EFC Education Finance Council

October 30, 2013

Office of the Comptroller of the Currency Legislative and Regulatory Activities Division
400 7th Street, SW
Suite 3E-218, Mail Stop 9W-11
Washington, DC20219
Docket Number OCC-2013-0010

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

Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC20429
Attn.: Comments, Robert E. Feldman,
Executive Secretary
RIN 3064-AD74

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

Federal Housing Finance Agency
Constitution Center, (OGC) Eighth Floor
400 7th Street SW
Washington, DC20024
Attn.: Alfred M. Pollard, General Counsel
Comments/RIN 2590-AA43

Department of Housing and Urban Development
Office of General Counsel
Regulations Division
451 7th Street, SW
Room 10276
Washington, DC20410-0500
RIN 2501-AD53

RE: Credit Risk Retention

Ladies and Gentlemen:

The Education Finance Council (EFC) is the national trade association representing nonprofit and state agency student loan and higher education assistance organizations. These public purpose student loan providers were created with the sole purpose of making college more affordable.

EFC appreciates the opportunity to comment on the agencies' joint re-proposed rule to implement the credit risk retention requirements of section 15G of the Securities and 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. EFC supports the principle that securitizers should retain an appropriate amount of credit risk in order to ensure that the interests of securitizers and investors are aligned. However, the re-proposed rules fail to recognize the unique underlying characteristics and structures of nonprofit public purpose student loan issuers which align their interests with investors and consumers. Accordingly, EFC makes the following recommendations:

- All nonprofit public purpose student loan providers should be exempt from credit risk retention requirements.
- The exemption for issuers of qualified scholarship funding bonds should not require such bonds to be tax-exempt.
- If all nonprofit public purpose student loan providers are not exempt, risk already retained in their student loan securitizations should count toward credit risk retention requirements.

All nonprofit public purpose student loan providers should be exempt from credit risk retention requirements.

EFC disagrees with the agencies' statement in the re-proposed rules that "nonprofit student lending differs little from for-profit student loan lending and that there does not appear to be anything inherent in the underwriting practices on nonprofit student loan lending to suggest that these securitizations align interests of securitizers with interests of investors so that an exemption would be appropriate." The public purpose definition of nonprofit student loan organizations, the unique structure of deals issued by nonprofit entities, and the history of investor interest in nonprofit issuance reflect the strong alignment of investor interests and nonprofits' securitization transactions.

<u>Definition of Nonprofit Issuers vs. For-Profit Issuers</u>

Nonprofit student loan providers are fundamentally distinct from for-profit issuers. Nonprofit student loan providers are organized under section 501(c)(3) of the Internal Revenue Code (the Code), which requires the provider to be both organized and operated exclusively for exempt purposes set forth in section 501(c)(3), and none of its earnings may inure to any private shareholder or individual. Included in the exempt purposes is the advancement of education. Each nonprofit student loan organization operates under the Code's requirements providing comfort to investors that no funds generated by student loans may be used for the private benefit of any officer or director of the company. This is in stark contrast to the mandate of for-profit companies which is to generate revenue and maximize shareholder value.

In addition, most 501(c)(3) issuers are protected under the Bankruptcy Code as "a corporation that is not a moneyed, business, or commercial corporation"[1] due to the fact that their activities are limited to educational, charitable, or other similar activities to fulfill the purpose for which the 501(c)(3) was formed. Conversely, for-profit student loan ABS securitizers that are corporations, partnerships, statutory trusts, or limited liability companies are subject to voluntary and involuntary bankruptcy proceedings under chapter 7 or 11 of the Bankruptcy Code. Bankruptcy protection will be discussed further in the following section.

[1] See, e.g., 11 U.S.C 303(a) pertaining to involuntary bankruptcy cases

Structural Differences between Nonprofit and For-Profit Securitizations

The structure of nonprofit student loan issuers' securitizations is unique in that they own the underlying student loans and act as the issuing entity with respect to the asset-backed securities collateralized by those student loans. Nonprofit issuers do not use an "originate-to-distribute" business model and instead keep the underlying loans in a securitization on their balance sheets, effectively retaining all of the risk of the transaction and inherently satisfying the 5% credit risk retention requirement.

Pursuant to Section __.3(a), the "sponsor" of a securitization transaction (or a majority owned affiliate of the sponsor) is required to comply with the risk retention requirements set forth in the re-proposed rule. The re-proposed rule defines sponsor as "a person who organizes and initiates a securitization transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuing entity." A key feature included in this definition is that an entity *sale* or *transfer* assets directly or indirectly to the issuing entity. Direct issue revenue bonds that do not include selling or transferring assets to an issuing entity do not have a "sponsor", and, therefore, should not be subject to require risk retention. If a nonprofit student loan provider defaults on its obligation to make payments to investors, its own assets (i.e., the securitized student loans) are subject to foreclosure under the related securitization indenture. In contrast, for-profit student loan securitizers and sponsors of securitizations backed by RMBS, auto loans, credit cards and other traditional asset classes use transaction structures in which the sponsor sells the securitized assets, directly or indirectly, to the issuing entity for cash or other forms of consideration, thereby leaving the issuing entity, rather than the sponsor, as the party with "skin in the game."

Moody's Investors Service analyzes bankruptcy risks of for-profit corporations seeking to securitize student loans "the same as the approach taken in securitization of other assets...since the credit risk implications to investors are similar to other asset types."[2] Moody's notes under a typical structure used by a private for-profit student loan-backed securities (SLBS) issuer, "Student loans are sold to a bankruptcy-remote SPV [special purpose vehicle] and then are transferred or pledged to a trust or other entity which issues SLBS." Conversely, "State agency originators issue SLBS as 'limited recourse debt obligations' backed by a pool of student loans. The issuer grants an indenture trustee a security interest in the student loan assets, but there is no sale or transfer of the loans." Nonprofit SLBS issuers "use a legal structure that is similar to that employed by state agency issuers. An indenture provides for the issuance of limited recourse bonds which are secured by an interest in student loan assets."

While SPVs are used to protect investors against bankruptcy risk, Kutak Rock LLP notes that "In analyzing debt offerings by 501(c)(3) issuers, rating agencies generally conclude the risk of a voluntary bankruptcy filing by these issuers is limited, in part, because the activities of the issuers are restricted to their 501(c)(3) charitable, educational or other nonprofit purposes. The rating agencies have focused on

[2] Moody's Investors Service, Structured Finance Special Report, "Bankruptcy Risk Analysis in Student Loan Backed Securities Structures: Moody's Approach," October 2, 1998.

another feature of the Bankruptcy Code that protects these issuers against becoming the subject of a bankruptcy proceeding. Under Section 303(a) of the Bankruptcy Code, an involuntary bankruptcy case may not be commenced against 'a corporation that is not a moneyed, business, or commercial corporation.'"[3] In its 1998 analysis, Moody's cited, "In the 17 year history of student loan transactions, there has been no known case of a nonprofit seeking voluntary bankruptcy protection." This fact remains true to this day.

History of Investor Interest

Investors are more comfortable with student loan bonds issued by nonprofit entities and tend to view for-profit deal structures as riskier than those of nonprofits, evidencing the alignment of nonprofit securitization transactions and investor interests. Many nonprofit issuance is A or AA-rated with a starting parity between 105% and 115%; while for-profit deals are all AAA-rated with a starting parity between 120% and 130%. Nonprofit deals with slightly lower ratings and starting parity are able to go to market because investors are traditionally more comfortable with nonprofit issuers given the unique on-balance sheet structure of the deals and characteristics of the issuer as previously discussed.

Alignment of Nonprofit Alternative Student Loan Programs and Consumer Interests

The unique structure of nonprofit student loan issuers and the history of investor interest in their products allow them to offer consumer-friendly alternative loan programs with flexible terms, low-cost rates, and borrower benefits to help students affordably fund the gap between federal student loans, scholarships, grants and the rising costs of college.

Nonprofit and state agencies provide in-depth counseling to borrowers to help them understand and manage their loan responsibilities as well as flexible repayment options to ease the burden for those experiencing economic hardship. These lenders offer six-month grace periods along with forbearances and deferments ranging from three months to eight years for half-time or greater enrollment in college; internship or residency programs; VISTA, Peace Corps, or AmeriCorps participation; hardship; unemployment; maternity; military duty; and medical issues. Regarding flexibility of repayment, nonprofit and state agencies offer options such as extended repayment terms for defaulted loans or borrowers experiencing long-term economic hardship; loan consolidation plans; and temporary reduced payment plans and graduated repayment plans comparable to the federal Income Based Repayment (IBR) and Income Contingent Repayment plans. For example, one lender uses the same calculation as the federal IBR program to offer their own IBR plan. One lender provides short-term and long-term relief repayment plans for borrowers who are delinquent. Under these plans, borrowers are allowed to make only a fraction of their payments for an extended period of time, some delinquent payments are forgiven, or interest not covered by the lower payments is forgiven.

[3] Kutak Rock LLP, Structured Finance Memorandum, "Comparisons of Bankruptcy Considerations for Issuers of Student Loan Debt," March 29, 2011.

The consumer-friendly terms, extensive borrower outreach, and flexibility of nonprofit and state agencies' alternative student loan programs had led to low default rates ranging from 0.5% to 3%—an average of about half the default rate of for-profit lenders' programs—creating reliable cash-flows for investors, affordable loans for consumers, and sustainable securitizations for issuers.

The exemption for issuers of qualified scholarship funding bonds should not require such bonds to be tax-exempt.

Section 15G(c)(1)(G)(iii) of the Exchange Act requires the Agencies to provide an exemption for "qualified scholarship funding bonds" as defined in Section 150(d)(2) of the Code of 1986.[4] Pursuant to this requirement, §__.21(a)(4) of the Proposing Release provides that the risk retention requirement does not apply to "any asset-backed security that meets the definition of a qualified scholarship funding bond, as set forth in Section 150(d)(2) of the [Code]."

EFC respectfully requests that the Agencies make it clear that, in order to satisfy the qualified scholarship funding bond exemption, it is sufficient that the issuer be the type of entity described in the definition of qualified scholarship funding bond. Alternatively, a clear exemption for nonprofit public purpose student loan providers would clear up this ambiguity. The Dodd-Frank Act exemption for qualified scholarship funding bonds should not be read to require that those bonds be exempt from federal income taxation in order to be exempt from the risk retention requirement

If all nonprofit public purpose student loan providers are not exempt, risk already retained in their student loan securitizations should count toward credit risk retention requirements.

The re-proposed rule grants additional flexibility in the way in which sponsors can achieve the required 5% risk-retention. Previously, "securitization sponsors were required to hold 5% of the par value of each class of ABS interests (Vertical Retention), a 5% of par value first-loss tranche (Horizontal Retention), or an L shaped 50-50 combination of the two. The re-proposal provides flexibility to sponsors to combine Horizontal Retentions and Vertical Retentions in any proportion necessary to achieve the required risk retention percentage of 5% of the fair value of the ABS interests issued by the issuing entity." In addition, "the re-proposal has removed the premium capture cash reserve account (PCCRA) concept in exchange for changing the standard risk retention requirement from a percentage of the par value to a

[4] The term "qualified scholarship funding bond" is defined in Section 150(d)(2) of the Code as "a bond issued by a corporation which – (A) is a corporation not for profit established and operated exclusively for the purpose of acquiring student loan notes incurred under the Higher Education Act of 1965, and (B) is organized at the request of the State or 1 or more political subdivisions thereof or is requested to exercise such power by 1 or more political subdivisions and required by its corporate charter and bylaws, or required by State law, to devote any income (after payment of expenses, debt service and the creation of reserves for the same) to the purchase of additional student loan notes or to pay over any income to the United States."

percentage of the fair value."[5] According to *Commercial Mortgage Alert*, the enhanced flexibility "drew qualified cheers from commercial MBS pros" since the change would "give CMBS issuers more flexibility to split up the risk-retention requirement between themselves and B-piece buyers. As expected, the revision also killed off the most-feared aspect of the original proposal: a rule that would have blocked issuers from capturing their profits up front."[6]

Nonprofit student-loan securitizers do not have other parties with whom to "split up the risk" and do not capture profits, due to their 501(c)(3) status. Given the flexibility granted to other asset classes, EFC assumes risk already retained by student loan issuers will be applied to the maximum 5% risk retention requirement. In the current market, investors and rating agencies are already demanding overcollateralized transactions, to which issuers are responding with starting parities of at least 105%--achieving the 5% requirement. Moreover, as previously discussed, since nonprofit public purpose student loan organizations do not use SPVs, they inherently retain all of the risk and achieve the risk retention requirement.

EFC requests that the agencies make clear that overcollateralization in securitization transactions and retention of the underlying assets in a securitization will be considered retained risk and be applied toward the requirements under the final rule.

The credit risk retention rule rightfully serves to align the interests of securitizers, consumers, and investors. EFC supports the goal of the agencies in implementing rules to ensure fairness, equity, and shared risk in the structured finance marketplace and believe our recommendations align with that goal and the underlying principles of the rule.

Sincerely,

Vince Sampson
President
Education Finance Council

[5] Morgan Stanley, Securitized Market Insights, "Risk Retention Re-Proposal: Implications," September 6, 2013.
[6] Commercial Mortgage Alert, "Latest Risk-Retention Proposal Eases Fears," September 6, 2013.