaction. We would never ignore our legal obligations. In addition, the fees we earn for servicing our transactions are a significant source of income for Ford Credit.

Follow-up #2 – Auto ABS versus Mortgage ABS Business Model

Differences between auto ABS and mortgage ABS fall into three categories:

1. Business model (originate-to-distribute vs. captive finance)
2. Product (mortgage loans vs. vehicle loans)
3. ABS transaction (RMBS vs. auto ABS)

Mortgage ABS	*Auto ABS*
Business Model Differences	
• Originate-to-distribute firms did not retain a stake in the success of the loans they originated. This incentivized moral hazard as firms were more interested in higher volume than prudently underwriting loans. The originate-to-distribute model does not foster a long term perspective. • Financial intermediaries earned fees for buying and securitizing mortgages, which more than offset the losses of any small piece retained.	• Ford Credit and other auto finance companies use securitization as a critical funding source. We do NOT use securitization for risk transfer or capital relief. • As a captive finance company, our primary objective is to support the parent manufacturing company. We take a long term view of securitization. • Captive finance companies are not earning fees to securitize loans. The performance of the loans affects our financial statements regardless of whether they or securitized or not. We have always retained the equity tranche in our public/Rule 144A ABS programs.
• Many mortgage ABS investments were held off-balance sheet and hidden from investors.	• Ford Credit's securitization transactions are reported on our balance sheet providing greater transparency to investors. • We don't sell a significant amount of our retail loan or lease portfolio. We originate and service auto loans without regard to whether they are or will be securitized. Our servicing employees do not know whether a retail loan or lease has been securitized.
• Not only did the underwriting standards suffer, but abusive practices emerged in the form of misleading and unsustainable products such as ARMs with teaser rates, negatively amortizing and interest only loans.	• Ford Credit aims to foster positive, long-term relationships with our customers. Our prudent underwriting practices have remained unchanged for years. We strive for repeat business and customers who will purchase another Ford Motor Company vehicle.
Product Differences	
• Long term – up to 30 years • Monthly payment typically represents a large percent of the borrower's income	• Typically not greater than 72 months • Monthly payment represents a smaller percent of the borrower's income
• Complex contract. Many variations and product features	• Simple contract. Most car financing is "plain vanilla", equal monthly payments with little product variation
• Home values are subject to speculative bubbles, and were financed assuming prices would at a minimum hold their value and in certain cases to appreciate.	• Financed cars and trucks are reliable collateral that are not subject to speculation. The original financing and ABS structures assume they will depreciate in value.

• The underlying collateral of mortgage ABS is not liquid. Real estate markets often experience periods of illiquidity and mortgage servicers sometimes retain foreclosed properties in hope of greater recoveries. • Foreclosing on properties is a difficult and time consuming process involving extensive documentation.	• The underlying collateral of auto ABS is very liquid. Nation-wide auto auction markets function quickly and efficiently. Approximately 40 million used cars are sold annually, with about 10 million sold at auctions. Given the depreciating asset, there is strong incentive to liquidate the collateral quickly. • Repossessing the vehicle is a relatively easy and quick process.
ABS Transaction Differences	
• Mortgage based investment products became progressively more complex and the ability for investors to understand or model these transaction was limited. As a result, investors relied on rating agencies for much of their due diligence. • A typical RMBS transaction was highly structured, and could have 20 - 30 classes of securities in which the entire interest was sold.	• Ford Credit's ABS structures are straight forward and have remained consistent for years. Including features such as sequential pay, limited number of note classes, ample excess spread, and equity tranche retention. • The rebound in the auto ABS market (in sharp contrast to RMBS) is proof of the soundness of auto ABS structures.
• Some transactions actually reduce enhancement over time. Others altered priority of payments under certain adverse conditions, to the detriment of investors.	• The typical auto ABS transaction will build enhancement over time
• Some intermediaries hedged against their holdings by buying credit default swaps (CDS) on mortgage related products.	• Captive finance companies typically only hedge interest rate or currency exchange rate risk as necessary. Our transactions are generated to facilitate financing—never to speculate on the markets.
• Many mortgage products relied on consumers' ability to absorb interest rate shocks and changes in market value of the underlying asset.	• Our public/Rule 144A retail ABS programs have always been based on fixed rate equal monthly payment arrangements. • For the consumer, honoring auto payments often rank very high, because they need a car to get to their job, and for day-to-day living (in bankruptcy proceedings auto loans are frequently reaffirmed for these reasons).