

Please note that the comments expressed herein are solely my personal views

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- **12 CFR Part 244**
- **Docket No. R-1411**
- **Credit Risk Retention**

Dear Jennifer Johnson.

Thank you for giving us the opportunity to comment on your proposed rule: Credit Risk Retention.

The OCC, Board, FDIC, Commission, FHFA, and HUD (the Agencies) are proposing rules to implement the credit risk retention requirements of section 15G of the Securities Exchange Act of 1934 (15 U.S.C. § 78o-11), as added by section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). Section 15G generally requires the securitizer of asset-backed securities to retain not less than five percent of the credit risk of the assets collateralizing the asset-backed securities. Section 15G includes a variety of exemptions from these requirements, including an exemption for asset-backed securities that are collateralized exclusively by residential mortgages that qualify as “qualified residential mortgages” (QRM), as such term is defined by the Agencies by rule, and lower requirements for securitized commercial loans, commercial real estate loans and consumer automobile loans if the loans meet certain underwriting standards established by the banking agencies.

I generally support the proposals, which are long overdue. I agree with their main objectives, which are to align incentives with risk and information, and to improve transparency and confidence in ABS markets. These proposals build on and expand earlier provisions relating to certain ABS, and in total, should promote confidence and integrity in ABS markets.

The proposals are generally rules-based. Whilst this has the advantage of a certain objectivity and measurability, it does raise the possibility that securitizers will play the rules, by changing structures and forms, or via loopholes in the proposals. I would prefer a stronger principles-based approach, such that securitizers would have to retain at least 5% of the

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credit risk of the assets underlying the securities full stop, rather than merely comply with these point-in-time proposed rules.

Definition of sponsor and originator

I agree with the proposed definitions here. I also agree that the risk retention requirements should apply to the sponsor and not to the depositor. In answer to specific question number 7, where two or more entities each meet the definition of sponsor for a single securitization transaction, all sponsors should be required to retain credit risk in some proportional amount. This would prevent multiple sponsors from manipulating the credit risk retention requirements in their favour, to the detriment of investors.

Retention methods

All of the proposed retention methods meet the requirement that the sponsor retain an economic interest equal to at least five percent of the aggregate credit risk of the assets collateralizing an issuance of ABS. However, I think you have laboured the point regarding the representative sample method. In answer to specific question number 47, this is not a suitable alternative as a risk retention option, as it is open to manipulation and is difficult to audit. How would the sponsor use a "random selection process" to identify those loans from within the designated pool that will be included in the representative sample? This is not as simple as pulling numbers out of a hat. How should the "material characteristics" be chosen and defined? What is the null hypothesis and the assumed distribution? I would welcome further definitions and guidance here.

I strongly agree that there should be limitations on hedging, financing and transferring the retained risks. This would help to ensure that sponsors maintain "skin in the game", which is the intention of the proposals.

Premium capture cash reserve account

I agree that sponsors should be subject to additional risk retention requirements if they seek to capitalize or monetize excess spreads. This is basic economic theory. Capitalizing excess spreads is not prudent, market consistent, or realistic. Such risk premia should be accounted for as they are earned, and not anticipated in advance, otherwise the sponsor is effectively misrepresenting the economic substance of the ABS, usually by undervaluing its risk.

Qualified residential mortgages

I believe that there is scope for reduced credit risk retention requirements for ABS collateralized solely by low risk assets. However, we must be careful when defining what constitutes "low risk" here. The proposals employ such wordings as "lower risk of default" "sufficient credit quality", and "very high credit quality", when defining QRM, which is at first meaningless. The proposals then state that:

A substantial body of evidence, both in academic literature and developed for this rulemaking, supports the view that loans that meet the minimum standards established by the Agencies have low credit risk even in stressful economic environments that combine high unemployment with sharp drops in house prices.

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I find this statement contentious and backwards looking. In any event I do not agree with all of the proposed eligibility criteria¹, particularly the maximum loan-to-value ratio of 80%, which is far too optimistic. I would propose that the eligibility criteria should be strengthened in order that QRM should genuinely be expected to be of very high credit quality, even under stress and shock conditions.

In summary, I welcome and support your proposed rule. I would only recommend that clarification and guidance should be provided for some of the subjective issues, and that the eligibility criteria for QRM should be strengthened, so that they genuinely would be expected to be of very high credit quality.

Yours faithfully

Chris Barnard

¹ However I fully support that the loan must be secured by a perfected first lien on the property, the conditions on payment terms and that the maximum interest rate that could be charged during the first five years of the loan should be used for calculating interest payments.