INVESTMENT COMPANY INSTITUTE

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July 29, 2011

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549
File Number S7-14-11
RIN 3235-AK96

Office of the Comptroller of the Currency
250 E Street, S.W., Mail Stop 2-3
Washington, D.C. 20219
Docket Number OCC 2011-0002
RIN 1557-AD40

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551
Docket Number 2011-1411
RIN 7100-AD70

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
RIN 3064-AD74

Mr. Alfred M. Pollard
General Counsel
Attention: Comments/RIN 2590-AA43
Federal Housing Finance Agency
1700 G Street, N.W., Fourth Floor
Washington, D.C. 20552

Regulations Division
Office of General Counsel
Department of Housing and Urban Development
451 7th Street, S.W., Room 10276
Washington, D.C. 20410-0500
RIN 2501-AD53

Re: Credit Risk Retention

Ladies and Gentlemen:

The Investment Company Institute[1] supports the goal of the joint proposal of the Securities and Exchange Commission ("SEC" or "Commission"), Office of the Comptroller of the Currency

[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $13.3 trillion and serve over 90 million shareholders.

("OCC"), Board of Governors of the Federal Reserve System ("Federal Reserve"), Federal Deposit Insurance Corporation ("FDIC"), Federal Housing Finance Agency, and Department of Housing and Urban Development (together, the "Agencies") to better align the interests of securitizers of asset-backed securities ("ABS") with those of investors in ABS. The proposal would implement the credit risk retention requirements of Section 15G of the Securities Exchange Act of 1934 ("Exchange Act"), as added by Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), generally to require an ABS sponsor to retain not less than five percent of the credit risk of any asset that the sponsor, through the issuance of the ABS, transfers, sells, or conveys to a third party.[2] As purchasers of ABS, registered investment companies ("funds") have a strong interest in ensuring that securitizers of ABS act consistently with the interests of investors.[3]

We are concerned, however, that the proposed standards for risk retention may not be appropriate or necessary for certain classes of ABS in which funds invest. We commend the Agencies for recognizing that ABS have diverse characteristics and for seeking to tailor the proposed risk retention requirements based on the characteristics of different ABS. We do not believe, however, that the proposed requirements sufficiently reflect differences among certain classes of ABS or market practice for those particular securities.[4] This is particularly so with respect to notes issued by asset-backed commercial paper ("ABCP") programs and securities issued by municipal tender option bond ("TOB") programs. In addition, we are concerned that certain of the standards proposed with respect to mortgage-backed securities ("MBS"), in particular commercial mortgage-backed securities ("CMBS"), may impair the viability of those markets – a result in the best interests of neither investors, including funds, nor the individuals and firms that obtain financing through those markets. Finally, we support a "qualified residential mortgage" ("QRM") standard under the proposed exemption from the risk retention requirements for residential mortgage-backed securities ("RMBS") that are backed solely by very high quality loans, although our members have somewhat different views regarding the appropriate QRM standard.

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[2] *Credit Risk Retention,* Securities Exchange Act Release No. 64148 (March 30, 2011), available at http://www.sec.gov/rules/proposed/2011/34-64148.pdf ("Release").

[3] Funds also have an interest in strong disclosure standards for ABS, and we have, in the past, supported the Commission's efforts to improve disclosure and reporting for ABS. *See* Letter from Karrie McMillan, General Counsel, ICI, to Elizabeth M. Murphy, Secretary, SEC, dated Nov. 15, 2010; Letter from Karrie McMillan, General Counsel, ICI, to Elizabeth M. Murphy, Secretary, SEC, dated Aug. 2, 2010.

[4] As Congress stated in the legislative history for Section 15G of the Exchange Act, "a 'one size fits all' approach to risk retention may adversely affect certain securitization markets . . . . Accordingly, the bill requires that the initial joint rulemaking include separate components addressing individual asset classes -- home mortgages, commercial mortgages, commercial loans, auto loans, and any other asset class that the regulators deem appropriate. The Committee expects that these regulations will recognize differences in the assets securitized, in existing risk management practices, and in the structure of asset-backed securities, and that regulators will make appropriate adjustments to the amount of risk retention required." S. Rep. No. 111-176, at 130 (2010).

We address each of the foregoing concerns in turn below.

I. Asset-Backed Commercial Paper Programs

The proposal includes a risk retention option specifically designed for ABCP programs that meet certain conditions.[5] We appreciate the Agencies' recognition that this instrument has unique characteristics, and recognize that the Agencies have sought to make this option consistent with existing market practice.[6] We understand, however, that most existing ABCP programs could not meet the proposed rule's conditions.[7] We therefore recommend, in lieu of the ABCP risk retention option, that the Agencies exclude or exempt from the proposal's risk retention requirements[8] those bank-sponsored ABCP programs that meet certain criteria, which we believe reflect the alignment of interests Section 15G of the Exchange Act was intended to achieve, or deem such programs to comply with the risk retention requirements.[9]

A. Background

ABCP programs are short-term, senior-secured investment vehicles that issue instruments in the money markets. They are used by a wide variety of corporations – such as banks, finance companies, and broker-dealers – to obtain low-cost financing for a diverse range of financial receivables.

ABCP is offered continuously and carries repayment dates that usually range from overnight up to 270 days. ABCP programs are referred to as "asset-backed" because the bankruptcy remote, special-purpose vehicles that issue the ABCP own, or have security interests in, multiple pools of various types of financial receivables.

ABCP programs typically are supported by credit enhancement and committed liquidity facilities. The liquidity support for an ABCP program typically equals the face amount of ABCP outstanding, to protect investors in case of a market interruption or any timing differences with respect

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[5] Proposed Rule § ____.9.

[6] Release at 41.

[7] *See, e.g.,* Letter from Tom Deutsch, Executive Director, American Securitization Forum, to the Agencies, dated June 10, 2011, at 99-101, *available at* http://www.sec.gov/comments/s7-14-11/s71411-57.pdf.

[8] Section 15G of the Exchange Act states that the risk retention rules adopted by the Agencies shall provide for "a total or partial exemption of any securitization, as may be appropriate in the public interest and for the protection of investors . . ." Section 15G(c)(1)(G)(i).

[9] ABCP issued by structured investment vehicles ("SIVs") and securities arbitrage ABCP programs experienced significant difficulties during the credit crisis. Generally, we do not suggest that these types of programs be excluded from or exempt from the risk retention requirements or eligible for the ABCP risk retention option under the proposed rules.

to repayment.[10] For ABCP programs referred to as "fully supported," the liquidity facilities can be drawn to fund all of the receivables held by the program, even if some of those receivables are deemed to be "defaulted." For "partially supported" ABCP programs, the liquidity facilities will fund only "performing" receivables, *i.e.*, those not deemed to be in default. As a means of offsetting this potential source of risk, partially supported programs have credit enhancement facilities at both the pool level[11] (supporting individual transactions, often in the form of overcollateralization) and at the program level.[12] Generally, investors analyze ABCP transactions primarily on the strength of the ABCP program sponsor and of these programs' credit and liquidity arrangements, and less on the receivables being financed.

B. Bank-Sponsored ABCP Programs Should Not be Subject to Additional Risk Retention Requirements

We believe that the alignment of incentives between originator and investor that is sought by the Dodd-Frank Act largely has been achieved for bank-sponsored ABCP programs. Accordingly, it is unnecessary to impose additional risk retention requirements on these programs. On January 28, 2010, regulators including the Federal Reserve, the OCC, and the FDIC adopted a rule that requires banks sponsoring ABCP programs to consolidate ABCP conduits onto their balance sheets, aligning regulatory capital requirements with changes to generally accepted accounting principles.[13] This rule reflects the banking regulators' acknowledgement that risk exposure in ABCP programs generally is borne by the regulated bank sponsor, which must reserve adequate capital to cover any such risk.[14] We believe this alignment of interest that exists in bank-sponsored ABCP programs is an important prerequisite for an ABCP program to be exempted or excluded from, or deemed to comply with, the proposal's risk retention requirements. We also recommend the following as criteria to identify those bank-sponsored ABCP programs that are uniquely structured to provide safeguards to investors and the marketplace. We believe these criteria align the interests of sponsors with those of investors, consistent with the policy objectives of Section 15G of the Exchange Act, such that imposing additional risk

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[10] In the event that maturing ABCP cannot be refunded in the money markets, the administrator of the program (which is often the financial institution sponsoring the program) will draw upon the liquidity facilities in an amount sufficient to redeem all maturing ABCP.

[11] In some cases, the amount of pool-level credit enhancement for a given transaction is set dynamically, in that it increases to offset deteriorating pool performance.

[12] Program-level credit enhancement is often in the form of a letter of credit or a cash collateral account, effectively providing a five to ten percent subordinated cushion for the ABCP.

[13] *Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance; Regulatory Capital; Impact of Modifications to Generally Accepted Accounting Principles; Consolidation of Asset-Backed Commercial Paper Programs; and Other Related Issues,* 75 FR 4636 (Jan. 28, 2010).

[14] *Id.* at 4643.

retention requirements would be unnecessary. The criteria are the following:

(i) the sponsoring institution is a regulated banking institution;

(ii) the issuing entity is bankruptcy remote;

(iii) regulated liquidity providers have entered into a legally binding commitment to provide 100 percent liquidity coverage for all issued ABCP, at least 95 percent of which is provided by the sponsoring institution;

(iv) at least five percent program-wide, first loss credit enhancement is provided by the sponsoring institution of any partially-supported ABCP conduit in the form of an irrevocable and unconditional letter of credit, cash collateral, guarantee or other similar facility, or no credit enhancement is required for any fully-supported ABCP conduit; and

(v) monthly investor performance reports that include loan level detail are provided on a timely basis.

These criteria align the incentives of the sponsor and investors by ensuring that the risk of the ABCP conduit remains with the bank sponsor, and that the sponsor is responsible for substantially all of the liquidity and a key portion of any credit support for the conduit. In addition, the monthly investor reports provide an important monitoring mechanism. According to an assessment of this criteria performed by a rating agency for one of our members, the criteria would capture approximately 70 percent of the ABCP market in the United States. Importantly, the criteria would exclude SIVs, as well as those securities arbitrage programs that are not sponsored by a regulated banking institution and do not have available liquidity equal to at least the amount of ABCP outstanding.

We therefore request that the Agencies exclude or exempt bank-sponsored ABCP programs that meet these strict criteria from the proposed risk retention requirements, or deem these programs to satisfy the risk retention requirements. If, on the other hand, the Agencies adopt the proposed rules as written, it will be very difficult for existing ABCP programs to meet the conditions of the proposed risk retention option for ABCP programs. This will cause ABCP lending to slow significantly, and negatively affect both businesses seeking funding through this financing method and investors in ABCP.

Should the Agencies conclude that imposing further risk retention requirements on bank-sponsored ABCP programs is appropriate, we urge you to redefine the parameters for the proposed ABCP risk retention option, based on comments received, to better reflect current market practice and existing ABCP structures. For example, while originator-seller horizontal risk retention is a method that would work for certain ABCP programs, we believe that other risk retention methods should also

be permitted as part of the ABCP risk retention option. Such methods should include those otherwise permitted under the proposed rules, as well as credit enhancements that serve an analogous function to the risk retention requirements, such as letters of credit and cash collateral accounts, which are standard in the market.

II. Municipal Tender Option Bond Programs

The proposal is silent regarding municipal TOBs. We request clarification that TOBs are not within the scope of the proposal or, alternatively, that they be exempted from its requirements.[15] Although TOBs have certain features that are similar to those of ABS, market participants generally do not perceive TOBs as ABS. Nor do we believe that TOBs raise the concerns that Congress intended to address when it enacted Section 15G of the Exchange Act. The structural characteristics of TOB programs would make it difficult for their sponsors to satisfy the proposed risk retention requirements. If TOB sponsors were forced to restructure their programs significantly to comply with the proposed rules' requirements, the increase in the cost of TOB program sponsorship could adversely affect the state and local governments that indirectly receive funding through these programs.

A. Background

A municipal TOB program is created by a sponsor bank that deposits one or more high-quality municipal bonds into a trust which issues two classes of tax-exempt securities: a short-term security (the "floater") that is supported by a liquidity facility and an inverse floating rate security (the "residual").[16] The floater is a variable-rate demand security that bears interest at a rate adjusted at specified intervals (daily, weekly, or other intervals up to one year) according to a specific index or through a remarketing process. The liquidity facility supports a "put" or demand feature, allowing the floater holder to tender the security and receive, with specified notice, face value plus accrued interest, typically either from remarketing proceeds or a draw on the liquidity facility.[17] Floater holders bear limited and well-defined insolvency and default risks associated with the underlying bonds, and rely upon their largely unfettered put right to manage these risks. Tax-exempt money market funds are the principal holders of the floaters. The residuals generally are held by the entity that selects the underlying municipal bonds that serve as collateral for the trust. Holders of residuals are typically long-term investors, such as the TOB program sponsor bank or an affiliate, tax-exempt bond funds, closed-end funds, or other institutional investors in municipal bonds. Residual holders receive all interest

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[15] *See supra* note 8.

[16] TOBs generally are structured with a single long-term municipal bond in the trust but they may be structured with a pool of long-term municipal bonds.

[17] The liquidity facility is subject to termination upon certain major credit events affecting the issuer of the underlying municipal bonds (such as bankruptcy and ratings falling to below investment grade). Under these circumstances, the TOB trust would be collapsed and the floater holders would be paid from the sale of the collateral, or would receive the collateral if such proceeds were not sufficient to pay the holders in full.

payments from the underlying bonds that are not needed to pay interest on the floaters and expenses of the trust. Due to the operation of the liquidity facility, which provides holders of the floaters par amounts plus accrued interest upon demand, the residual holder bears all of the market risk associated with the TOB trust. Accordingly, the residual holder has a significant incentive to ensure that the underlying municipal bonds are of high credit quality.

B. TOBs Are Not the Types of Securities Section 15G Was Intended To Address

We do not believe that Congress, in enacting Section 15G, intended that the risk retention requirements apply to securitizations backed by municipal securities, such as TOBs. The legislative history indicates that Section 15G was directed toward securities generally considered by market participants to be traditional ABS, and especially toward mitigating risks associated with ABS backed by mortgages.[18]

TOBs have many features that distinguish them from the types of securities that 15G was intended to address. For example, the underlying collateral in a TOB trust is limited to municipal bonds, which have very different characteristics than the privately negotiated loans and trade receivables that serve as collateral for many types of ABS. These municipal bonds are of high quality, are typically rated in the top two long-term rating categories of nationally recognized statistical ratings organizations, and generally are publicly traded. In addition, a TOB trust typically holds securities of only one municipal issuer for which information is publicly available, resulting in greater transparency than in a typical ABS transaction. TOB trusts do not utilize tranching, and therefore have a simpler and more transparent structure than typical ABS.

Importantly, TOB programs are designed to create a short-term security with the same credit characteristics as the underlying long-term collateral. In fact, investors in TOB floaters and residuals consider themselves to be co-investors in the underlying bonds which collateralize a TOB trust for both credit quality and diversification purposes. This contrasts with typical ABS, in which the investor considers itself to be holding the trust for credit quality and diversification purposes. Unlike typical ABS programs, which are characterized by significant diversity in structures, TOB programs generally have the same basic structure. The TOB trust documentation extensively describes the program's

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[18] *See* S. Rep. No. 111-176, at 128 (2010) ("The Committee's investigation into the causes of the financial crisis identified abuses of the securitization process as a major contributing factor. Two problems emerged in the crisis. First, under the 'originate to distribute' model, loans were made expressly to be sold into securitization pools, which meant that the lenders did not expect to bear the credit risk of borrower default. This led to significant deterioration in credit and loan underwriting standards, particularly in residential mortgages . . . . Second, it proved impossible for investors in asset-backed securities to assess the risks of the underlying assets, particularly when those assets were resecuritized into complex instruments like collateralized debt obligations (CDOs) and CDO-squared. With the onset of the crisis, there was widespread uncertainty regarding the true financial condition of holders of asset-backed securities, freezing interbank lending and constricting the general flow of credit. Complexity and opacity in securitization markets created the conditions that allowed the financial shock from the subprime mortgage sector to spread into a global financial crisis . . .").

structure and the obligations of each of the trust's participants (*i.e.*, liquidity provider, remarketing agent, trustee), as well as information regarding the underlying collateral in the trust. Indeed, each trust is individually rated with a long-term rating based on the credit quality of the collateral and a short-term rating based on that of the liquidity provider, unlike typical ABS which are rated on the basis of the program's over-collateralization and generalized characteristics of the entire pool of collateral.

Neither Section 15G of the Exchange Act nor the proposal mentions TOBs, suggesting neither Congress nor the Agencies intended TOBs to be subject to the proposed risk retention requirements.[19] The exemption in Section 15G for ABS issued or guaranteed by states or local governments and the Agencies' proposed implementation of this exemption support the view that Congress did not intend to capture these and other municipal repackagings in Section 15G.[20] The Agencies specifically request comment in the proposal regarding whether their proposed exemption is under or over-inclusive.[21] We strongly believe it is under-inclusive, and that the Agencies should use their authority under Section 15G to exempt from the risk retention requirements municipal repackagings, such as TOBs, that are collateralized by one or more securities of the type described in proposed Rule § ____.21(a)(3).[22]

C. Applying the Proposed Risk Retention Requirements to TOBs is not in the Public Interest

As noted, TOB trusts, because they purchase and hold longer-term debt, are an important source of demand for state and local government bonds. It would be very difficult for TOB sponsors to meet the proposal's risk retention standards, due to the structural characteristics of TOB programs, which differ from the types of ABS the proposal clearly is intended to address. As a result, imposing risk-retention rules on TOB program sponsors would raise the costs of TOB program sponsorship. This would likely cause the demand for TOB issuance to decrease, potentially raising the costs of financing to state and local governments at a time when their finances are already under stress.

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[19] As additional support, we note that the Federal Reserve's October 2010 report to Congress on risk retention, which was mandated by the Dodd-Frank Act and offers suggested alternatives for rulemaking under Section 15G, considers approaches for a range of different types of ABS, but makes no mention of TOBs or other municipal repackagings. Federal Reserve, *Report to the Congress on Risk Retention* (Oct. 2010), available at http://www.federalreserve.gov/boarddocs/rptcongress/securitization/riskretention.pdf.

[20] Section 15G states that the Agencies' risk retention rules shall provide for "a total or partial exemption for any asset-backed security that is a security issued or guaranteed by any State of the United States, or 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 of 1933 by reason of section 3(a)(2) of that Act . . ." Section 15G(c)(1)(G)(iii). To implement this requirement, the Agencies have proposed an exemption from the risk retention requirements for municipal securities. Proposed Rule § ____.21(a)(3).

[21] Release at 105.

[22] Section 15G(c)(1(G)(i).

Subjecting sponsors of TOB trusts to the proposed risk retention requirements is unnecessary to achieve the Agencies' regulatory objectives. It could also significantly reduce the availability of TOBs for tax-exempt money market funds and closed-end funds, and disrupt the operations of long-term bond funds that invest in the residuals. For all of these reasons, we request confirmation that TOB programs are outside the scope of the proposal or will be exempted from the proposal's risk retention requirements.

III. Mortgage-Backed Securities

Funds invest in a variety of MBS, including agency MBS (*i.e.*, MBS guaranteed by the Federal National Mortgage Association ("Fannie Mae") or the Federal Home Loan Mortgage Corporation ("Freddie Mac")); RMBS; and CMBS. ICI, on behalf of its members, supports maintaining a strong securitization market for MBS that is subject to high, clearly defined standards. At the same time, we believe it is important for the Agencies, in tailoring the proposed risk retention requirements to different types of MBS, to be mindful of the consequences of adopting standards that are overly restrictive or do not adequately reflect current market practice.

A. Residential Mortgage-Backed Securities

Section 15G provides that the Agencies' risk retention requirements shall not apply to RMBS that are collateralized solely by QRMs.[23] Section 15G includes specific standards that the Agencies must consider in jointly defining what constitutes a QRM. ICI, on behalf of its members, supports a QRM standard that would exempt from the risk retention requirements only RMBS backed by very high quality loans. Some of our members support the Agencies' QRM standard as proposed, and believe that only the highest quality mortgages should qualify under the standard. Other members, however, are concerned that the Agencies' proposed standard may be somewhat too restrictive and could have negative implications for mortgage financing to credit-worthy households. They are concerned that an excessively strict QRM standard could result in a lack of liquidity in the QRM market, which would discourage participation in the market by investors, including funds, and, as a result, further limit mortgage funding.

[23] Section 15G(e)(4).

B. Commercial Mortgage-Backed Securities

Section 15G of the Exchange Act states that, with respect to CMBS, the Agencies may provide for a special risk retention option in which a five percent horizontal, first-loss position is held by a third-party purchaser, if certain specified conditions are met.[24] The Agencies have implemented this provision by proposing a rule that would permit a CMBS sponsor to satisfy its risk retention obligation if a third-party purchaser acquires such an interest, subject to certain conditions.[25] This option accurately reflects the common market practice of allocating the first-loss position in a CMBS transaction to a third-party purchaser, typically known as the "B-piece buyer." Certain funds that invest in CMBS may buy the B-piece and could, under the proposed rule, potentially be a third-party purchaser. Our members that manage funds that may serve in this role have concerns that certain aspects of how the risk retention option for CMBS would operate may discourage or preclude funds from serving in the role of third-party purchaser, as well as have detrimental implications for the operation of the CMBS markets as a whole, with consequences both for investors in those markets and the businesses that obtain funding through those markets.

One of the conditions of the proposed rule is that a third-party purchaser may not sell or hedge the interest it is required to retain under the rule.[26] While we understand this provision is intended to place the third-party purchaser in the same position as if it were the sponsor retaining the same horizontal, first-loss risk retention position,[27] requiring the B-piece buyer to retain its interest for the life of the transaction would strongly discourage funds from purchasing these interests. In lieu of requiring the B-piece buyer to retain its interest for the life of the transaction, we recommend that the Agencies propose the following tiered approach: (i) require the B-piece buyer to retain its interest for a one-year period in which it may not sell or hedge the interest; (ii) for the following four years, permit the B-piece buyer to transfer its interest only to a "qualified transferee" that must meet the same criteria under the rule as the B-piece buyer; and (iii) for the remainder of the transaction, not impose restrictions on transfer or hedging.

Under the Agencies' proposed CMBS option, a B-piece purchaser is intended to stand in the shoes of the sponsor for purposes of complying with the risk retention rules. Under our recommended approach, requiring the B-piece purchaser to hold its interest for a one-year period provides a sufficient amount of time to reveal whether there are any significant deficiencies or fraud in the underwriting process. Permitting transfer to a "qualified transferee" that satisfies the same criteria under the proposed rule as the B-piece buyer for the following four years seems fully consistent with the Agencies'

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[24] Section 15G(c)(1)(E).

[25] Proposed Rule § ____.10.

[26] Proposed Rule § ____.10(a)(6).

[27] Release at 47.

policy objective of including the transfer restriction in the proposed CMBS option because the qualified transferee could have served as the original B-piece buyer.[28] We believe this approach, by imposing a reasonable holding period on third-party purchasers, would address Congress' and the Agencies' concern that the securitizer or, in this case, an entity standing in its place, not be able to reduce its exposure to the credit risk of the securitized assets.[29]

Another condition of the proposed rule would require that a sponsor utilizing the CMBS risk retention option disclose to potential investors in the CMBS transaction (and to the Agencies, upon request) the identity of the third-party purchaser, provide a description of the third-party purchaser's experience in investing in CMBS, include any other information regarding the third-party purchaser or its retention of an interest in the transaction "that is material to investors in light of the circumstances of the particular securitization transaction," provide the amount of the residual interest that the purchaser will retain or has retained in the transaction, list the purchase price paid for the interest, and describe the material terms of the interest retained by the third-party purchaser, among other information.[30] We agree that a sponsor that is satisfying its risk retention obligations by means of a third-party purchaser should provide potential investors with information relating to the interest retained by that third party and therefore support most of the proposed disclosure requirements, many of which are consistent with current market practice. We believe, however, that the proposed requirement to disclose the purchase price paid for the interest should be eliminated. Such disclosure is inconsistent with market practice and requiring it would discourage investors from serving in the role of third-party purchaser. This information is typically confidential, and is unnecessary to disclose publicly, given that information would be disclosed about the amount of the interest held.

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We appreciate that tailoring risk retention requirements to reflect the diversity that exists across the ABS markets is a sizable undertaking, especially when it must be done jointly by six federal agencies. The joint nature of this rulemaking makes it all the more important, however, for the Agencies to develop workable standards for risk retention *prior* to the rules' adoption. The proposal states that the Agencies will jointly approve "any written interpretations, written responses to requests for no-action letters and legal opinions, or other written interpretive guidance concerning the scope or terms of section 15G and the final rules issued thereunder that are intended to be relied on by the

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[28] We further note that B-piece buyers are institutional buyers, and that these interests are traded only in the Rule 144A market.

[29] *See* S. Rep. No. 111-176, at 129 (2010) ("The regulations will prohibit securitizers from hedging or otherwise transferring the credit risk they are required to retain."); Release at 58.
[30] *See* proposed Rule § ____.10(a)(5).

[30] *See* proposed Rule § ____.10(a)(5).

public generally."[31] As a result, addressing any issues raised by the proposal will be even more difficult after the rules are adopted. If there is any way we may further assist the Agencies, please feel free to contact me directly at (202) 326-5815 or Sarah Bessin at (202) 326-5835.

Sincerely,

/s/

Karrie McMillan
General Counsel

cc: The Honorable Mary L. Schapiro
The Honorable Kathleen L. Casey
The Honorable Elisse B. Walter
The Honorable Luis A. Aguilar
The Honorable Troy A. Paredes

[31] Release at 17.

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Secretary
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("OCC"), Board of Governors of the Federal Reserve System ("Federal Reserve"), Federal Deposit Insurance Corporation ("FDIC"), Federal Housing Finance Agency, and Department of Housing and Urban Development (together, the "Agencies") to better align the interests of securitizers of asset-backed securities ("ABS") with those of investors in ABS. The proposal would implement the credit risk retention requirements of Section 15G of the Securities Exchange Act of 1934 ("Exchange Act"), as added by Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), generally to require an ABS sponsor to retain not less than five percent of the credit risk of any asset that the sponsor, through the issuance of the ABS, transfers, sells, or conveys to a third party.[2] As purchasers of ABS, registered investment companies ("funds") have a strong interest in ensuring that securitizers of ABS act consistently with the interests of investors.[3]

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[2] *Credit Risk Retention,* Securities Exchange Act Release No. 64148 (March 30, 2011), available at http://www.sec.gov/rules/proposed/2011/34-64148.pdf ("Release").

[3] Funds also have an interest in strong disclosure standards for ABS, and we have, in the past, supported the Commission's efforts to improve disclosure and reporting for ABS. *See* Letter from Karrie McMillan, General Counsel, ICI, to Elizabeth M. Murphy, Secretary, SEC, dated Nov. 15, 2010; Letter from Karrie McMillan, General Counsel, ICI, to Elizabeth M. Murphy, Secretary, SEC, dated Aug. 2, 2010.

[4] As Congress stated in the legislative history for Section 15G of the Exchange Act, "a 'one size fits all' approach to risk retention may adversely affect certain securitization markets . . . . Accordingly, the bill requires that the initial joint rulemaking include separate components addressing individual asset classes -- home mortgages, commercial mortgages, commercial loans, auto loans, and any other asset class that the regulators deem appropriate. The Committee expects that these regulations will recognize differences in the assets securitized, in existing risk management practices, and in the structure of asset-backed securities, and that regulators will make appropriate adjustments to the amount of risk retention required." S. Rep. No. 111-176, at 130 (2010).

We address each of the foregoing concerns in turn below.

I. Asset-Backed Commercial Paper Programs

The proposal includes a risk retention option specifically designed for ABCP programs that meet certain conditions.[5] We appreciate the Agencies' recognition that this instrument has unique characteristics, and recognize that the Agencies have sought to make this option consistent with existing market practice.[6] We understand, however, that most existing ABCP programs could not meet the proposed rule's conditions.[7] We therefore recommend, in lieu of the ABCP risk retention option, that the Agencies exclude or exempt from the proposal's risk retention requirements[8] those bank-sponsored ABCP programs that meet certain criteria, which we believe reflect the alignment of interests Section 15G of the Exchange Act was intended to achieve, or deem such programs to comply with the risk retention requirements.[9]

A. Background

ABCP programs are short-term, senior-secured investment vehicles that issue instruments in the money markets. They are used by a wide variety of corporations – such as banks, finance companies, and broker-dealers – to obtain low-cost financing for a diverse range of financial receivables.

ABCP is offered continuously and carries repayment dates that usually range from overnight up to 270 days. ABCP programs are referred to as "asset-backed" because the bankruptcy remote, special-purpose vehicles that issue the ABCP own, or have security interests in, multiple pools of various types of financial receivables.

ABCP programs typically are supported by credit enhancement and committed liquidity facilities. The liquidity support for an ABCP program typically equals the face amount of ABCP outstanding, to protect investors in case of a market interruption or any timing differences with respect

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[5] Proposed Rule § ____.9.

[6] Release at 41.

[7] *See, e.g.,* Letter from Tom Deutsch, Executive Director, American Securitization Forum, to the Agencies, dated June 10, 2011, at 99-101, *available at* http://www.sec.gov/comments/s7-14-11/s71411-57.pdf.

[8] Section 15G of the Exchange Act states that the risk retention rules adopted by the Agencies shall provide for "a total or partial exemption of any securitization, as may be appropriate in the public interest and for the protection of investors . . ." Section 15G(c)(1)(G)(i).

[9] ABCP issued by structured investment vehicles ("SIVs") and securities arbitrage ABCP programs experienced significant difficulties during the credit crisis. Generally, we do not suggest that these types of programs be excluded from or exempt from the risk retention requirements or eligible for the ABCP risk retention option under the proposed rules.

to repayment.[10] For ABCP programs referred to as "fully supported," the liquidity facilities can be drawn to fund all of the receivables held by the program, even if some of those receivables are deemed to be "defaulted." For "partially supported" ABCP programs, the liquidity facilities will fund only "performing" receivables, *i.e.*, those not deemed to be in default. As a means of offsetting this potential source of risk, partially supported programs have credit enhancement facilities at both the pool level[11] (supporting individual transactions, often in the form of overcollateralization) and at the program level.[12] Generally, investors analyze ABCP transactions primarily on the strength of the ABCP program sponsor and of these programs' credit and liquidity arrangements, and less on the receivables being financed.

B. Bank-Sponsored ABCP Programs Should Not be Subject to Additional Risk Retention Requirements

We believe that the alignment of incentives between originator and investor that is sought by the Dodd-Frank Act largely has been achieved for bank-sponsored ABCP programs. Accordingly, it is unnecessary to impose additional risk retention requirements on these programs. On January 28, 2010, regulators including the Federal Reserve, the OCC, and the FDIC adopted a rule that requires banks sponsoring ABCP programs to consolidate ABCP conduits onto their balance sheets, aligning regulatory capital requirements with changes to generally accepted accounting principles.[13] This rule reflects the banking regulators' acknowledgement that risk exposure in ABCP programs generally is borne by the regulated bank sponsor, which must reserve adequate capital to cover any such risk.[14] We believe this alignment of interest that exists in bank-sponsored ABCP programs is an important prerequisite for an ABCP program to be exempted or excluded from, or deemed to comply with, the proposal's risk retention requirements. We also recommend the following as criteria to identify those bank-sponsored ABCP programs that are uniquely structured to provide safeguards to investors and the marketplace. We believe these criteria align the interests of sponsors with those of investors, consistent with the policy objectives of Section 15G of the Exchange Act, such that imposing additional risk

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[10] In the event that maturing ABCP cannot be refunded in the money markets, the administrator of the program (which is often the financial institution sponsoring the program) will draw upon the liquidity facilities in an amount sufficient to redeem all maturing ABCP.

[11] In some cases, the amount of pool-level credit enhancement for a given transaction is set dynamically, in that it increases to offset deteriorating pool performance.

[12] Program-level credit enhancement is often in the form of a letter of credit or a cash collateral account, effectively providing a five to ten percent subordinated cushion for the ABCP.

[13] *Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance; Regulatory Capital; Impact of Modifications to Generally Accepted Accounting Principles; Consolidation of Asset-Backed Commercial Paper Programs; and Other Related Issues,* 75 FR 4636 (Jan. 28, 2010).

[14] *Id.* at 4643.

retention requirements would be unnecessary. The criteria are the following:

(i) the sponsoring institution is a regulated banking institution;

(ii) the issuing entity is bankruptcy remote;

(iii) regulated liquidity providers have entered into a legally binding commitment to provide 100 percent liquidity coverage for all issued ABCP, at least 95 percent of which is provided by the sponsoring institution;

(iv) at least five percent program-wide, first loss credit enhancement is provided by the sponsoring institution of any partially-supported ABCP conduit in the form of an irrevocable and unconditional letter of credit, cash collateral, guarantee or other similar facility, or no credit enhancement is required for any fully-supported ABCP conduit; and

(v) monthly investor performance reports that include loan level detail are provided on a timely basis.

These criteria align the incentives of the sponsor and investors by ensuring that the risk of the ABCP conduit remains with the bank sponsor, and that the sponsor is responsible for substantially all of the liquidity and a key portion of any credit support for the conduit. In addition, the monthly investor reports provide an important monitoring mechanism. According to an assessment of this criteria performed by a rating agency for one of our members, the criteria would capture approximately 70 percent of the ABCP market in the United States. Importantly, the criteria would exclude SIVs, as well as those securities arbitrage programs that are not sponsored by a regulated banking institution and do not have available liquidity equal to at least the amount of ABCP outstanding.

We therefore request that the Agencies exclude or exempt bank-sponsored ABCP programs that meet these strict criteria from the proposed risk retention requirements, or deem these programs to satisfy the risk retention requirements. If, on the other hand, the Agencies adopt the proposed rules as written, it will be very difficult for existing ABCP programs to meet the conditions of the proposed risk retention option for ABCP programs. This will cause ABCP lending to slow significantly, and negatively affect both businesses seeking funding through this financing method and investors in ABCP.

Should the Agencies conclude that imposing further risk retention requirements on bank-sponsored ABCP programs is appropriate, we urge you to redefine the parameters for the proposed ABCP risk retention option, based on comments received, to better reflect current market practice and existing ABCP structures. For example, while originator-seller horizontal risk retention is a method that would work for certain ABCP programs, we believe that other risk retention methods should also

be permitted as part of the ABCP risk retention option. Such methods should include those otherwise permitted under the proposed rules, as well as credit enhancements that serve an analogous function to the risk retention requirements, such as letters of credit and cash collateral accounts, which are standard in the market.

II. Municipal Tender Option Bond Programs

The proposal is silent regarding municipal TOBs. We request clarification that TOBs are not within the scope of the proposal or, alternatively, that they be exempted from its requirements.[15] Although TOBs have certain features that are similar to those of ABS, market participants generally do not perceive TOBs as ABS. Nor do we believe that TOBs raise the concerns that Congress intended to address when it enacted Section 15G of the Exchange Act. The structural characteristics of TOB programs would make it difficult for their sponsors to satisfy the proposed risk retention requirements. If TOB sponsors were forced to restructure their programs significantly to comply with the proposed rules' requirements, the increase in the cost of TOB program sponsorship could adversely affect the state and local governments that indirectly receive funding through these programs.

A. Background

A municipal TOB program is created by a sponsor bank that deposits one or more high-quality municipal bonds into a trust which issues two classes of tax-exempt securities: a short-term security (the "floater") that is supported by a liquidity facility and an inverse floating rate security (the "residual").[16] The floater is a variable-rate demand security that bears interest at a rate adjusted at specified intervals (daily, weekly, or other intervals up to one year) according to a specific index or through a remarketing process. The liquidity facility supports a "put" or demand feature, allowing the floater holder to tender the security and receive, with specified notice, face value plus accrued interest, typically either from remarketing proceeds or a draw on the liquidity facility.[17] Floater holders bear limited and well-defined insolvency and default risks associated with the underlying bonds, and rely upon their largely unfettered put right to manage these risks. Tax-exempt money market funds are the principal holders of the floaters. The residuals generally are held by the entity that selects the underlying municipal bonds that serve as collateral for the trust. Holders of residuals are typically long-term investors, such as the TOB program sponsor bank or an affiliate, tax-exempt bond funds, closed-end funds, or other institutional investors in municipal bonds. Residual holders receive all interest

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[15] *See supra* note 8.

[16] TOBs generally are structured with a single long-term municipal bond in the trust but they may be structured with a pool of long-term municipal bonds.

[17] The liquidity facility is subject to termination upon certain major credit events affecting the issuer of the underlying municipal bonds (such as bankruptcy and ratings falling to below investment grade). Under these circumstances, the TOB trust would be collapsed and the floater holders would be paid from the sale of the collateral, or would receive the collateral if such proceeds were not sufficient to pay the holders in full.

payments from the underlying bonds that are not needed to pay interest on the floaters and expenses of the trust. Due to the operation of the liquidity facility, which provides holders of the floaters par amounts plus accrued interest upon demand, the residual holder bears all of the market risk associated with the TOB trust. Accordingly, the residual holder has a significant incentive to ensure that the underlying municipal bonds are of high credit quality.

B. TOBs Are Not the Types of Securities Section 15G Was Intended To Address

We do not believe that Congress, in enacting Section 15G, intended that the risk retention requirements apply to securitizations backed by municipal securities, such as TOBs. The legislative history indicates that Section 15G was directed toward securities generally considered by market participants to be traditional ABS, and especially toward mitigating risks associated with ABS backed by mortgages.[18]

TOBs have many features that distinguish them from the types of securities that 15G was intended to address. For example, the underlying collateral in a TOB trust is limited to municipal bonds, which have very different characteristics than the privately negotiated loans and trade receivables that serve as collateral for many types of ABS. These municipal bonds are of high quality, are typically rated in the top two long-term rating categories of nationally recognized statistical ratings organizations, and generally are publicly traded. In addition, a TOB trust typically holds securities of only one municipal issuer for which information is publicly available, resulting in greater transparency than in a typical ABS transaction. TOB trusts do not utilize tranching, and therefore have a simpler and more transparent structure than typical ABS.

Importantly, TOB programs are designed to create a short-term security with the same credit characteristics as the underlying long-term collateral. In fact, investors in TOB floaters and residuals consider themselves to be co-investors in the underlying bonds which collateralize a TOB trust for both credit quality and diversification purposes. This contrasts with typical ABS, in which the investor considers itself to be holding the trust for credit quality and diversification purposes. Unlike typical ABS programs, which are characterized by significant diversity in structures, TOB programs generally have the same basic structure. The TOB trust documentation extensively describes the program's

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[18] *See* S. Rep. No. 111-176, at 128 (2010) ("The Committee's investigation into the causes of the financial crisis identified abuses of the securitization process as a major contributing factor. Two problems emerged in the crisis. First, under the 'originate to distribute' model, loans were made expressly to be sold into securitization pools, which meant that the lenders did not expect to bear the credit risk of borrower default. This led to significant deterioration in credit and loan underwriting standards, particularly in residential mortgages . . . . Second, it proved impossible for investors in asset-backed securities to assess the risks of the underlying assets, particularly when those assets were resecuritized into complex instruments like collateralized debt obligations (CDOs) and CDO-squared. With the onset of the crisis, there was widespread uncertainty regarding the true financial condition of holders of asset-backed securities, freezing interbank lending and constricting the general flow of credit. Complexity and opacity in securitization markets created the conditions that allowed the financial shock from the subprime mortgage sector to spread into a global financial crisis . . .").

structure and the obligations of each of the trust's participants (*i.e.*, liquidity provider, remarketing agent, trustee), as well as information regarding the underlying collateral in the trust. Indeed, each trust is individually rated with a long-term rating based on the credit quality of the collateral and a short-term rating based on that of the liquidity provider, unlike typical ABS which are rated on the basis of the program's over-collateralization and generalized characteristics of the entire pool of collateral.

Neither Section 15G of the Exchange Act nor the proposal mentions TOBs, suggesting neither Congress nor the Agencies intended TOBs to be subject to the proposed risk retention requirements.[19] The exemption in Section 15G for ABS issued or guaranteed by states or local governments and the Agencies' proposed implementation of this exemption support the view that Congress did not intend to capture these and other municipal repackagings in Section 15G.[20] The Agencies specifically request comment in the proposal regarding whether their proposed exemption is under or over-inclusive.[21] We strongly believe it is under-inclusive, and that the Agencies should use their authority under Section 15G to exempt from the risk retention requirements municipal repackagings, such as TOBs, that are collateralized by one or more securities of the type described in proposed Rule § ____.21(a)(3).[22]

C. Applying the Proposed Risk Retention Requirements to TOBs is not in the Public Interest

As noted, TOB trusts, because they purchase and hold longer-term debt, are an important source of demand for state and local government bonds. It would be very difficult for TOB sponsors to meet the proposal's risk retention standards, due to the structural characteristics of TOB programs, which differ from the types of ABS the proposal clearly is intended to address. As a result, imposing risk-retention rules on TOB program sponsors would raise the costs of TOB program sponsorship. This would likely cause the demand for TOB issuance to decrease, potentially raising the costs of financing to state and local governments at a time when their finances are already under stress.

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[19] As additional support, we note that the Federal Reserve's October 2010 report to Congress on risk retention, which was mandated by the Dodd-Frank Act and offers suggested alternatives for rulemaking under Section 15G, considers approaches for a range of different types of ABS, but makes no mention of TOBs or other municipal repackagings. Federal Reserve, *Report to the Congress on Risk Retention* (Oct. 2010), available at http://www.federalreserve.gov/boarddocs/rptcongress/securitization/riskretention.pdf.

[20] Section 15G states that the Agencies' risk retention rules shall provide for "a total or partial exemption for any asset-backed security that is a security issued or guaranteed by any State of the United States, or 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 of 1933 by reason of section 3(a)(2) of that Act . . ." Section 15G(c)(1)(G)(iii). To implement this requirement, the Agencies have proposed an exemption from the risk retention requirements for municipal securities. Proposed Rule § ____.21(a)(3).

[21] Release at 105.

[22] Section 15G(c)(1(G)(i).

Subjecting sponsors of TOB trusts to the proposed risk retention requirements is unnecessary to achieve the Agencies' regulatory objectives. It could also significantly reduce the availability of TOBs for tax-exempt money market funds and closed-end funds, and disrupt the operations of long-term bond funds that invest in the residuals. For all of these reasons, we request confirmation that TOB programs are outside the scope of the proposal or will be exempted from the proposal's risk retention requirements.

III. Mortgage-Backed Securities

Funds invest in a variety of MBS, including agency MBS (*i.e.*, MBS guaranteed by the Federal National Mortgage Association ("Fannie Mae") or the Federal Home Loan Mortgage Corporation ("Freddie Mac")); RMBS; and CMBS. ICI, on behalf of its members, supports maintaining a strong securitization market for MBS that is subject to high, clearly defined standards. At the same time, we believe it is important for the Agencies, in tailoring the proposed risk retention requirements to different types of MBS, to be mindful of the consequences of adopting standards that are overly restrictive or do not adequately reflect current market practice.

A. Residential Mortgage-Backed Securities

Section 15G provides that the Agencies' risk retention requirements shall not apply to RMBS that are collateralized solely by QRMs.[23] Section 15G includes specific standards that the Agencies must consider in jointly defining what constitutes a QRM. ICI, on behalf of its members, supports a QRM standard that would exempt from the risk retention requirements only RMBS backed by very high quality loans. Some of our members support the Agencies' QRM standard as proposed, and believe that only the highest quality mortgages should qualify under the standard. Other members, however, are concerned that the Agencies' proposed standard may be somewhat too restrictive and could have negative implications for mortgage financing to credit-worthy households. They are concerned that an excessively strict QRM standard could result in a lack of liquidity in the QRM market, which would discourage participation in the market by investors, including funds, and, as a result, further limit mortgage funding.

[23] Section 15G(e)(4).

B. Commercial Mortgage-Backed Securities

Section 15G of the Exchange Act states that, with respect to CMBS, the Agencies may provide for a special risk retention option in which a five percent horizontal, first-loss position is held by a third-party purchaser, if certain specified conditions are met.[24] The Agencies have implemented this provision by proposing a rule that would permit a CMBS sponsor to satisfy its risk retention obligation if a third-party purchaser acquires such an interest, subject to certain conditions.[25] This option accurately reflects the common market practice of allocating the first-loss position in a CMBS transaction to a third-party purchaser, typically known as the "B-piece buyer." Certain funds that invest in CMBS may buy the B-piece and could, under the proposed rule, potentially be a third-party purchaser. Our members that manage funds that may serve in this role have concerns that certain aspects of how the risk retention option for CMBS would operate may discourage or preclude funds from serving in the role of third-party purchaser, as well as have detrimental implications for the operation of the CMBS markets as a whole, with consequences both for investors in those markets and the businesses that obtain funding through those markets.

One of the conditions of the proposed rule is that a third-party purchaser may not sell or hedge the interest it is required to retain under the rule.[26] While we understand this provision is intended to place the third-party purchaser in the same position as if it were the sponsor retaining the same horizontal, first-loss risk retention position,[27] requiring the B-piece buyer to retain its interest for the life of the transaction would strongly discourage funds from purchasing these interests. In lieu of requiring the B-piece buyer to retain its interest for the life of the transaction, we recommend that the Agencies propose the following tiered approach: (i) require the B-piece buyer to retain its interest for a one-year period in which it may not sell or hedge the interest; (ii) for the following four years, permit the B-piece buyer to transfer its interest only to a "qualified transferee" that must meet the same criteria under the rule as the B-piece buyer; and (iii) for the remainder of the transaction, not impose restrictions on transfer or hedging.

Under the Agencies' proposed CMBS option, a B-piece purchaser is intended to stand in the shoes of the sponsor for purposes of complying with the risk retention rules. Under our recommended approach, requiring the B-piece purchaser to hold its interest for a one-year period provides a sufficient amount of time to reveal whether there are any significant deficiencies or fraud in the underwriting process. Permitting transfer to a "qualified transferee" that satisfies the same criteria under the proposed rule as the B-piece buyer for the following four years seems fully consistent with the Agencies'

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[24] Section 15G(c)(1)(E).

[25] Proposed Rule § ____.10.

[26] Proposed Rule § ____.10(a)(6).

[27] Release at 47.

policy objective of including the transfer restriction in the proposed CMBS option because the qualified transferee could have served as the original B-piece buyer.[28] We believe this approach, by imposing a reasonable holding period on third-party purchasers, would address Congress' and the Agencies' concern that the securitizer or, in this case, an entity standing in its place, not be able to reduce its exposure to the credit risk of the securitized assets.[29]

Another condition of the proposed rule would require that a sponsor utilizing the CMBS risk retention option disclose to potential investors in the CMBS transaction (and to the Agencies, upon request) the identity of the third-party purchaser, provide a description of the third-party purchaser's experience in investing in CMBS, include any other information regarding the third-party purchaser or its retention of an interest in the transaction "that is material to investors in light of the circumstances of the particular securitization transaction," provide the amount of the residual interest that the purchaser will retain or has retained in the transaction, list the purchase price paid for the interest, and describe the material terms of the interest retained by the third-party purchaser, among other information.[30] We agree that a sponsor that is satisfying its risk retention obligations by means of a third-party purchaser should provide potential investors with information relating to the interest retained by that third party and therefore support most of the proposed disclosure requirements, many of which are consistent with current market practice. We believe, however, that the proposed requirement to disclose the purchase price paid for the interest should be eliminated. Such disclosure is inconsistent with market practice and requiring it would discourage investors from serving in the role of third-party purchaser. This information is typically confidential, and is unnecessary to disclose publicly, given that information would be disclosed about the amount of the interest held.

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We appreciate that tailoring risk retention requirements to reflect the diversity that exists across the ABS markets is a sizable undertaking, especially when it must be done jointly by six federal agencies. The joint nature of this rulemaking makes it all the more important, however, for the Agencies to develop workable standards for risk retention *prior* to the rules' adoption. The proposal states that the Agencies will jointly approve "any written interpretations, written responses to requests for no-action letters and legal opinions, or other written interpretive guidance concerning the scope or terms of section 15G and the final rules issued thereunder that are intended to be relied on by the

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[28] We further note that B-piece buyers are institutional buyers, and that these interests are traded only in the Rule 144A market.

[29] *See* S. Rep. No. 111-176, at 129 (2010) ("The regulations will prohibit securitizers from hedging or otherwise transferring the credit risk they are required to retain."); Release at 58.
[30] *See* proposed Rule § ____.10(a)(5).

[30] *See* proposed Rule § ____.10(a)(5).

public generally."[31] As a result, addressing any issues raised by the proposal will be even more difficult after the rules are adopted. If there is any way we may further assist the Agencies, please feel free to contact me directly at (202) 326-5815 or Sarah Bessin at (202) 326-5835.

Sincerely,

/s/

Karrie McMillan
General Counsel

cc: The Honorable Mary L. Schapiro
The Honorable Kathleen L. Casey
The Honorable Elisse B. Walter
The Honorable Luis A. Aguilar
The Honorable Troy A. Paredes

[31] Release at 17.

INVESTMENT COMPANY INSTITUTE

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July 29, 2011

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549
File Number S7-14-11
RIN 3235-AK96

Office of the Comptroller of the Currency
250 E Street, S.W., Mail Stop 2-3
Washington, D.C. 20219
Docket Number OCC 2011-0002
RIN 1557-AD40

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551
Docket Number 2011-1411
RIN 7100-AD70

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
RIN 3064-AD74

Mr. Alfred M. Pollard
General Counsel
Attention: Comments/RIN 2590-AA43
Federal Housing Finance Agency
1700 G Street, N.W., Fourth Floor
Washington, D.C. 20552

Regulations Division
Office of General Counsel
Department of Housing and Urban Development
451 7th Street, S.W., Room 10276
Washington, D.C. 20410-0500
RIN 2501-AD53

Re: Credit Risk Retention

Ladies and Gentlemen:

The Investment Company Institute[1] supports the goal of the joint proposal of the Securities and Exchange Commission ("SEC" or "Commission"), Office of the Comptroller of the Currency

[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $13.3 trillion and serve over 90 million shareholders.

("OCC"), Board of Governors of the Federal Reserve System ("Federal Reserve"), Federal Deposit Insurance Corporation ("FDIC"), Federal Housing Finance Agency, and Department of Housing and Urban Development (together, the "Agencies") to better align the interests of securitizers of asset-backed securities ("ABS") with those of investors in ABS. The proposal would implement the credit risk retention requirements of Section 15G of the Securities Exchange Act of 1934 ("Exchange Act"), as added by Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), generally to require an ABS sponsor to retain not less than five percent of the credit risk of any asset that the sponsor, through the issuance of the ABS, transfers, sells, or conveys to a third party.[2] As purchasers of ABS, registered investment companies ("funds") have a strong interest in ensuring that securitizers of ABS act consistently with the interests of investors.[3]

We are concerned, however, that the proposed standards for risk retention may not be appropriate or necessary for certain classes of ABS in which funds invest. We commend the Agencies for recognizing that ABS have diverse characteristics and for seeking to tailor the proposed risk retention requirements based on the characteristics of different ABS. We do not believe, however, that the proposed requirements sufficiently reflect differences among certain classes of ABS or market practice for those particular securities.[4] This is particularly so with respect to notes issued by asset-backed commercial paper ("ABCP") programs and securities issued by municipal tender option bond ("TOB") programs. In addition, we are concerned that certain of the standards proposed with respect to mortgage-backed securities ("MBS"), in particular commercial mortgage-backed securities ("CMBS"), may impair the viability of those markets – a result in the best interests of neither investors, including funds, nor the individuals and firms that obtain financing through those markets. Finally, we support a "qualified residential mortgage" ("QRM") standard under the proposed exemption from the risk retention requirements for residential mortgage-backed securities ("RMBS") that are backed solely by very high quality loans, although our members have somewhat different views regarding the appropriate QRM standard.

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[3] Funds also have an interest in strong disclosure standards for ABS, and we have, in the past, supported the Commission's efforts to improve disclosure and reporting for ABS. *See* Letter from Karrie McMillan, General Counsel, ICI, to Elizabeth M. Murphy, Secretary, SEC, dated Nov. 15, 2010; Letter from Karrie McMillan, General Counsel, ICI, to Elizabeth M. Murphy, Secretary, SEC, dated Aug. 2, 2010.

[4] As Congress stated in the legislative history for Section 15G of the Exchange Act, "a 'one size fits all' approach to risk retention may adversely affect certain securitization markets . . . . Accordingly, the bill requires that the initial joint rulemaking include separate components addressing individual asset classes -- home mortgages, commercial mortgages, commercial loans, auto loans, and any other asset class that the regulators deem appropriate. The Committee expects that these regulations will recognize differences in the assets securitized, in existing risk management practices, and in the structure of asset-backed securities, and that regulators will make appropriate adjustments to the amount of risk retention required." S. Rep. No. 111-176, at 130 (2010).

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[8] Section 15G of the Exchange Act states that the risk retention rules adopted by the Agencies shall provide for "a total or partial exemption of any securitization, as may be appropriate in the public interest and for the protection of investors . . ." Section 15G(c)(1)(G)(i).

[9] ABCP issued by structured investment vehicles ("SIVs") and securities arbitrage ABCP programs experienced significant difficulties during the credit crisis. Generally, we do not suggest that these types of programs be excluded from or exempt from the risk retention requirements or eligible for the ABCP risk retention option under the proposed rules.

to repayment.[10] For ABCP programs referred to as "fully supported," the liquidity facilities can be drawn to fund all of the receivables held by the program, even if some of those receivables are deemed to be "defaulted." For "partially supported" ABCP programs, the liquidity facilities will fund only "performing" receivables, *i.e.*, those not deemed to be in default. As a means of offsetting this potential source of risk, partially supported programs have credit enhancement facilities at both the pool level[11] (supporting individual transactions, often in the form of overcollateralization) and at the program level.[12] Generally, investors analyze ABCP transactions primarily on the strength of the ABCP program sponsor and of these programs' credit and liquidity arrangements, and less on the receivables being financed.

B. Bank-Sponsored ABCP Programs Should Not be Subject to Additional Risk Retention Requirements

We believe that the alignment of incentives between originator and investor that is sought by the Dodd-Frank Act largely has been achieved for bank-sponsored ABCP programs. Accordingly, it is unnecessary to impose additional risk retention requirements on these programs. On January 28, 2010, regulators including the Federal Reserve, the OCC, and the FDIC adopted a rule that requires banks sponsoring ABCP programs to consolidate ABCP conduits onto their balance sheets, aligning regulatory capital requirements with changes to generally accepted accounting principles.[13] This rule reflects the banking regulators' acknowledgement that risk exposure in ABCP programs generally is borne by the regulated bank sponsor, which must reserve adequate capital to cover any such risk.[14] We believe this alignment of interest that exists in bank-sponsored ABCP programs is an important prerequisite for an ABCP program to be exempted or excluded from, or deemed to comply with, the proposal's risk retention requirements. We also recommend the following as criteria to identify those bank-sponsored ABCP programs that are uniquely structured to provide safeguards to investors and the marketplace. We believe these criteria align the interests of sponsors with those of investors, consistent with the policy objectives of Section 15G of the Exchange Act, such that imposing additional risk

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[10] In the event that maturing ABCP cannot be refunded in the money markets, the administrator of the program (which is often the financial institution sponsoring the program) will draw upon the liquidity facilities in an amount sufficient to redeem all maturing ABCP.

[11] In some cases, the amount of pool-level credit enhancement for a given transaction is set dynamically, in that it increases to offset deteriorating pool performance.

[12] Program-level credit enhancement is often in the form of a letter of credit or a cash collateral account, effectively providing a five to ten percent subordinated cushion for the ABCP.

[13] *Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance; Regulatory Capital; Impact of Modifications to Generally Accepted Accounting Principles; Consolidation of Asset-Backed Commercial Paper Programs; and Other Related Issues,* 75 FR 4636 (Jan. 28, 2010).

[14] *Id.* at 4643.

retention requirements would be unnecessary. The criteria are the following:

(i) the sponsoring institution is a regulated banking institution;

(ii) the issuing entity is bankruptcy remote;

(iii) regulated liquidity providers have entered into a legally binding commitment to provide 100 percent liquidity coverage for all issued ABCP, at least 95 percent of which is provided by the sponsoring institution;

(iv) at least five percent program-wide, first loss credit enhancement is provided by the sponsoring institution of any partially-supported ABCP conduit in the form of an irrevocable and unconditional letter of credit, cash collateral, guarantee or other similar facility, or no credit enhancement is required for any fully-supported ABCP conduit; and

(v) monthly investor performance reports that include loan level detail are provided on a timely basis.

These criteria align the incentives of the sponsor and investors by ensuring that the risk of the ABCP conduit remains with the bank sponsor, and that the sponsor is responsible for substantially all of the liquidity and a key portion of any credit support for the conduit. In addition, the monthly investor reports provide an important monitoring mechanism. According to an assessment of this criteria performed by a rating agency for one of our members, the criteria would capture approximately 70 percent of the ABCP market in the United States. Importantly, the criteria would exclude SIVs, as well as those securities arbitrage programs that are not sponsored by a regulated banking institution and do not have available liquidity equal to at least the amount of ABCP outstanding.

We therefore request that the Agencies exclude or exempt bank-sponsored ABCP programs that meet these strict criteria from the proposed risk retention requirements, or deem these programs to satisfy the risk retention requirements. If, on the other hand, the Agencies adopt the proposed rules as written, it will be very difficult for existing ABCP programs to meet the conditions of the proposed risk retention option for ABCP programs. This will cause ABCP lending to slow significantly, and negatively affect both businesses seeking funding through this financing method and investors in ABCP.

Should the Agencies conclude that imposing further risk retention requirements on bank-sponsored ABCP programs is appropriate, we urge you to redefine the parameters for the proposed ABCP risk retention option, based on comments received, to better reflect current market practice and existing ABCP structures. For example, while originator-seller horizontal risk retention is a method that would work for certain ABCP programs, we believe that other risk retention methods should also

be permitted as part of the ABCP risk retention option. Such methods should include those otherwise permitted under the proposed rules, as well as credit enhancements that serve an analogous function to the risk retention requirements, such as letters of credit and cash collateral accounts, which are standard in the market.

II. Municipal Tender Option Bond Programs

The proposal is silent regarding municipal TOBs. We request clarification that TOBs are not within the scope of the proposal or, alternatively, that they be exempted from its requirements.[15] Although TOBs have certain features that are similar to those of ABS, market participants generally do not perceive TOBs as ABS. Nor do we believe that TOBs raise the concerns that Congress intended to address when it enacted Section 15G of the Exchange Act. The structural characteristics of TOB programs would make it difficult for their sponsors to satisfy the proposed risk retention requirements. If TOB sponsors were forced to restructure their programs significantly to comply with the proposed rules' requirements, the increase in the cost of TOB program sponsorship could adversely affect the state and local governments that indirectly receive funding through these programs.

A. Background

A municipal TOB program is created by a sponsor bank that deposits one or more high-quality municipal bonds into a trust which issues two classes of tax-exempt securities: a short-term security (the "floater") that is supported by a liquidity facility and an inverse floating rate security (the "residual").[16] The floater is a variable-rate demand security that bears interest at a rate adjusted at specified intervals (daily, weekly, or other intervals up to one year) according to a specific index or through a remarketing process. The liquidity facility supports a "put" or demand feature, allowing the floater holder to tender the security and receive, with specified notice, face value plus accrued interest, typically either from remarketing proceeds or a draw on the liquidity facility.[17] Floater holders bear limited and well-defined insolvency and default risks associated with the underlying bonds, and rely upon their largely unfettered put right to manage these risks. Tax-exempt money market funds are the principal holders of the floaters. The residuals generally are held by the entity that selects the underlying municipal bonds that serve as collateral for the trust. Holders of residuals are typically long-term investors, such as the TOB program sponsor bank or an affiliate, tax-exempt bond funds, closed-end funds, or other institutional investors in municipal bonds. Residual holders receive all interest

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[15] *See supra* note 8.

[16] TOBs generally are structured with a single long-term municipal bond in the trust but they may be structured with a pool of long-term municipal bonds.

[17] The liquidity facility is subject to termination upon certain major credit events affecting the issuer of the underlying municipal bonds (such as bankruptcy and ratings falling to below investment grade). Under these circumstances, the TOB trust would be collapsed and the floater holders would be paid from the sale of the collateral, or would receive the collateral if such proceeds were not sufficient to pay the holders in full.

payments from the underlying bonds that are not needed to pay interest on the floaters and expenses of the trust. Due to the operation of the liquidity facility, which provides holders of the floaters par amounts plus accrued interest upon demand, the residual holder bears all of the market risk associated with the TOB trust. Accordingly, the residual holder has a significant incentive to ensure that the underlying municipal bonds are of high credit quality.

B. TOBs Are Not the Types of Securities Section 15G Was Intended To Address

We do not believe that Congress, in enacting Section 15G, intended that the risk retention requirements apply to securitizations backed by municipal securities, such as TOBs. The legislative history indicates that Section 15G was directed toward securities generally considered by market participants to be traditional ABS, and especially toward mitigating risks associated with ABS backed by mortgages.[18]

TOBs have many features that distinguish them from the types of securities that 15G was intended to address. For example, the underlying collateral in a TOB trust is limited to municipal bonds, which have very different characteristics than the privately negotiated loans and trade receivables that serve as collateral for many types of ABS. These municipal bonds are of high quality, are typically rated in the top two long-term rating categories of nationally recognized statistical ratings organizations, and generally are publicly traded. In addition, a TOB trust typically holds securities of only one municipal issuer for which information is publicly available, resulting in greater transparency than in a typical ABS transaction. TOB trusts do not utilize tranching, and therefore have a simpler and more transparent structure than typical ABS.

Importantly, TOB programs are designed to create a short-term security with the same credit characteristics as the underlying long-term collateral. In fact, investors in TOB floaters and residuals consider themselves to be co-investors in the underlying bonds which collateralize a TOB trust for both credit quality and diversification purposes. This contrasts with typical ABS, in which the investor considers itself to be holding the trust for credit quality and diversification purposes. Unlike typical ABS programs, which are characterized by significant diversity in structures, TOB programs generally have the same basic structure. The TOB trust documentation extensively describes the program's

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[18] *See* S. Rep. No. 111-176, at 128 (2010) ("The Committee's investigation into the causes of the financial crisis identified abuses of the securitization process as a major contributing factor. Two problems emerged in the crisis. First, under the 'originate to distribute' model, loans were made expressly to be sold into securitization pools, which meant that the lenders did not expect to bear the credit risk of borrower default. This led to significant deterioration in credit and loan underwriting standards, particularly in residential mortgages . . . . Second, it proved impossible for investors in asset-backed securities to assess the risks of the underlying assets, particularly when those assets were resecuritized into complex instruments like collateralized debt obligations (CDOs) and CDO-squared. With the onset of the crisis, there was widespread uncertainty regarding the true financial condition of holders of asset-backed securities, freezing interbank lending and constricting the general flow of credit. Complexity and opacity in securitization markets created the conditions that allowed the financial shock from the subprime mortgage sector to spread into a global financial crisis . . .").

structure and the obligations of each of the trust's participants (*i.e.*, liquidity provider, remarketing agent, trustee), as well as information regarding the underlying collateral in the trust. Indeed, each trust is individually rated with a long-term rating based on the credit quality of the collateral and a short-term rating based on that of the liquidity provider, unlike typical ABS which are rated on the basis of the program's over-collateralization and generalized characteristics of the entire pool of collateral.

Neither Section 15G of the Exchange Act nor the proposal mentions TOBs, suggesting neither Congress nor the Agencies intended TOBs to be subject to the proposed risk retention requirements.[19] The exemption in Section 15G for ABS issued or guaranteed by states or local governments and the Agencies' proposed implementation of this exemption support the view that Congress did not intend to capture these and other municipal repackagings in Section 15G.[20] The Agencies specifically request comment in the proposal regarding whether their proposed exemption is under or over-inclusive.[21] We strongly believe it is under-inclusive, and that the Agencies should use their authority under Section 15G to exempt from the risk retention requirements municipal repackagings, such as TOBs, that are collateralized by one or more securities of the type described in proposed Rule § ____.21(a)(3).[22]

C. Applying the Proposed Risk Retention Requirements to TOBs is not in the Public Interest

As noted, TOB trusts, because they purchase and hold longer-term debt, are an important source of demand for state and local government bonds. It would be very difficult for TOB sponsors to meet the proposal's risk retention standards, due to the structural characteristics of TOB programs, which differ from the types of ABS the proposal clearly is intended to address. As a result, imposing risk-retention rules on TOB program sponsors would raise the costs of TOB program sponsorship. This would likely cause the demand for TOB issuance to decrease, potentially raising the costs of financing to state and local governments at a time when their finances are already under stress.

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[19] As additional support, we note that the Federal Reserve's October 2010 report to Congress on risk retention, which was mandated by the Dodd-Frank Act and offers suggested alternatives for rulemaking under Section 15G, considers approaches for a range of different types of ABS, but makes no mention of TOBs or other municipal repackagings. Federal Reserve, *Report to the Congress on Risk Retention* (Oct. 2010), available at http://www.federalreserve.gov/boarddocs/rptcongress/securitization/riskretention.pdf.

[20] Section 15G states that the Agencies' risk retention rules shall provide for "a total or partial exemption for any asset-backed security that is a security issued or guaranteed by any State of the United States, or 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 of 1933 by reason of section 3(a)(2) of that Act . . ." Section 15G(c)(1)(G)(iii). To implement this requirement, the Agencies have proposed an exemption from the risk retention requirements for municipal securities. Proposed Rule § ____.21(a)(3).

[21] Release at 105.

[22] Section 15G(c)(1(G)(i).

Subjecting sponsors of TOB trusts to the proposed risk retention requirements is unnecessary to achieve the Agencies' regulatory objectives. It could also significantly reduce the availability of TOBs for tax-exempt money market funds and closed-end funds, and disrupt the operations of long-term bond funds that invest in the residuals. For all of these reasons, we request confirmation that TOB programs are outside the scope of the proposal or will be exempted from the proposal's risk retention requirements.

III. Mortgage-Backed Securities

Funds invest in a variety of MBS, including agency MBS (*i.e.*, MBS guaranteed by the Federal National Mortgage Association ("Fannie Mae") or the Federal Home Loan Mortgage Corporation ("Freddie Mac")); RMBS; and CMBS. ICI, on behalf of its members, supports maintaining a strong securitization market for MBS that is subject to high, clearly defined standards. At the same time, we believe it is important for the Agencies, in tailoring the proposed risk retention requirements to different types of MBS, to be mindful of the consequences of adopting standards that are overly restrictive or do not adequately reflect current market practice.

A. Residential Mortgage-Backed Securities

Section 15G provides that the Agencies' risk retention requirements shall not apply to RMBS that are collateralized solely by QRMs.[23] Section 15G includes specific standards that the Agencies must consider in jointly defining what constitutes a QRM. ICI, on behalf of its members, supports a QRM standard that would exempt from the risk retention requirements only RMBS backed by very high quality loans. Some of our members support the Agencies' QRM standard as proposed, and believe that only the highest quality mortgages should qualify under the standard. Other members, however, are concerned that the Agencies' proposed standard may be somewhat too restrictive and could have negative implications for mortgage financing to credit-worthy households. They are concerned that an excessively strict QRM standard could result in a lack of liquidity in the QRM market, which would discourage participation in the market by investors, including funds, and, as a result, further limit mortgage funding.

[23] Section 15G(e)(4).

B. Commercial Mortgage-Backed Securities

Section 15G of the Exchange Act states that, with respect to CMBS, the Agencies may provide for a special risk retention option in which a five percent horizontal, first-loss position is held by a third-party purchaser, if certain specified conditions are met.[24] The Agencies have implemented this provision by proposing a rule that would permit a CMBS sponsor to satisfy its risk retention obligation if a third-party purchaser acquires such an interest, subject to certain conditions.[25] This option accurately reflects the common market practice of allocating the first-loss position in a CMBS transaction to a third-party purchaser, typically known as the "B-piece buyer." Certain funds that invest in CMBS may buy the B-piece and could, under the proposed rule, potentially be a third-party purchaser. Our members that manage funds that may serve in this role have concerns that certain aspects of how the risk retention option for CMBS would operate may discourage or preclude funds from serving in the role of third-party purchaser, as well as have detrimental implications for the operation of the CMBS markets as a whole, with consequences both for investors in those markets and the businesses that obtain funding through those markets.

One of the conditions of the proposed rule is that a third-party purchaser may not sell or hedge the interest it is required to retain under the rule.[26] While we understand this provision is intended to place the third-party purchaser in the same position as if it were the sponsor retaining the same horizontal, first-loss risk retention position,[27] requiring the B-piece buyer to retain its interest for the life of the transaction would strongly discourage funds from purchasing these interests. In lieu of requiring the B-piece buyer to retain its interest for the life of the transaction, we recommend that the Agencies propose the following tiered approach: (i) require the B-piece buyer to retain its interest for a one-year period in which it may not sell or hedge the interest; (ii) for the following four years, permit the B-piece buyer to transfer its interest only to a "qualified transferee" that must meet the same criteria under the rule as the B-piece buyer; and (iii) for the remainder of the transaction, not impose restrictions on transfer or hedging.

Under the Agencies' proposed CMBS option, a B-piece purchaser is intended to stand in the shoes of the sponsor for purposes of complying with the risk retention rules. Under our recommended approach, requiring the B-piece purchaser to hold its interest for a one-year period provides a sufficient amount of time to reveal whether there are any significant deficiencies or fraud in the underwriting process. Permitting transfer to a "qualified transferee" that satisfies the same criteria under the proposed rule as the B-piece buyer for the following four years seems fully consistent with the Agencies'

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[24] Section 15G(c)(1)(E).

[25] Proposed Rule § ____.10.

[26] Proposed Rule § ____.10(a)(6).

[27] Release at 47.

policy objective of including the transfer restriction in the proposed CMBS option because the qualified transferee could have served as the original B-piece buyer.[28] We believe this approach, by imposing a reasonable holding period on third-party purchasers, would address Congress' and the Agencies' concern that the securitizer or, in this case, an entity standing in its place, not be able to reduce its exposure to the credit risk of the securitized assets.[29]

Another condition of the proposed rule would require that a sponsor utilizing the CMBS risk retention option disclose to potential investors in the CMBS transaction (and to the Agencies, upon request) the identity of the third-party purchaser, provide a description of the third-party purchaser's experience in investing in CMBS, include any other information regarding the third-party purchaser or its retention of an interest in the transaction "that is material to investors in light of the circumstances of the particular securitization transaction," provide the amount of the residual interest that the purchaser will retain or has retained in the transaction, list the purchase price paid for the interest, and describe the material terms of the interest retained by the third-party purchaser, among other information.[30] We agree that a sponsor that is satisfying its risk retention obligations by means of a third-party purchaser should provide potential investors with information relating to the interest retained by that third party and therefore support most of the proposed disclosure requirements, many of which are consistent with current market practice. We believe, however, that the proposed requirement to disclose the purchase price paid for the interest should be eliminated. Such disclosure is inconsistent with market practice and requiring it would discourage investors from serving in the role of third-party purchaser. This information is typically confidential, and is unnecessary to disclose publicly, given that information would be disclosed about the amount of the interest held.

* * * * *

We appreciate that tailoring risk retention requirements to reflect the diversity that exists across the ABS markets is a sizable undertaking, especially when it must be done jointly by six federal agencies. The joint nature of this rulemaking makes it all the more important, however, for the Agencies to develop workable standards for risk retention *prior* to the rules' adoption. The proposal states that the Agencies will jointly approve "any written interpretations, written responses to requests for no-action letters and legal opinions, or other written interpretive guidance concerning the scope or terms of section 15G and the final rules issued thereunder that are intended to be relied on by the

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[28] We further note that B-piece buyers are institutional buyers, and that these interests are traded only in the Rule 144A market.

[29] *See* S. Rep. No. 111-176, at 129 (2010) ("The regulations will prohibit securitizers from hedging or otherwise transferring the credit risk they are required to retain."); Release at 58.
[30] *See* proposed Rule § ____.10(a)(5).

[30] *See* proposed Rule § ____.10(a)(5).

public generally."[31] As a result, addressing any issues raised by the proposal will be even more difficult after the rules are adopted. If there is any way we may further assist the Agencies, please feel free to contact me directly at (202) 326-5815 or Sarah Bessin at (202) 326-5835.

Sincerely,

/s/

Karrie McMillan
General Counsel

cc: The Honorable Mary L. Schapiro
The Honorable Kathleen L. Casey
The Honorable Elisse B. Walter
The Honorable Luis A. Aguilar
The Honorable Troy A. Paredes

[31] Release at 17.

INVESTMENT COMPANY INSTITUTE

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July 29, 2011

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549
File Number S7-14-11
RIN 3235-AK96

Office of the Comptroller of the Currency
250 E Street, S.W., Mail Stop 2-3
Washington, D.C. 20219
Docket Number OCC 2011-0002
RIN 1557-AD40

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551
Docket Number 2011-1411
RIN 7100-AD70

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
RIN 3064-AD74

Mr. Alfred M. Pollard
General Counsel
Attention: Comments/RIN 2590-AA43
Federal Housing Finance Agency
1700 G Street, N.W., Fourth Floor
Washington, D.C. 20552

Regulations Division
Office of General Counsel
Department of Housing and Urban Development
451 7th Street, S.W., Room 10276
Washington, D.C. 20410-0500
RIN 2501-AD53

Re: Credit Risk Retention

Ladies and Gentlemen:

The Investment Company Institute[1] supports the goal of the joint proposal of the Securities and Exchange Commission ("SEC" or "Commission"), Office of the Comptroller of the Currency

[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $13.3 trillion and serve over 90 million shareholders.

("OCC"), Board of Governors of the Federal Reserve System ("Federal Reserve"), Federal Deposit Insurance Corporation ("FDIC"), Federal Housing Finance Agency, and Department of Housing and Urban Development (together, the "Agencies") to better align the interests of securitizers of asset-backed securities ("ABS") with those of investors in ABS. The proposal would implement the credit risk retention requirements of Section 15G of the Securities Exchange Act of 1934 ("Exchange Act"), as added by Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), generally to require an ABS sponsor to retain not less than five percent of the credit risk of any asset that the sponsor, through the issuance of the ABS, transfers, sells, or conveys to a third party.[2] As purchasers of ABS, registered investment companies ("funds") have a strong interest in ensuring that securitizers of ABS act consistently with the interests of investors.[3]

We are concerned, however, that the proposed standards for risk retention may not be appropriate or necessary for certain classes of ABS in which funds invest. We commend the Agencies for recognizing that ABS have diverse characteristics and for seeking to tailor the proposed risk retention requirements based on the characteristics of different ABS. We do not believe, however, that the proposed requirements sufficiently reflect differences among certain classes of ABS or market practice for those particular securities.[4] This is particularly so with respect to notes issued by asset-backed commercial paper ("ABCP") programs and securities issued by municipal tender option bond ("TOB") programs. In addition, we are concerned that certain of the standards proposed with respect to mortgage-backed securities ("MBS"), in particular commercial mortgage-backed securities ("CMBS"), may impair the viability of those markets – a result in the best interests of neither investors, including funds, nor the individuals and firms that obtain financing through those markets. Finally, we support a "qualified residential mortgage" ("QRM") standard under the proposed exemption from the risk retention requirements for residential mortgage-backed securities ("RMBS") that are backed solely by very high quality loans, although our members have somewhat different views regarding the appropriate QRM standard.

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[2] *Credit Risk Retention,* Securities Exchange Act Release No. 64148 (March 30, 2011), available at http://www.sec.gov/rules/proposed/2011/34-64148.pdf ("Release").

[3] Funds also have an interest in strong disclosure standards for ABS, and we have, in the past, supported the Commission's efforts to improve disclosure and reporting for ABS. *See* Letter from Karrie McMillan, General Counsel, ICI, to Elizabeth M. Murphy, Secretary, SEC, dated Nov. 15, 2010; Letter from Karrie McMillan, General Counsel, ICI, to Elizabeth M. Murphy, Secretary, SEC, dated Aug. 2, 2010.

[4] As Congress stated in the legislative history for Section 15G of the Exchange Act, "a 'one size fits all' approach to risk retention may adversely affect certain securitization markets . . . . Accordingly, the bill requires that the initial joint rulemaking include separate components addressing individual asset classes -- home mortgages, commercial mortgages, commercial loans, auto loans, and any other asset class that the regulators deem appropriate. The Committee expects that these regulations will recognize differences in the assets securitized, in existing risk management practices, and in the structure of asset-backed securities, and that regulators will make appropriate adjustments to the amount of risk retention required." S. Rep. No. 111-176, at 130 (2010).

We address each of the foregoing concerns in turn below.

I. Asset-Backed Commercial Paper Programs

The proposal includes a risk retention option specifically designed for ABCP programs that meet certain conditions.[5] We appreciate the Agencies' recognition that this instrument has unique characteristics, and recognize that the Agencies have sought to make this option consistent with existing market practice.[6] We understand, however, that most existing ABCP programs could not meet the proposed rule's conditions.[7] We therefore recommend, in lieu of the ABCP risk retention option, that the Agencies exclude or exempt from the proposal's risk retention requirements[8] those bank-sponsored ABCP programs that meet certain criteria, which we believe reflect the alignment of interests Section 15G of the Exchange Act was intended to achieve, or deem such programs to comply with the risk retention requirements.[9]

A. Background

ABCP programs are short-term, senior-secured investment vehicles that issue instruments in the money markets. They are used by a wide variety of corporations – such as banks, finance companies, and broker-dealers – to obtain low-cost financing for a diverse range of financial receivables.

ABCP is offered continuously and carries repayment dates that usually range from overnight up to 270 days. ABCP programs are referred to as "asset-backed" because the bankruptcy remote, special-purpose vehicles that issue the ABCP own, or have security interests in, multiple pools of various types of financial receivables.

ABCP programs typically are supported by credit enhancement and committed liquidity facilities. The liquidity support for an ABCP program typically equals the face amount of ABCP outstanding, to protect investors in case of a market interruption or any timing differences with respect

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[5] Proposed Rule § ____.9.

[6] Release at 41.

[7] *See, e.g.,* Letter from Tom Deutsch, Executive Director, American Securitization Forum, to the Agencies, dated June 10, 2011, at 99-101, *available at* http://www.sec.gov/comments/s7-14-11/s71411-57.pdf.

[8] Section 15G of the Exchange Act states that the risk retention rules adopted by the Agencies shall provide for "a total or partial exemption of any securitization, as may be appropriate in the public interest and for the protection of investors . . ." Section 15G(c)(1)(G)(i).

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B. Bank-Sponsored ABCP Programs Should Not be Subject to Additional Risk Retention Requirements

We believe that the alignment of incentives between originator and investor that is sought by the Dodd-Frank Act largely has been achieved for bank-sponsored ABCP programs. Accordingly, it is unnecessary to impose additional risk retention requirements on these programs. On January 28, 2010, regulators including the Federal Reserve, the OCC, and the FDIC adopted a rule that requires banks sponsoring ABCP programs to consolidate ABCP conduits onto their balance sheets, aligning regulatory capital requirements with changes to generally accepted accounting principles.[13] This rule reflects the banking regulators' acknowledgement that risk exposure in ABCP programs generally is borne by the regulated bank sponsor, which must reserve adequate capital to cover any such risk.[14] We believe this alignment of interest that exists in bank-sponsored ABCP programs is an important prerequisite for an ABCP program to be exempted or excluded from, or deemed to comply with, the proposal's risk retention requirements. We also recommend the following as criteria to identify those bank-sponsored ABCP programs that are uniquely structured to provide safeguards to investors and the marketplace. We believe these criteria align the interests of sponsors with those of investors, consistent with the policy objectives of Section 15G of the Exchange Act, such that imposing additional risk

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[12] Program-level credit enhancement is often in the form of a letter of credit or a cash collateral account, effectively providing a five to ten percent subordinated cushion for the ABCP.

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[14] *Id.* at 4643.

retention requirements would be unnecessary. The criteria are the following:

(i) the sponsoring institution is a regulated banking institution;

(ii) the issuing entity is bankruptcy remote;

(iii) regulated liquidity providers have entered into a legally binding commitment to provide 100 percent liquidity coverage for all issued ABCP, at least 95 percent of which is provided by the sponsoring institution;

(iv) at least five percent program-wide, first loss credit enhancement is provided by the sponsoring institution of any partially-supported ABCP conduit in the form of an irrevocable and unconditional letter of credit, cash collateral, guarantee or other similar facility, or no credit enhancement is required for any fully-supported ABCP conduit; and

(v) monthly investor performance reports that include loan level detail are provided on a timely basis.

These criteria align the incentives of the sponsor and investors by ensuring that the risk of the ABCP conduit remains with the bank sponsor, and that the sponsor is responsible for substantially all of the liquidity and a key portion of any credit support for the conduit. In addition, the monthly investor reports provide an important monitoring mechanism. According to an assessment of this criteria performed by a rating agency for one of our members, the criteria would capture approximately 70 percent of the ABCP market in the United States. Importantly, the criteria would exclude SIVs, as well as those securities arbitrage programs that are not sponsored by a regulated banking institution and do not have available liquidity equal to at least the amount of ABCP outstanding.

We therefore request that the Agencies exclude or exempt bank-sponsored ABCP programs that meet these strict criteria from the proposed risk retention requirements, or deem these programs to satisfy the risk retention requirements. If, on the other hand, the Agencies adopt the proposed rules as written, it will be very difficult for existing ABCP programs to meet the conditions of the proposed risk retention option for ABCP programs. This will cause ABCP lending to slow significantly, and negatively affect both businesses seeking funding through this financing method and investors in ABCP.

Should the Agencies conclude that imposing further risk retention requirements on bank-sponsored ABCP programs is appropriate, we urge you to redefine the parameters for the proposed ABCP risk retention option, based on comments received, to better reflect current market practice and existing ABCP structures. For example, while originator-seller horizontal risk retention is a method that would work for certain ABCP programs, we believe that other risk retention methods should also

be permitted as part of the ABCP risk retention option. Such methods should include those otherwise permitted under the proposed rules, as well as credit enhancements that serve an analogous function to the risk retention requirements, such as letters of credit and cash collateral accounts, which are standard in the market.

II. Municipal Tender Option Bond Programs

The proposal is silent regarding municipal TOBs. We request clarification that TOBs are not within the scope of the proposal or, alternatively, that they be exempted from its requirements.[15] Although TOBs have certain features that are similar to those of ABS, market participants generally do not perceive TOBs as ABS. Nor do we believe that TOBs raise the concerns that Congress intended to address when it enacted Section 15G of the Exchange Act. The structural characteristics of TOB programs would make it difficult for their sponsors to satisfy the proposed risk retention requirements. If TOB sponsors were forced to restructure their programs significantly to comply with the proposed rules' requirements, the increase in the cost of TOB program sponsorship could adversely affect the state and local governments that indirectly receive funding through these programs.

A. Background

A municipal TOB program is created by a sponsor bank that deposits one or more high-quality municipal bonds into a trust which issues two classes of tax-exempt securities: a short-term security (the "floater") that is supported by a liquidity facility and an inverse floating rate security (the "residual").[16] The floater is a variable-rate demand security that bears interest at a rate adjusted at specified intervals (daily, weekly, or other intervals up to one year) according to a specific index or through a remarketing process. The liquidity facility supports a "put" or demand feature, allowing the floater holder to tender the security and receive, with specified notice, face value plus accrued interest, typically either from remarketing proceeds or a draw on the liquidity facility.[17] Floater holders bear limited and well-defined insolvency and default risks associated with the underlying bonds, and rely upon their largely unfettered put right to manage these risks. Tax-exempt money market funds are the principal holders of the floaters. The residuals generally are held by the entity that selects the underlying municipal bonds that serve as collateral for the trust. Holders of residuals are typically long-term investors, such as the TOB program sponsor bank or an affiliate, tax-exempt bond funds, closed-end funds, or other institutional investors in municipal bonds. Residual holders receive all interest

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[15] *See supra* note 8.

[16] TOBs generally are structured with a single long-term municipal bond in the trust but they may be structured with a pool of long-term municipal bonds.

[17] The liquidity facility is subject to termination upon certain major credit events affecting the issuer of the underlying municipal bonds (such as bankruptcy and ratings falling to below investment grade). Under these circumstances, the TOB trust would be collapsed and the floater holders would be paid from the sale of the collateral, or would receive the collateral if such proceeds were not sufficient to pay the holders in full.

payments from the underlying bonds that are not needed to pay interest on the floaters and expenses of the trust. Due to the operation of the liquidity facility, which provides holders of the floaters par amounts plus accrued interest upon demand, the residual holder bears all of the market risk associated with the TOB trust. Accordingly, the residual holder has a significant incentive to ensure that the underlying municipal bonds are of high credit quality.

B. TOBs Are Not the Types of Securities Section 15G Was Intended To Address

We do not believe that Congress, in enacting Section 15G, intended that the risk retention requirements apply to securitizations backed by municipal securities, such as TOBs. The legislative history indicates that Section 15G was directed toward securities generally considered by market participants to be traditional ABS, and especially toward mitigating risks associated with ABS backed by mortgages.[18]

TOBs have many features that distinguish them from the types of securities that 15G was intended to address. For example, the underlying collateral in a TOB trust is limited to municipal bonds, which have very different characteristics than the privately negotiated loans and trade receivables that serve as collateral for many types of ABS. These municipal bonds are of high quality, are typically rated in the top two long-term rating categories of nationally recognized statistical ratings organizations, and generally are publicly traded. In addition, a TOB trust typically holds securities of only one municipal issuer for which information is publicly available, resulting in greater transparency than in a typical ABS transaction. TOB trusts do not utilize tranching, and therefore have a simpler and more transparent structure than typical ABS.

Importantly, TOB programs are designed to create a short-term security with the same credit characteristics as the underlying long-term collateral. In fact, investors in TOB floaters and residuals consider themselves to be co-investors in the underlying bonds which collateralize a TOB trust for both credit quality and diversification purposes. This contrasts with typical ABS, in which the investor considers itself to be holding the trust for credit quality and diversification purposes. Unlike typical ABS programs, which are characterized by significant diversity in structures, TOB programs generally have the same basic structure. The TOB trust documentation extensively describes the program's

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[18] *See* S. Rep. No. 111-176, at 128 (2010) ("The Committee's investigation into the causes of the financial crisis identified abuses of the securitization process as a major contributing factor. Two problems emerged in the crisis. First, under the 'originate to distribute' model, loans were made expressly to be sold into securitization pools, which meant that the lenders did not expect to bear the credit risk of borrower default. This led to significant deterioration in credit and loan underwriting standards, particularly in residential mortgages . . . . Second, it proved impossible for investors in asset-backed securities to assess the risks of the underlying assets, particularly when those assets were resecuritized into complex instruments like collateralized debt obligations (CDOs) and CDO-squared. With the onset of the crisis, there was widespread uncertainty regarding the true financial condition of holders of asset-backed securities, freezing interbank lending and constricting the general flow of credit. Complexity and opacity in securitization markets created the conditions that allowed the financial shock from the subprime mortgage sector to spread into a global financial crisis . . .").

structure and the obligations of each of the trust's participants (*i.e.*, liquidity provider, remarketing agent, trustee), as well as information regarding the underlying collateral in the trust. Indeed, each trust is individually rated with a long-term rating based on the credit quality of the collateral and a short-term rating based on that of the liquidity provider, unlike typical ABS which are rated on the basis of the program's over-collateralization and generalized characteristics of the entire pool of collateral.

Neither Section 15G of the Exchange Act nor the proposal mentions TOBs, suggesting neither Congress nor the Agencies intended TOBs to be subject to the proposed risk retention requirements.[19] The exemption in Section 15G for ABS issued or guaranteed by states or local governments and the Agencies' proposed implementation of this exemption support the view that Congress did not intend to capture these and other municipal repackagings in Section 15G.[20] The Agencies specifically request comment in the proposal regarding whether their proposed exemption is under or over-inclusive.[21] We strongly believe it is under-inclusive, and that the Agencies should use their authority under Section 15G to exempt from the risk retention requirements municipal repackagings, such as TOBs, that are collateralized by one or more securities of the type described in proposed Rule § ____.21(a)(3).[22]

C. Applying the Proposed Risk Retention Requirements to TOBs is not in the Public Interest

As noted, TOB trusts, because they purchase and hold longer-term debt, are an important source of demand for state and local government bonds. It would be very difficult for TOB sponsors to meet the proposal's risk retention standards, due to the structural characteristics of TOB programs, which differ from the types of ABS the proposal clearly is intended to address. As a result, imposing risk-retention rules on TOB program sponsors would raise the costs of TOB program sponsorship. This would likely cause the demand for TOB issuance to decrease, potentially raising the costs of financing to state and local governments at a time when their finances are already under stress.

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[19] As additional support, we note that the Federal Reserve's October 2010 report to Congress on risk retention, which was mandated by the Dodd-Frank Act and offers suggested alternatives for rulemaking under Section 15G, considers approaches for a range of different types of ABS, but makes no mention of TOBs or other municipal repackagings. Federal Reserve, *Report to the Congress on Risk Retention* (Oct. 2010), available at http://www.federalreserve.gov/boarddocs/rptcongress/securitization/riskretention.pdf.

[20] Section 15G states that the Agencies' risk retention rules shall provide for "a total or partial exemption for any asset-backed security that is a security issued or guaranteed by any State of the United States, or 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 of 1933 by reason of section 3(a)(2) of that Act . . ." Section 15G(c)(1)(G)(iii). To implement this requirement, the Agencies have proposed an exemption from the risk retention requirements for municipal securities. Proposed Rule § ____.21(a)(3).

[21] Release at 105.

[22] Section 15G(c)(1(G)(i).

Subjecting sponsors of TOB trusts to the proposed risk retention requirements is unnecessary to achieve the Agencies' regulatory objectives. It could also significantly reduce the availability of TOBs for tax-exempt money market funds and closed-end funds, and disrupt the operations of long-term bond funds that invest in the residuals. For all of these reasons, we request confirmation that TOB programs are outside the scope of the proposal or will be exempted from the proposal's risk retention requirements.

III. Mortgage-Backed Securities

Funds invest in a variety of MBS, including agency MBS (*i.e.*, MBS guaranteed by the Federal National Mortgage Association ("Fannie Mae") or the Federal Home Loan Mortgage Corporation ("Freddie Mac")); RMBS; and CMBS. ICI, on behalf of its members, supports maintaining a strong securitization market for MBS that is subject to high, clearly defined standards. At the same time, we believe it is important for the Agencies, in tailoring the proposed risk retention requirements to different types of MBS, to be mindful of the consequences of adopting standards that are overly restrictive or do not adequately reflect current market practice.

A. Residential Mortgage-Backed Securities

Section 15G provides that the Agencies' risk retention requirements shall not apply to RMBS that are collateralized solely by QRMs.[23] Section 15G includes specific standards that the Agencies must consider in jointly defining what constitutes a QRM. ICI, on behalf of its members, supports a QRM standard that would exempt from the risk retention requirements only RMBS backed by very high quality loans. Some of our members support the Agencies' QRM standard as proposed, and believe that only the highest quality mortgages should qualify under the standard. Other members, however, are concerned that the Agencies' proposed standard may be somewhat too restrictive and could have negative implications for mortgage financing to credit-worthy households. They are concerned that an excessively strict QRM standard could result in a lack of liquidity in the QRM market, which would discourage participation in the market by investors, including funds, and, as a result, further limit mortgage funding.

[23] Section 15G(e)(4).

B. Commercial Mortgage-Backed Securities

Section 15G of the Exchange Act states that, with respect to CMBS, the Agencies may provide for a special risk retention option in which a five percent horizontal, first-loss position is held by a third-party purchaser, if certain specified conditions are met.[24] The Agencies have implemented this provision by proposing a rule that would permit a CMBS sponsor to satisfy its risk retention obligation if a third-party purchaser acquires such an interest, subject to certain conditions.[25] This option accurately reflects the common market practice of allocating the first-loss position in a CMBS transaction to a third-party purchaser, typically known as the "B-piece buyer." Certain funds that invest in CMBS may buy the B-piece and could, under the proposed rule, potentially be a third-party purchaser. Our members that manage funds that may serve in this role have concerns that certain aspects of how the risk retention option for CMBS would operate may discourage or preclude funds from serving in the role of third-party purchaser, as well as have detrimental implications for the operation of the CMBS markets as a whole, with consequences both for investors in those markets and the businesses that obtain funding through those markets.

One of the conditions of the proposed rule is that a third-party purchaser may not sell or hedge the interest it is required to retain under the rule.[26] While we understand this provision is intended to place the third-party purchaser in the same position as if it were the sponsor retaining the same horizontal, first-loss risk retention position,[27] requiring the B-piece buyer to retain its interest for the life of the transaction would strongly discourage funds from purchasing these interests. In lieu of requiring the B-piece buyer to retain its interest for the life of the transaction, we recommend that the Agencies propose the following tiered approach: (i) require the B-piece buyer to retain its interest for a one-year period in which it may not sell or hedge the interest; (ii) for the following four years, permit the B-piece buyer to transfer its interest only to a "qualified transferee" that must meet the same criteria under the rule as the B-piece buyer; and (iii) for the remainder of the transaction, not impose restrictions on transfer or hedging.

Under the Agencies' proposed CMBS option, a B-piece purchaser is intended to stand in the shoes of the sponsor for purposes of complying with the risk retention rules. Under our recommended approach, requiring the B-piece purchaser to hold its interest for a one-year period provides a sufficient amount of time to reveal whether there are any significant deficiencies or fraud in the underwriting process. Permitting transfer to a "qualified transferee" that satisfies the same criteria under the proposed rule as the B-piece buyer for the following four years seems fully consistent with the Agencies'

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[24] Section 15G(c)(1)(E).

[25] Proposed Rule § ____.10.

[26] Proposed Rule § ____.10(a)(6).

[27] Release at 47.

policy objective of including the transfer restriction in the proposed CMBS option because the qualified transferee could have served as the original B-piece buyer.[28] We believe this approach, by imposing a reasonable holding period on third-party purchasers, would address Congress' and the Agencies' concern that the securitizer or, in this case, an entity standing in its place, not be able to reduce its exposure to the credit risk of the securitized assets.[29]

Another condition of the proposed rule would require that a sponsor utilizing the CMBS risk retention option disclose to potential investors in the CMBS transaction (and to the Agencies, upon request) the identity of the third-party purchaser, provide a description of the third-party purchaser's experience in investing in CMBS, include any other information regarding the third-party purchaser or its retention of an interest in the transaction "that is material to investors in light of the circumstances of the particular securitization transaction," provide the amount of the residual interest that the purchaser will retain or has retained in the transaction, list the purchase price paid for the interest, and describe the material terms of the interest retained by the third-party purchaser, among other information.[30] We agree that a sponsor that is satisfying its risk retention obligations by means of a third-party purchaser should provide potential investors with information relating to the interest retained by that third party and therefore support most of the proposed disclosure requirements, many of which are consistent with current market practice. We believe, however, that the proposed requirement to disclose the purchase price paid for the interest should be eliminated. Such disclosure is inconsistent with market practice and requiring it would discourage investors from serving in the role of third-party purchaser. This information is typically confidential, and is unnecessary to disclose publicly, given that information would be disclosed about the amount of the interest held.

* * * * *

We appreciate that tailoring risk retention requirements to reflect the diversity that exists across the ABS markets is a sizable undertaking, especially when it must be done jointly by six federal agencies. The joint nature of this rulemaking makes it all the more important, however, for the Agencies to develop workable standards for risk retention *prior* to the rules' adoption. The proposal states that the Agencies will jointly approve "any written interpretations, written responses to requests for no-action letters and legal opinions, or other written interpretive guidance concerning the scope or terms of section 15G and the final rules issued thereunder that are intended to be relied on by the

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[28] We further note that B-piece buyers are institutional buyers, and that these interests are traded only in the Rule 144A market.

[29] *See* S. Rep. No. 111-176, at 129 (2010) ("The regulations will prohibit securitizers from hedging or otherwise transferring the credit risk they are required to retain."); Release at 58.
[30] *See* proposed Rule § ____.10(a)(5).

[30] *See* proposed Rule § ____.10(a)(5).

public generally."[31] As a result, addressing any issues raised by the proposal will be even more difficult after the rules are adopted. If there is any way we may further assist the Agencies, please feel free to contact me directly at (202) 326-5815 or Sarah Bessin at (202) 326-5835.

Sincerely,

/s/

Karrie McMillan
General Counsel

cc: The Honorable Mary L. Schapiro
The Honorable Kathleen L. Casey
The Honorable Elisse B. Walter
The Honorable Luis A. Aguilar
The Honorable Troy A. Paredes

[31] Release at 17.

INVESTMENT COMPANY INSTITUTE

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July 29, 2011

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549
File Number S7-14-11
RIN 3235-AK96

Office of the Comptroller of the Currency
250 E Street, S.W., Mail Stop 2-3
Washington, D.C. 20219
Docket Number OCC 2011-0002
RIN 1557-AD40

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551
Docket Number 2011-1411
RIN 7100-AD70

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
RIN 3064-AD74

Mr. Alfred M. Pollard
General Counsel
Attention: Comments/RIN 2590-AA43
Federal Housing Finance Agency
1700 G Street, N.W., Fourth Floor
Washington, D.C. 20552

Regulations Division
Office of General Counsel
Department of Housing and Urban Development
451 7th Street, S.W., Room 10276
Washington, D.C. 20410-0500
RIN 2501-AD53

Re: Credit Risk Retention

Ladies and Gentlemen:

The Investment Company Institute[1] supports the goal of the joint proposal of the Securities and Exchange Commission ("SEC" or "Commission"), Office of the Comptroller of the Currency

[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $13.3 trillion and serve over 90 million shareholders.

("OCC"), Board of Governors of the Federal Reserve System ("Federal Reserve"), Federal Deposit Insurance Corporation ("FDIC"), Federal Housing Finance Agency, and Department of Housing and Urban Development (together, the "Agencies") to better align the interests of securitizers of asset-backed securities ("ABS") with those of investors in ABS. The proposal would implement the credit risk retention requirements of Section 15G of the Securities Exchange Act of 1934 ("Exchange Act"), as added by Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), generally to require an ABS sponsor to retain not less than five percent of the credit risk of any asset that the sponsor, through the issuance of the ABS, transfers, sells, or conveys to a third party.[2] As purchasers of ABS, registered investment companies ("funds") have a strong interest in ensuring that securitizers of ABS act consistently with the interests of investors.[3]

We are concerned, however, that the proposed standards for risk retention may not be appropriate or necessary for certain classes of ABS in which funds invest. We commend the Agencies for recognizing that ABS have diverse characteristics and for seeking to tailor the proposed risk retention requirements based on the characteristics of different ABS. We do not believe, however, that the proposed requirements sufficiently reflect differences among certain classes of ABS or market practice for those particular securities.[4] This is particularly so with respect to notes issued by asset-backed commercial paper ("ABCP") programs and securities issued by municipal tender option bond ("TOB") programs. In addition, we are concerned that certain of the standards proposed with respect to mortgage-backed securities ("MBS"), in particular commercial mortgage-backed securities ("CMBS"), may impair the viability of those markets – a result in the best interests of neither investors, including funds, nor the individuals and firms that obtain financing through those markets. Finally, we support a "qualified residential mortgage" ("QRM") standard under the proposed exemption from the risk retention requirements for residential mortgage-backed securities ("RMBS") that are backed solely by very high quality loans, although our members have somewhat different views regarding the appropriate QRM standard.

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[2] *Credit Risk Retention,* Securities Exchange Act Release No. 64148 (March 30, 2011), available at http://www.sec.gov/rules/proposed/2011/34-64148.pdf ("Release").

[3] Funds also have an interest in strong disclosure standards for ABS, and we have, in the past, supported the Commission's efforts to improve disclosure and reporting for ABS. *See* Letter from Karrie McMillan, General Counsel, ICI, to Elizabeth M. Murphy, Secretary, SEC, dated Nov. 15, 2010; Letter from Karrie McMillan, General Counsel, ICI, to Elizabeth M. Murphy, Secretary, SEC, dated Aug. 2, 2010.

[4] As Congress stated in the legislative history for Section 15G of the Exchange Act, "a 'one size fits all' approach to risk retention may adversely affect certain securitization markets . . . . Accordingly, the bill requires that the initial joint rulemaking include separate components addressing individual asset classes -- home mortgages, commercial mortgages, commercial loans, auto loans, and any other asset class that the regulators deem appropriate. The Committee expects that these regulations will recognize differences in the assets securitized, in existing risk management practices, and in the structure of asset-backed securities, and that regulators will make appropriate adjustments to the amount of risk retention required." S. Rep. No. 111-176, at 130 (2010).

We address each of the foregoing concerns in turn below.

I. Asset-Backed Commercial Paper Programs

The proposal includes a risk retention option specifically designed for ABCP programs that meet certain conditions.[5] We appreciate the Agencies' recognition that this instrument has unique characteristics, and recognize that the Agencies have sought to make this option consistent with existing market practice.[6] We understand, however, that most existing ABCP programs could not meet the proposed rule's conditions.[7] We therefore recommend, in lieu of the ABCP risk retention option, that the Agencies exclude or exempt from the proposal's risk retention requirements[8] those bank-sponsored ABCP programs that meet certain criteria, which we believe reflect the alignment of interests Section 15G of the Exchange Act was intended to achieve, or deem such programs to comply with the risk retention requirements.[9]

A. Background

ABCP programs are short-term, senior-secured investment vehicles that issue instruments in the money markets. They are used by a wide variety of corporations – such as banks, finance companies, and broker-dealers – to obtain low-cost financing for a diverse range of financial receivables.

ABCP is offered continuously and carries repayment dates that usually range from overnight up to 270 days. ABCP programs are referred to as "asset-backed" because the bankruptcy remote, special-purpose vehicles that issue the ABCP own, or have security interests in, multiple pools of various types of financial receivables.

ABCP programs typically are supported by credit enhancement and committed liquidity facilities. The liquidity support for an ABCP program typically equals the face amount of ABCP outstanding, to protect investors in case of a market interruption or any timing differences with respect

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[5] Proposed Rule § ____.9.

[6] Release at 41.

[7] *See, e.g.,* Letter from Tom Deutsch, Executive Director, American Securitization Forum, to the Agencies, dated June 10, 2011, at 99-101, *available at* http://www.sec.gov/comments/s7-14-11/s71411-57.pdf.

[8] Section 15G of the Exchange Act states that the risk retention rules adopted by the Agencies shall provide for "a total or partial exemption of any securitization, as may be appropriate in the public interest and for the protection of investors . . ." Section 15G(c)(1)(G)(i).

[9] ABCP issued by structured investment vehicles ("SIVs") and securities arbitrage ABCP programs experienced significant difficulties during the credit crisis. Generally, we do not suggest that these types of programs be excluded from or exempt from the risk retention requirements or eligible for the ABCP risk retention option under the proposed rules.

to repayment.[10] For ABCP programs referred to as "fully supported," the liquidity facilities can be drawn to fund all of the receivables held by the program, even if some of those receivables are deemed to be "defaulted." For "partially supported" ABCP programs, the liquidity facilities will fund only "performing" receivables, *i.e.*, those not deemed to be in default. As a means of offsetting this potential source of risk, partially supported programs have credit enhancement facilities at both the pool level[11] (supporting individual transactions, often in the form of overcollateralization) and at the program level.[12] Generally, investors analyze ABCP transactions primarily on the strength of the ABCP program sponsor and of these programs' credit and liquidity arrangements, and less on the receivables being financed.

B. Bank-Sponsored ABCP Programs Should Not be Subject to Additional Risk Retention Requirements

We believe that the alignment of incentives between originator and investor that is sought by the Dodd-Frank Act largely has been achieved for bank-sponsored ABCP programs. Accordingly, it is unnecessary to impose additional risk retention requirements on these programs. On January 28, 2010, regulators including the Federal Reserve, the OCC, and the FDIC adopted a rule that requires banks sponsoring ABCP programs to consolidate ABCP conduits onto their balance sheets, aligning regulatory capital requirements with changes to generally accepted accounting principles.[13] This rule reflects the banking regulators' acknowledgement that risk exposure in ABCP programs generally is borne by the regulated bank sponsor, which must reserve adequate capital to cover any such risk.[14] We believe this alignment of interest that exists in bank-sponsored ABCP programs is an important prerequisite for an ABCP program to be exempted or excluded from, or deemed to comply with, the proposal's risk retention requirements. We also recommend the following as criteria to identify those bank-sponsored ABCP programs that are uniquely structured to provide safeguards to investors and the marketplace. We believe these criteria align the interests of sponsors with those of investors, consistent with the policy objectives of Section 15G of the Exchange Act, such that imposing additional risk

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[10] In the event that maturing ABCP cannot be refunded in the money markets, the administrator of the program (which is often the financial institution sponsoring the program) will draw upon the liquidity facilities in an amount sufficient to redeem all maturing ABCP.

[11] In some cases, the amount of pool-level credit enhancement for a given transaction is set dynamically, in that it increases to offset deteriorating pool performance.

[12] Program-level credit enhancement is often in the form of a letter of credit or a cash collateral account, effectively providing a five to ten percent subordinated cushion for the ABCP.

[13] *Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance; Regulatory Capital; Impact of Modifications to Generally Accepted Accounting Principles; Consolidation of Asset-Backed Commercial Paper Programs; and Other Related Issues,* 75 FR 4636 (Jan. 28, 2010).

[14] *Id.* at 4643.

retention requirements would be unnecessary. The criteria are the following:

(i) the sponsoring institution is a regulated banking institution;

(ii) the issuing entity is bankruptcy remote;

(iii) regulated liquidity providers have entered into a legally binding commitment to provide 100 percent liquidity coverage for all issued ABCP, at least 95 percent of which is provided by the sponsoring institution;

(iv) at least five percent program-wide, first loss credit enhancement is provided by the sponsoring institution of any partially-supported ABCP conduit in the form of an irrevocable and unconditional letter of credit, cash collateral, guarantee or other similar facility, or no credit enhancement is required for any fully-supported ABCP conduit; and

(v) monthly investor performance reports that include loan level detail are provided on a timely basis.

These criteria align the incentives of the sponsor and investors by ensuring that the risk of the ABCP conduit remains with the bank sponsor, and that the sponsor is responsible for substantially all of the liquidity and a key portion of any credit support for the conduit. In addition, the monthly investor reports provide an important monitoring mechanism. According to an assessment of this criteria performed by a rating agency for one of our members, the criteria would capture approximately 70 percent of the ABCP market in the United States. Importantly, the criteria would exclude SIVs, as well as those securities arbitrage programs that are not sponsored by a regulated banking institution and do not have available liquidity equal to at least the amount of ABCP outstanding.

We therefore request that the Agencies exclude or exempt bank-sponsored ABCP programs that meet these strict criteria from the proposed risk retention requirements, or deem these programs to satisfy the risk retention requirements. If, on the other hand, the Agencies adopt the proposed rules as written, it will be very difficult for existing ABCP programs to meet the conditions of the proposed risk retention option for ABCP programs. This will cause ABCP lending to slow significantly, and negatively affect both businesses seeking funding through this financing method and investors in ABCP.

Should the Agencies conclude that imposing further risk retention requirements on bank-sponsored ABCP programs is appropriate, we urge you to redefine the parameters for the proposed ABCP risk retention option, based on comments received, to better reflect current market practice and existing ABCP structures. For example, while originator-seller horizontal risk retention is a method that would work for certain ABCP programs, we believe that other risk retention methods should also

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A. Background

A municipal TOB program is created by a sponsor bank that deposits one or more high-quality municipal bonds into a trust which issues two classes of tax-exempt securities: a short-term security (the "floater") that is supported by a liquidity facility and an inverse floating rate security (the "residual").[16] The floater is a variable-rate demand security that bears interest at a rate adjusted at specified intervals (daily, weekly, or other intervals up to one year) according to a specific index or through a remarketing process. The liquidity facility supports a "put" or demand feature, allowing the floater holder to tender the security and receive, with specified notice, face value plus accrued interest, typically either from remarketing proceeds or a draw on the liquidity facility.[17] Floater holders bear limited and well-defined insolvency and default risks associated with the underlying bonds, and rely upon their largely unfettered put right to manage these risks. Tax-exempt money market funds are the principal holders of the floaters. The residuals generally are held by the entity that selects the underlying municipal bonds that serve as collateral for the trust. Holders of residuals are typically long-term investors, such as the TOB program sponsor bank or an affiliate, tax-exempt bond funds, closed-end funds, or other institutional investors in municipal bonds. Residual holders receive all interest

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[15] *See supra* note 8.

[16] TOBs generally are structured with a single long-term municipal bond in the trust but they may be structured with a pool of long-term municipal bonds.

[17] The liquidity facility is subject to termination upon certain major credit events affecting the issuer of the underlying municipal bonds (such as bankruptcy and ratings falling to below investment grade). Under these circumstances, the TOB trust would be collapsed and the floater holders would be paid from the sale of the collateral, or would receive the collateral if such proceeds were not sufficient to pay the holders in full.

payments from the underlying bonds that are not needed to pay interest on the floaters and expenses of the trust. Due to the operation of the liquidity facility, which provides holders of the floaters par amounts plus accrued interest upon demand, the residual holder bears all of the market risk associated with the TOB trust. Accordingly, the residual holder has a significant incentive to ensure that the underlying municipal bonds are of high credit quality.

B. TOBs Are Not the Types of Securities Section 15G Was Intended To Address

We do not believe that Congress, in enacting Section 15G, intended that the risk retention requirements apply to securitizations backed by municipal securities, such as TOBs. The legislative history indicates that Section 15G was directed toward securities generally considered by market participants to be traditional ABS, and especially toward mitigating risks associated with ABS backed by mortgages.[18]

TOBs have many features that distinguish them from the types of securities that 15G was intended to address. For example, the underlying collateral in a TOB trust is limited to municipal bonds, which have very different characteristics than the privately negotiated loans and trade receivables that serve as collateral for many types of ABS. These municipal bonds are of high quality, are typically rated in the top two long-term rating categories of nationally recognized statistical ratings organizations, and generally are publicly traded. In addition, a TOB trust typically holds securities of only one municipal issuer for which information is publicly available, resulting in greater transparency than in a typical ABS transaction. TOB trusts do not utilize tranching, and therefore have a simpler and more transparent structure than typical ABS.

Importantly, TOB programs are designed to create a short-term security with the same credit characteristics as the underlying long-term collateral. In fact, investors in TOB floaters and residuals consider themselves to be co-investors in the underlying bonds which collateralize a TOB trust for both credit quality and diversification purposes. This contrasts with typical ABS, in which the investor considers itself to be holding the trust for credit quality and diversification purposes. Unlike typical ABS programs, which are characterized by significant diversity in structures, TOB programs generally have the same basic structure. The TOB trust documentation extensively describes the program's

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[18] *See* S. Rep. No. 111-176, at 128 (2010) ("The Committee's investigation into the causes of the financial crisis identified abuses of the securitization process as a major contributing factor. Two problems emerged in the crisis. First, under the 'originate to distribute' model, loans were made expressly to be sold into securitization pools, which meant that the lenders did not expect to bear the credit risk of borrower default. This led to significant deterioration in credit and loan underwriting standards, particularly in residential mortgages . . . . Second, it proved impossible for investors in asset-backed securities to assess the risks of the underlying assets, particularly when those assets were resecuritized into complex instruments like collateralized debt obligations (CDOs) and CDO-squared. With the onset of the crisis, there was widespread uncertainty regarding the true financial condition of holders of asset-backed securities, freezing interbank lending and constricting the general flow of credit. Complexity and opacity in securitization markets created the conditions that allowed the financial shock from the subprime mortgage sector to spread into a global financial crisis . . .").

structure and the obligations of each of the trust's participants (*i.e.*, liquidity provider, remarketing agent, trustee), as well as information regarding the underlying collateral in the trust. Indeed, each trust is individually rated with a long-term rating based on the credit quality of the collateral and a short-term rating based on that of the liquidity provider, unlike typical ABS which are rated on the basis of the program's over-collateralization and generalized characteristics of the entire pool of collateral.

Neither Section 15G of the Exchange Act nor the proposal mentions TOBs, suggesting neither Congress nor the Agencies intended TOBs to be subject to the proposed risk retention requirements.[19] The exemption in Section 15G for ABS issued or guaranteed by states or local governments and the Agencies' proposed implementation of this exemption support the view that Congress did not intend to capture these and other municipal repackagings in Section 15G.[20] The Agencies specifically request comment in the proposal regarding whether their proposed exemption is under or over-inclusive.[21] We strongly believe it is under-inclusive, and that the Agencies should use their authority under Section 15G to exempt from the risk retention requirements municipal repackagings, such as TOBs, that are collateralized by one or more securities of the type described in proposed Rule § ____.21(a)(3).[22]

C. Applying the Proposed Risk Retention Requirements to TOBs is not in the Public Interest

As noted, TOB trusts, because they purchase and hold longer-term debt, are an important source of demand for state and local government bonds. It would be very difficult for TOB sponsors to meet the proposal's risk retention standards, due to the structural characteristics of TOB programs, which differ from the types of ABS the proposal clearly is intended to address. As a result, imposing risk-retention rules on TOB program sponsors would raise the costs of TOB program sponsorship. This would likely cause the demand for TOB issuance to decrease, potentially raising the costs of financing to state and local governments at a time when their finances are already under stress.

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[19] As additional support, we note that the Federal Reserve's October 2010 report to Congress on risk retention, which was mandated by the Dodd-Frank Act and offers suggested alternatives for rulemaking under Section 15G, considers approaches for a range of different types of ABS, but makes no mention of TOBs or other municipal repackagings. Federal Reserve, *Report to the Congress on Risk Retention* (Oct. 2010), available at http://www.federalreserve.gov/boarddocs/rptcongress/securitization/riskretention.pdf.

[20] Section 15G states that the Agencies' risk retention rules shall provide for "a total or partial exemption for any asset-backed security that is a security issued or guaranteed by any State of the United States, or 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 of 1933 by reason of section 3(a)(2) of that Act . . ." Section 15G(c)(1)(G)(iii). To implement this requirement, the Agencies have proposed an exemption from the risk retention requirements for municipal securities. Proposed Rule § ____.21(a)(3).

[21] Release at 105.

[22] Section 15G(c)(1(G)(i).

Subjecting sponsors of TOB trusts to the proposed risk retention requirements is unnecessary to achieve the Agencies' regulatory objectives. It could also significantly reduce the availability of TOBs for tax-exempt money market funds and closed-end funds, and disrupt the operations of long-term bond funds that invest in the residuals. For all of these reasons, we request confirmation that TOB programs are outside the scope of the proposal or will be exempted from the proposal's risk retention requirements.

III. Mortgage-Backed Securities

Funds invest in a variety of MBS, including agency MBS (*i.e.*, MBS guaranteed by the Federal National Mortgage Association ("Fannie Mae") or the Federal Home Loan Mortgage Corporation ("Freddie Mac")); RMBS; and CMBS. ICI, on behalf of its members, supports maintaining a strong securitization market for MBS that is subject to high, clearly defined standards. At the same time, we believe it is important for the Agencies, in tailoring the proposed risk retention requirements to different types of MBS, to be mindful of the consequences of adopting standards that are overly restrictive or do not adequately reflect current market practice.

A. Residential Mortgage-Backed Securities

Section 15G provides that the Agencies' risk retention requirements shall not apply to RMBS that are collateralized solely by QRMs.[23] Section 15G includes specific standards that the Agencies must consider in jointly defining what constitutes a QRM. ICI, on behalf of its members, supports a QRM standard that would exempt from the risk retention requirements only RMBS backed by very high quality loans. Some of our members support the Agencies' QRM standard as proposed, and believe that only the highest quality mortgages should qualify under the standard. Other members, however, are concerned that the Agencies' proposed standard may be somewhat too restrictive and could have negative implications for mortgage financing to credit-worthy households. They are concerned that an excessively strict QRM standard could result in a lack of liquidity in the QRM market, which would discourage participation in the market by investors, including funds, and, as a result, further limit mortgage funding.

[23] Section 15G(e)(4).

B. Commercial Mortgage-Backed Securities

Section 15G of the Exchange Act states that, with respect to CMBS, the Agencies may provide for a special risk retention option in which a five percent horizontal, first-loss position is held by a third-party purchaser, if certain specified conditions are met.[24] The Agencies have implemented this provision by proposing a rule that would permit a CMBS sponsor to satisfy its risk retention obligation if a third-party purchaser acquires such an interest, subject to certain conditions.[25] This option accurately reflects the common market practice of allocating the first-loss position in a CMBS transaction to a third-party purchaser, typically known as the "B-piece buyer." Certain funds that invest in CMBS may buy the B-piece and could, under the proposed rule, potentially be a third-party purchaser. Our members that manage funds that may serve in this role have concerns that certain aspects of how the risk retention option for CMBS would operate may discourage or preclude funds from serving in the role of third-party purchaser, as well as have detrimental implications for the operation of the CMBS markets as a whole, with consequences both for investors in those markets and the businesses that obtain funding through those markets.

One of the conditions of the proposed rule is that a third-party purchaser may not sell or hedge the interest it is required to retain under the rule.[26] While we understand this provision is intended to place the third-party purchaser in the same position as if it were the sponsor retaining the same horizontal, first-loss risk retention position,[27] requiring the B-piece buyer to retain its interest for the life of the transaction would strongly discourage funds from purchasing these interests. In lieu of requiring the B-piece buyer to retain its interest for the life of the transaction, we recommend that the Agencies propose the following tiered approach: (i) require the B-piece buyer to retain its interest for a one-year period in which it may not sell or hedge the interest; (ii) for the following four years, permit the B-piece buyer to transfer its interest only to a "qualified transferee" that must meet the same criteria under the rule as the B-piece buyer; and (iii) for the remainder of the transaction, not impose restrictions on transfer or hedging.

Under the Agencies' proposed CMBS option, a B-piece purchaser is intended to stand in the shoes of the sponsor for purposes of complying with the risk retention rules. Under our recommended approach, requiring the B-piece purchaser to hold its interest for a one-year period provides a sufficient amount of time to reveal whether there are any significant deficiencies or fraud in the underwriting process. Permitting transfer to a "qualified transferee" that satisfies the same criteria under the proposed rule as the B-piece buyer for the following four years seems fully consistent with the Agencies'

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[24] Section 15G(c)(1)(E).

[25] Proposed Rule § ____.10.

[26] Proposed Rule § ____.10(a)(6).

[27] Release at 47.

policy objective of including the transfer restriction in the proposed CMBS option because the qualified transferee could have served as the original B-piece buyer.[28] We believe this approach, by imposing a reasonable holding period on third-party purchasers, would address Congress' and the Agencies' concern that the securitizer or, in this case, an entity standing in its place, not be able to reduce its exposure to the credit risk of the securitized assets.[29]

Another condition of the proposed rule would require that a sponsor utilizing the CMBS risk retention option disclose to potential investors in the CMBS transaction (and to the Agencies, upon request) the identity of the third-party purchaser, provide a description of the third-party purchaser's experience in investing in CMBS, include any other information regarding the third-party purchaser or its retention of an interest in the transaction "that is material to investors in light of the circumstances of the particular securitization transaction," provide the amount of the residual interest that the purchaser will retain or has retained in the transaction, list the purchase price paid for the interest, and describe the material terms of the interest retained by the third-party purchaser, among other information.[30] We agree that a sponsor that is satisfying its risk retention obligations by means of a third-party purchaser should provide potential investors with information relating to the interest retained by that third party and therefore support most of the proposed disclosure requirements, many of which are consistent with current market practice. We believe, however, that the proposed requirement to disclose the purchase price paid for the interest should be eliminated. Such disclosure is inconsistent with market practice and requiring it would discourage investors from serving in the role of third-party purchaser. This information is typically confidential, and is unnecessary to disclose publicly, given that information would be disclosed about the amount of the interest held.

* * * * *

We appreciate that tailoring risk retention requirements to reflect the diversity that exists across the ABS markets is a sizable undertaking, especially when it must be done jointly by six federal agencies. The joint nature of this rulemaking makes it all the more important, however, for the Agencies to develop workable standards for risk retention *prior* to the rules' adoption. The proposal states that the Agencies will jointly approve "any written interpretations, written responses to requests for no-action letters and legal opinions, or other written interpretive guidance concerning the scope or terms of section 15G and the final rules issued thereunder that are intended to be relied on by the

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[28] We further note that B-piece buyers are institutional buyers, and that these interests are traded only in the Rule 144A market.

[29] *See* S. Rep. No. 111-176, at 129 (2010) ("The regulations will prohibit securitizers from hedging or otherwise transferring the credit risk they are required to retain."); Release at 58.
[30] *See* proposed Rule § ____.10(a)(5).

[30] *See* proposed Rule § ____.10(a)(5).

public generally."[31] As a result, addressing any issues raised by the proposal will be even more difficult after the rules are adopted. If there is any way we may further assist the Agencies, please feel free to contact me directly at (202) 326-5815 or Sarah Bessin at (202) 326-5835.

Sincerely,

/s/

Karrie McMillan
General Counsel

cc: The Honorable Mary L. Schapiro
The Honorable Kathleen L. Casey
The Honorable Elisse B. Walter
The Honorable Luis A. Aguilar
The Honorable Troy A. Paredes

[31] Release at 17.

INVESTMENT COMPANY INSTITUTE

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July 29, 2011

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549
File Number S7-14-11
RIN 3235-AK96

Office of the Comptroller of the Currency
250 E Street, S.W., Mail Stop 2-3
Washington, D.C. 20219
Docket Number OCC 2011-0002
RIN 1557-AD40

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551
Docket Number 2011-1411
RIN 7100-AD70

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
RIN 3064-AD74

Mr. Alfred M. Pollard
General Counsel
Attention: Comments/RIN 2590-AA43
Federal Housing Finance Agency
1700 G Street, N.W., Fourth Floor
Washington, D.C. 20552

Regulations Division
Office of General Counsel
Department of Housing and Urban Development
451 7th Street, S.W., Room 10276
Washington, D.C. 20410-0500
RIN 2501-AD53

Re: Credit Risk Retention

Ladies and Gentlemen:

The Investment Company Institute[1] supports the goal of the joint proposal of the Securities and Exchange Commission ("SEC" or "Commission"), Office of the Comptroller of the Currency

[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $13.3 trillion and serve over 90 million shareholders.

("OCC"), Board of Governors of the Federal Reserve System ("Federal Reserve"), Federal Deposit Insurance Corporation ("FDIC"), Federal Housing Finance Agency, and Department of Housing and Urban Development (together, the "Agencies") to better align the interests of securitizers of asset-backed securities ("ABS") with those of investors in ABS. The proposal would implement the credit risk retention requirements of Section 15G of the Securities Exchange Act of 1934 ("Exchange Act"), as added by Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), generally to require an ABS sponsor to retain not less than five percent of the credit risk of any asset that the sponsor, through the issuance of the ABS, transfers, sells, or conveys to a third party.[2] As purchasers of ABS, registered investment companies ("funds") have a strong interest in ensuring that securitizers of ABS act consistently with the interests of investors.[3]

We are concerned, however, that the proposed standards for risk retention may not be appropriate or necessary for certain classes of ABS in which funds invest. We commend the Agencies for recognizing that ABS have diverse characteristics and for seeking to tailor the proposed risk retention requirements based on the characteristics of different ABS. We do not believe, however, that the proposed requirements sufficiently reflect differences among certain classes of ABS or market practice for those particular securities.[4] This is particularly so with respect to notes issued by asset-backed commercial paper ("ABCP") programs and securities issued by municipal tender option bond ("TOB") programs. In addition, we are concerned that certain of the standards proposed with respect to mortgage-backed securities ("MBS"), in particular commercial mortgage-backed securities ("CMBS"), may impair the viability of those markets – a result in the best interests of neither investors, including funds, nor the individuals and firms that obtain financing through those markets. Finally, we support a "qualified residential mortgage" ("QRM") standard under the proposed exemption from the risk retention requirements for residential mortgage-backed securities ("RMBS") that are backed solely by very high quality loans, although our members have somewhat different views regarding the appropriate QRM standard.

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[2] *Credit Risk Retention,* Securities Exchange Act Release No. 64148 (March 30, 2011), available at http://www.sec.gov/rules/proposed/2011/34-64148.pdf ("Release").

[3] Funds also have an interest in strong disclosure standards for ABS, and we have, in the past, supported the Commission's efforts to improve disclosure and reporting for ABS. *See* Letter from Karrie McMillan, General Counsel, ICI, to Elizabeth M. Murphy, Secretary, SEC, dated Nov. 15, 2010; Letter from Karrie McMillan, General Counsel, ICI, to Elizabeth M. Murphy, Secretary, SEC, dated Aug. 2, 2010.

[4] As Congress stated in the legislative history for Section 15G of the Exchange Act, "a 'one size fits all' approach to risk retention may adversely affect certain securitization markets . . . . Accordingly, the bill requires that the initial joint rulemaking include separate components addressing individual asset classes -- home mortgages, commercial mortgages, commercial loans, auto loans, and any other asset class that the regulators deem appropriate. The Committee expects that these regulations will recognize differences in the assets securitized, in existing risk management practices, and in the structure of asset-backed securities, and that regulators will make appropriate adjustments to the amount of risk retention required." S. Rep. No. 111-176, at 130 (2010).

We address each of the foregoing concerns in turn below.

I. Asset-Backed Commercial Paper Programs

The proposal includes a risk retention option specifically designed for ABCP programs that meet certain conditions.[5] We appreciate the Agencies' recognition that this instrument has unique characteristics, and recognize that the Agencies have sought to make this option consistent with existing market practice.[6] We understand, however, that most existing ABCP programs could not meet the proposed rule's conditions.[7] We therefore recommend, in lieu of the ABCP risk retention option, that the Agencies exclude or exempt from the proposal's risk retention requirements[8] those bank-sponsored ABCP programs that meet certain criteria, which we believe reflect the alignment of interests Section 15G of the Exchange Act was intended to achieve, or deem such programs to comply with the risk retention requirements.[9]

A. Background

ABCP programs are short-term, senior-secured investment vehicles that issue instruments in the money markets. They are used by a wide variety of corporations – such as banks, finance companies, and broker-dealers – to obtain low-cost financing for a diverse range of financial receivables.

ABCP is offered continuously and carries repayment dates that usually range from overnight up to 270 days. ABCP programs are referred to as "asset-backed" because the bankruptcy remote, special-purpose vehicles that issue the ABCP own, or have security interests in, multiple pools of various types of financial receivables.

ABCP programs typically are supported by credit enhancement and committed liquidity facilities. The liquidity support for an ABCP program typically equals the face amount of ABCP outstanding, to protect investors in case of a market interruption or any timing differences with respect

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[5] Proposed Rule § ____.9.

[6] Release at 41.

[7] *See, e.g.,* Letter from Tom Deutsch, Executive Director, American Securitization Forum, to the Agencies, dated June 10, 2011, at 99-101, *available at* http://www.sec.gov/comments/s7-14-11/s71411-57.pdf.

[8] Section 15G of the Exchange Act states that the risk retention rules adopted by the Agencies shall provide for "a total or partial exemption of any securitization, as may be appropriate in the public interest and for the protection of investors . . ." Section 15G(c)(1)(G)(i).

[9] ABCP issued by structured investment vehicles ("SIVs") and securities arbitrage ABCP programs experienced significant difficulties during the credit crisis. Generally, we do not suggest that these types of programs be excluded from or exempt from the risk retention requirements or eligible for the ABCP risk retention option under the proposed rules.

to repayment.[10] For ABCP programs referred to as "fully supported," the liquidity facilities can be drawn to fund all of the receivables held by the program, even if some of those receivables are deemed to be "defaulted." For "partially supported" ABCP programs, the liquidity facilities will fund only "performing" receivables, *i.e.*, those not deemed to be in default. As a means of offsetting this potential source of risk, partially supported programs have credit enhancement facilities at both the pool level[11] (supporting individual transactions, often in the form of overcollateralization) and at the program level.[12] Generally, investors analyze ABCP transactions primarily on the strength of the ABCP program sponsor and of these programs' credit and liquidity arrangements, and less on the receivables being financed.

B. Bank-Sponsored ABCP Programs Should Not be Subject to Additional Risk Retention Requirements

We believe that the alignment of incentives between originator and investor that is sought by the Dodd-Frank Act largely has been achieved for bank-sponsored ABCP programs. Accordingly, it is unnecessary to impose additional risk retention requirements on these programs. On January 28, 2010, regulators including the Federal Reserve, the OCC, and the FDIC adopted a rule that requires banks sponsoring ABCP programs to consolidate ABCP conduits onto their balance sheets, aligning regulatory capital requirements with changes to generally accepted accounting principles.[13] This rule reflects the banking regulators' acknowledgement that risk exposure in ABCP programs generally is borne by the regulated bank sponsor, which must reserve adequate capital to cover any such risk.[14] We believe this alignment of interest that exists in bank-sponsored ABCP programs is an important prerequisite for an ABCP program to be exempted or excluded from, or deemed to comply with, the proposal's risk retention requirements. We also recommend the following as criteria to identify those bank-sponsored ABCP programs that are uniquely structured to provide safeguards to investors and the marketplace. We believe these criteria align the interests of sponsors with those of investors, consistent with the policy objectives of Section 15G of the Exchange Act, such that imposing additional risk

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[10] In the event that maturing ABCP cannot be refunded in the money markets, the administrator of the program (which is often the financial institution sponsoring the program) will draw upon the liquidity facilities in an amount sufficient to redeem all maturing ABCP.

[11] In some cases, the amount of pool-level credit enhancement for a given transaction is set dynamically, in that it increases to offset deteriorating pool performance.

[12] Program-level credit enhancement is often in the form of a letter of credit or a cash collateral account, effectively providing a five to ten percent subordinated cushion for the ABCP.

[13] *Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance; Regulatory Capital; Impact of Modifications to Generally Accepted Accounting Principles; Consolidation of Asset-Backed Commercial Paper Programs; and Other Related Issues,* 75 FR 4636 (Jan. 28, 2010).

[14] *Id.* at 4643.

retention requirements would be unnecessary. The criteria are the following:

(i) the sponsoring institution is a regulated banking institution;

(ii) the issuing entity is bankruptcy remote;

(iii) regulated liquidity providers have entered into a legally binding commitment to provide 100 percent liquidity coverage for all issued ABCP, at least 95 percent of which is provided by the sponsoring institution;

(iv) at least five percent program-wide, first loss credit enhancement is provided by the sponsoring institution of any partially-supported ABCP conduit in the form of an irrevocable and unconditional letter of credit, cash collateral, guarantee or other similar facility, or no credit enhancement is required for any fully-supported ABCP conduit; and

(v) monthly investor performance reports that include loan level detail are provided on a timely basis.

These criteria align the incentives of the sponsor and investors by ensuring that the risk of the ABCP conduit remains with the bank sponsor, and that the sponsor is responsible for substantially all of the liquidity and a key portion of any credit support for the conduit. In addition, the monthly investor reports provide an important monitoring mechanism. According to an assessment of this criteria performed by a rating agency for one of our members, the criteria would capture approximately 70 percent of the ABCP market in the United States. Importantly, the criteria would exclude SIVs, as well as those securities arbitrage programs that are not sponsored by a regulated banking institution and do not have available liquidity equal to at least the amount of ABCP outstanding.

We therefore request that the Agencies exclude or exempt bank-sponsored ABCP programs that meet these strict criteria from the proposed risk retention requirements, or deem these programs to satisfy the risk retention requirements. If, on the other hand, the Agencies adopt the proposed rules as written, it will be very difficult for existing ABCP programs to meet the conditions of the proposed risk retention option for ABCP programs. This will cause ABCP lending to slow significantly, and negatively affect both businesses seeking funding through this financing method and investors in ABCP.

Should the Agencies conclude that imposing further risk retention requirements on bank-sponsored ABCP programs is appropriate, we urge you to redefine the parameters for the proposed ABCP risk retention option, based on comments received, to better reflect current market practice and existing ABCP structures. For example, while originator-seller horizontal risk retention is a method that would work for certain ABCP programs, we believe that other risk retention methods should also

be permitted as part of the ABCP risk retention option. Such methods should include those otherwise permitted under the proposed rules, as well as credit enhancements that serve an analogous function to the risk retention requirements, such as letters of credit and cash collateral accounts, which are standard in the market.

II. Municipal Tender Option Bond Programs

The proposal is silent regarding municipal TOBs. We request clarification that TOBs are not within the scope of the proposal or, alternatively, that they be exempted from its requirements.[15] Although TOBs have certain features that are similar to those of ABS, market participants generally do not perceive TOBs as ABS. Nor do we believe that TOBs raise the concerns that Congress intended to address when it enacted Section 15G of the Exchange Act. The structural characteristics of TOB programs would make it difficult for their sponsors to satisfy the proposed risk retention requirements. If TOB sponsors were forced to restructure their programs significantly to comply with the proposed rules' requirements, the increase in the cost of TOB program sponsorship could adversely affect the state and local governments that indirectly receive funding through these programs.

A. Background

A municipal TOB program is created by a sponsor bank that deposits one or more high-quality municipal bonds into a trust which issues two classes of tax-exempt securities: a short-term security (the "floater") that is supported by a liquidity facility and an inverse floating rate security (the "residual").[16] The floater is a variable-rate demand security that bears interest at a rate adjusted at specified intervals (daily, weekly, or other intervals up to one year) according to a specific index or through a remarketing process. The liquidity facility supports a "put" or demand feature, allowing the floater holder to tender the security and receive, with specified notice, face value plus accrued interest, typically either from remarketing proceeds or a draw on the liquidity facility.[17] Floater holders bear limited and well-defined insolvency and default risks associated with the underlying bonds, and rely upon their largely unfettered put right to manage these risks. Tax-exempt money market funds are the principal holders of the floaters. The residuals generally are held by the entity that selects the underlying municipal bonds that serve as collateral for the trust. Holders of residuals are typically long-term investors, such as the TOB program sponsor bank or an affiliate, tax-exempt bond funds, closed-end funds, or other institutional investors in municipal bonds. Residual holders receive all interest

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[15] *See supra* note 8.

[16] TOBs generally are structured with a single long-term municipal bond in the trust but they may be structured with a pool of long-term municipal bonds.

[17] The liquidity facility is subject to termination upon certain major credit events affecting the issuer of the underlying municipal bonds (such as bankruptcy and ratings falling to below investment grade). Under these circumstances, the TOB trust would be collapsed and the floater holders would be paid from the sale of the collateral, or would receive the collateral if such proceeds were not sufficient to pay the holders in full.

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B. TOBs Are Not the Types of Securities Section 15G Was Intended To Address

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TOBs have many features that distinguish them from the types of securities that 15G was intended to address. For example, the underlying collateral in a TOB trust is limited to municipal bonds, which have very different characteristics than the privately negotiated loans and trade receivables that serve as collateral for many types of ABS. These municipal bonds are of high quality, are typically rated in the top two long-term rating categories of nationally recognized statistical ratings organizations, and generally are publicly traded. In addition, a TOB trust typically holds securities of only one municipal issuer for which information is publicly available, resulting in greater transparency than in a typical ABS transaction. TOB trusts do not utilize tranching, and therefore have a simpler and more transparent structure than typical ABS.

Importantly, TOB programs are designed to create a short-term security with the same credit characteristics as the underlying long-term collateral. In fact, investors in TOB floaters and residuals consider themselves to be co-investors in the underlying bonds which collateralize a TOB trust for both credit quality and diversification purposes. This contrasts with typical ABS, in which the investor considers itself to be holding the trust for credit quality and diversification purposes. Unlike typical ABS programs, which are characterized by significant diversity in structures, TOB programs generally have the same basic structure. The TOB trust documentation extensively describes the program's

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[18] *See* S. Rep. No. 111-176, at 128 (2010) ("The Committee's investigation into the causes of the financial crisis identified abuses of the securitization process as a major contributing factor. Two problems emerged in the crisis. First, under the 'originate to distribute' model, loans were made expressly to be sold into securitization pools, which meant that the lenders did not expect to bear the credit risk of borrower default. This led to significant deterioration in credit and loan underwriting standards, particularly in residential mortgages . . . . Second, it proved impossible for investors in asset-backed securities to assess the risks of the underlying assets, particularly when those assets were resecuritized into complex instruments like collateralized debt obligations (CDOs) and CDO-squared. With the onset of the crisis, there was widespread uncertainty regarding the true financial condition of holders of asset-backed securities, freezing interbank lending and constricting the general flow of credit. Complexity and opacity in securitization markets created the conditions that allowed the financial shock from the subprime mortgage sector to spread into a global financial crisis . . .").

structure and the obligations of each of the trust's participants (*i.e.*, liquidity provider, remarketing agent, trustee), as well as information regarding the underlying collateral in the trust. Indeed, each trust is individually rated with a long-term rating based on the credit quality of the collateral and a short-term rating based on that of the liquidity provider, unlike typical ABS which are rated on the basis of the program's over-collateralization and generalized characteristics of the entire pool of collateral.

Neither Section 15G of the Exchange Act nor the proposal mentions TOBs, suggesting neither Congress nor the Agencies intended TOBs to be subject to the proposed risk retention requirements.[19] The exemption in Section 15G for ABS issued or guaranteed by states or local governments and the Agencies' proposed implementation of this exemption support the view that Congress did not intend to capture these and other municipal repackagings in Section 15G.[20] The Agencies specifically request comment in the proposal regarding whether their proposed exemption is under or over-inclusive.[21] We strongly believe it is under-inclusive, and that the Agencies should use their authority under Section 15G to exempt from the risk retention requirements municipal repackagings, such as TOBs, that are collateralized by one or more securities of the type described in proposed Rule § ____.21(a)(3).[22]

C. Applying the Proposed Risk Retention Requirements to TOBs is not in the Public Interest

As noted, TOB trusts, because they purchase and hold longer-term debt, are an important source of demand for state and local government bonds. It would be very difficult for TOB sponsors to meet the proposal's risk retention standards, due to the structural characteristics of TOB programs, which differ from the types of ABS the proposal clearly is intended to address. As a result, imposing risk-retention rules on TOB program sponsors would raise the costs of TOB program sponsorship. This would likely cause the demand for TOB issuance to decrease, potentially raising the costs of financing to state and local governments at a time when their finances are already under stress.

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[19] As additional support, we note that the Federal Reserve's October 2010 report to Congress on risk retention, which was mandated by the Dodd-Frank Act and offers suggested alternatives for rulemaking under Section 15G, considers approaches for a range of different types of ABS, but makes no mention of TOBs or other municipal repackagings. Federal Reserve, *Report to the Congress on Risk Retention* (Oct. 2010), available at http://www.federalreserve.gov/boarddocs/rptcongress/securitization/riskretention.pdf.

[20] Section 15G states that the Agencies' risk retention rules shall provide for "a total or partial exemption for any asset-backed security that is a security issued or guaranteed by any State of the United States, or 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 of 1933 by reason of section 3(a)(2) of that Act . . ." Section 15G(c)(1)(G)(iii). To implement this requirement, the Agencies have proposed an exemption from the risk retention requirements for municipal securities. Proposed Rule § ____.21(a)(3).

[21] Release at 105.

[22] Section 15G(c)(1(G)(i).

Subjecting sponsors of TOB trusts to the proposed risk retention requirements is unnecessary to achieve the Agencies' regulatory objectives. It could also significantly reduce the availability of TOBs for tax-exempt money market funds and closed-end funds, and disrupt the operations of long-term bond funds that invest in the residuals. For all of these reasons, we request confirmation that TOB programs are outside the scope of the proposal or will be exempted from the proposal's risk retention requirements.

III. Mortgage-Backed Securities

Funds invest in a variety of MBS, including agency MBS (*i.e.*, MBS guaranteed by the Federal National Mortgage Association ("Fannie Mae") or the Federal Home Loan Mortgage Corporation ("Freddie Mac")); RMBS; and CMBS. ICI, on behalf of its members, supports maintaining a strong securitization market for MBS that is subject to high, clearly defined standards. At the same time, we believe it is important for the Agencies, in tailoring the proposed risk retention requirements to different types of MBS, to be mindful of the consequences of adopting standards that are overly restrictive or do not adequately reflect current market practice.

A. Residential Mortgage-Backed Securities

Section 15G provides that the Agencies' risk retention requirements shall not apply to RMBS that are collateralized solely by QRMs.[23] Section 15G includes specific standards that the Agencies must consider in jointly defining what constitutes a QRM. ICI, on behalf of its members, supports a QRM standard that would exempt from the risk retention requirements only RMBS backed by very high quality loans. Some of our members support the Agencies' QRM standard as proposed, and believe that only the highest quality mortgages should qualify under the standard. Other members, however, are concerned that the Agencies' proposed standard may be somewhat too restrictive and could have negative implications for mortgage financing to credit-worthy households. They are concerned that an excessively strict QRM standard could result in a lack of liquidity in the QRM market, which would discourage participation in the market by investors, including funds, and, as a result, further limit mortgage funding.

[23] Section 15G(e)(4).

B. Commercial Mortgage-Backed Securities

Section 15G of the Exchange Act states that, with respect to CMBS, the Agencies may provide for a special risk retention option in which a five percent horizontal, first-loss position is held by a third-party purchaser, if certain specified conditions are met.[24] The Agencies have implemented this provision by proposing a rule that would permit a CMBS sponsor to satisfy its risk retention obligation if a third-party purchaser acquires such an interest, subject to certain conditions.[25] This option accurately reflects the common market practice of allocating the first-loss position in a CMBS transaction to a third-party purchaser, typically known as the "B-piece buyer." Certain funds that invest in CMBS may buy the B-piece and could, under the proposed rule, potentially be a third-party purchaser. Our members that manage funds that may serve in this role have concerns that certain aspects of how the risk retention option for CMBS would operate may discourage or preclude funds from serving in the role of third-party purchaser, as well as have detrimental implications for the operation of the CMBS markets as a whole, with consequences both for investors in those markets and the businesses that obtain funding through those markets.

One of the conditions of the proposed rule is that a third-party purchaser may not sell or hedge the interest it is required to retain under the rule.[26] While we understand this provision is intended to place the third-party purchaser in the same position as if it were the sponsor retaining the same horizontal, first-loss risk retention position,[27] requiring the B-piece buyer to retain its interest for the life of the transaction would strongly discourage funds from purchasing these interests. In lieu of requiring the B-piece buyer to retain its interest for the life of the transaction, we recommend that the Agencies propose the following tiered approach: (i) require the B-piece buyer to retain its interest for a one-year period in which it may not sell or hedge the interest; (ii) for the following four years, permit the B-piece buyer to transfer its interest only to a "qualified transferee" that must meet the same criteria under the rule as the B-piece buyer; and (iii) for the remainder of the transaction, not impose restrictions on transfer or hedging.

Under the Agencies' proposed CMBS option, a B-piece purchaser is intended to stand in the shoes of the sponsor for purposes of complying with the risk retention rules. Under our recommended approach, requiring the B-piece purchaser to hold its interest for a one-year period provides a sufficient amount of time to reveal whether there are any significant deficiencies or fraud in the underwriting process. Permitting transfer to a "qualified transferee" that satisfies the same criteria under the proposed rule as the B-piece buyer for the following four years seems fully consistent with the Agencies'

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[24] Section 15G(c)(1)(E).

[25] Proposed Rule § ____.10.

[26] Proposed Rule § ____.10(a)(6).

[27] Release at 47.

policy objective of including the transfer restriction in the proposed CMBS option because the qualified transferee could have served as the original B-piece buyer.[28] We believe this approach, by imposing a reasonable holding period on third-party purchasers, would address Congress' and the Agencies' concern that the securitizer or, in this case, an entity standing in its place, not be able to reduce its exposure to the credit risk of the securitized assets.[29]

Another condition of the proposed rule would require that a sponsor utilizing the CMBS risk retention option disclose to potential investors in the CMBS transaction (and to the Agencies, upon request) the identity of the third-party purchaser, provide a description of the third-party purchaser's experience in investing in CMBS, include any other information regarding the third-party purchaser or its retention of an interest in the transaction "that is material to investors in light of the circumstances of the particular securitization transaction," provide the amount of the residual interest that the purchaser will retain or has retained in the transaction, list the purchase price paid for the interest, and describe the material terms of the interest retained by the third-party purchaser, among other information.[30] We agree that a sponsor that is satisfying its risk retention obligations by means of a third-party purchaser should provide potential investors with information relating to the interest retained by that third party and therefore support most of the proposed disclosure requirements, many of which are consistent with current market practice. We believe, however, that the proposed requirement to disclose the purchase price paid for the interest should be eliminated. Such disclosure is inconsistent with market practice and requiring it would discourage investors from serving in the role of third-party purchaser. This information is typically confidential, and is unnecessary to disclose publicly, given that information would be disclosed about the amount of the interest held.

* * * * *

We appreciate that tailoring risk retention requirements to reflect the diversity that exists across the ABS markets is a sizable undertaking, especially when it must be done jointly by six federal agencies. The joint nature of this rulemaking makes it all the more important, however, for the Agencies to develop workable standards for risk retention *prior* to the rules' adoption. The proposal states that the Agencies will jointly approve "any written interpretations, written responses to requests for no-action letters and legal opinions, or other written interpretive guidance concerning the scope or terms of section 15G and the final rules issued thereunder that are intended to be relied on by the

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[28] We further note that B-piece buyers are institutional buyers, and that these interests are traded only in the Rule 144A market.

[29] *See* S. Rep. No. 111-176, at 129 (2010) ("The regulations will prohibit securitizers from hedging or otherwise transferring the credit risk they are required to retain."); Release at 58.
[30] *See* proposed Rule § ____.10(a)(5).

[30] *See* proposed Rule § ____.10(a)(5).

public generally."[31] As a result, addressing any issues raised by the proposal will be even more difficult after the rules are adopted. If there is any way we may further assist the Agencies, please feel free to contact me directly at (202) 326-5815 or Sarah Bessin at (202) 326-5835.

Sincerely,

/s/

Karrie McMillan
General Counsel

cc: The Honorable Mary L. Schapiro
The Honorable Kathleen L. Casey
The Honorable Elisse B. Walter
The Honorable Luis A. Aguilar
The Honorable Troy A. Paredes

[31] Release at 17.

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July 29, 2011

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549
File Number S7-14-11
RIN 3235-AK96

Office of the Comptroller of the Currency
250 E Street, S.W., Mail Stop 2-3
Washington, D.C. 20219
Docket Number OCC 2011-0002
RIN 1557-AD40

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551
Docket Number 2011-1411
RIN 7100-AD70

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
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RIN 3064-AD74

Mr. Alfred M. Pollard
General Counsel
Attention: Comments/RIN 2590-AA43
Federal Housing Finance Agency
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Washington, D.C. 20552

Regulations Division
Office of General Counsel
Department of Housing and Urban Development
451 7th Street, S.W., Room 10276
Washington, D.C. 20410-0500
RIN 2501-AD53

Re: Credit Risk Retention

Ladies and Gentlemen:

The Investment Company Institute[1] supports the goal of the joint proposal of the Securities and Exchange Commission ("SEC" or "Commission"), Office of the Comptroller of the Currency

[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $13.3 trillion and serve over 90 million shareholders.

("OCC"), Board of Governors of the Federal Reserve System ("Federal Reserve"), Federal Deposit Insurance Corporation ("FDIC"), Federal Housing Finance Agency, and Department of Housing and Urban Development (together, the "Agencies") to better align the interests of securitizers of asset-backed securities ("ABS") with those of investors in ABS. The proposal would implement the credit risk retention requirements of Section 15G of the Securities Exchange Act of 1934 ("Exchange Act"), as added by Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), generally to require an ABS sponsor to retain not less than five percent of the credit risk of any asset that the sponsor, through the issuance of the ABS, transfers, sells, or conveys to a third party.[2] As purchasers of ABS, registered investment companies ("funds") have a strong interest in ensuring that securitizers of ABS act consistently with the interests of investors.[3]

We are concerned, however, that the proposed standards for risk retention may not be appropriate or necessary for certain classes of ABS in which funds invest. We commend the Agencies for recognizing that ABS have diverse characteristics and for seeking to tailor the proposed risk retention requirements based on the characteristics of different ABS. We do not believe, however, that the proposed requirements sufficiently reflect differences among certain classes of ABS or market practice for those particular securities.[4] This is particularly so with respect to notes issued by asset-backed commercial paper ("ABCP") programs and securities issued by municipal tender option bond ("TOB") programs. In addition, we are concerned that certain of the standards proposed with respect to mortgage-backed securities ("MBS"), in particular commercial mortgage-backed securities ("CMBS"), may impair the viability of those markets – a result in the best interests of neither investors, including funds, nor the individuals and firms that obtain financing through those markets. Finally, we support a "qualified residential mortgage" ("QRM") standard under the proposed exemption from the risk retention requirements for residential mortgage-backed securities ("RMBS") that are backed solely by very high quality loans, although our members have somewhat different views regarding the appropriate QRM standard.

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[2] *Credit Risk Retention,* Securities Exchange Act Release No. 64148 (March 30, 2011), available at http://www.sec.gov/rules/proposed/2011/34-64148.pdf ("Release").

[3] Funds also have an interest in strong disclosure standards for ABS, and we have, in the past, supported the Commission's efforts to improve disclosure and reporting for ABS. *See* Letter from Karrie McMillan, General Counsel, ICI, to Elizabeth M. Murphy, Secretary, SEC, dated Nov. 15, 2010; Letter from Karrie McMillan, General Counsel, ICI, to Elizabeth M. Murphy, Secretary, SEC, dated Aug. 2, 2010.

[4] As Congress stated in the legislative history for Section 15G of the Exchange Act, "a 'one size fits all' approach to risk retention may adversely affect certain securitization markets . . . . Accordingly, the bill requires that the initial joint rulemaking include separate components addressing individual asset classes -- home mortgages, commercial mortgages, commercial loans, auto loans, and any other asset class that the regulators deem appropriate. The Committee expects that these regulations will recognize differences in the assets securitized, in existing risk management practices, and in the structure of asset-backed securities, and that regulators will make appropriate adjustments to the amount of risk retention required." S. Rep. No. 111-176, at 130 (2010).

We address each of the foregoing concerns in turn below.

I. Asset-Backed Commercial Paper Programs

The proposal includes a risk retention option specifically designed for ABCP programs that meet certain conditions.[5] We appreciate the Agencies' recognition that this instrument has unique characteristics, and recognize that the Agencies have sought to make this option consistent with existing market practice.[6] We understand, however, that most existing ABCP programs could not meet the proposed rule's conditions.[7] We therefore recommend, in lieu of the ABCP risk retention option, that the Agencies exclude or exempt from the proposal's risk retention requirements[8] those bank-sponsored ABCP programs that meet certain criteria, which we believe reflect the alignment of interests Section 15G of the Exchange Act was intended to achieve, or deem such programs to comply with the risk retention requirements.[9]

A. Background

ABCP programs are short-term, senior-secured investment vehicles that issue instruments in the money markets. They are used by a wide variety of corporations – such as banks, finance companies, and broker-dealers – to obtain low-cost financing for a diverse range of financial receivables.

ABCP is offered continuously and carries repayment dates that usually range from overnight up to 270 days. ABCP programs are referred to as "asset-backed" because the bankruptcy remote, special-purpose vehicles that issue the ABCP own, or have security interests in, multiple pools of various types of financial receivables.

ABCP programs typically are supported by credit enhancement and committed liquidity facilities. The liquidity support for an ABCP program typically equals the face amount of ABCP outstanding, to protect investors in case of a market interruption or any timing differences with respect

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[5] Proposed Rule § ____.9.

[6] Release at 41.

[7] *See, e.g.,* Letter from Tom Deutsch, Executive Director, American Securitization Forum, to the Agencies, dated June 10, 2011, at 99-101, *available at* http://www.sec.gov/comments/s7-14-11/s71411-57.pdf.

[8] Section 15G of the Exchange Act states that the risk retention rules adopted by the Agencies shall provide for "a total or partial exemption of any securitization, as may be appropriate in the public interest and for the protection of investors . . ." Section 15G(c)(1)(G)(i).

[9] ABCP issued by structured investment vehicles ("SIVs") and securities arbitrage ABCP programs experienced significant difficulties during the credit crisis. Generally, we do not suggest that these types of programs be excluded from or exempt from the risk retention requirements or eligible for the ABCP risk retention option under the proposed rules.

to repayment.[10] For ABCP programs referred to as "fully supported," the liquidity facilities can be drawn to fund all of the receivables held by the program, even if some of those receivables are deemed to be "defaulted." For "partially supported" ABCP programs, the liquidity facilities will fund only "performing" receivables, *i.e.*, those not deemed to be in default. As a means of offsetting this potential source of risk, partially supported programs have credit enhancement facilities at both the pool level[11] (supporting individual transactions, often in the form of overcollateralization) and at the program level.[12] Generally, investors analyze ABCP transactions primarily on the strength of the ABCP program sponsor and of these programs' credit and liquidity arrangements, and less on the receivables being financed.

B. Bank-Sponsored ABCP Programs Should Not be Subject to Additional Risk Retention Requirements

We believe that the alignment of incentives between originator and investor that is sought by the Dodd-Frank Act largely has been achieved for bank-sponsored ABCP programs. Accordingly, it is unnecessary to impose additional risk retention requirements on these programs. On January 28, 2010, regulators including the Federal Reserve, the OCC, and the FDIC adopted a rule that requires banks sponsoring ABCP programs to consolidate ABCP conduits onto their balance sheets, aligning regulatory capital requirements with changes to generally accepted accounting principles.[13] This rule reflects the banking regulators' acknowledgement that risk exposure in ABCP programs generally is borne by the regulated bank sponsor, which must reserve adequate capital to cover any such risk.[14] We believe this alignment of interest that exists in bank-sponsored ABCP programs is an important prerequisite for an ABCP program to be exempted or excluded from, or deemed to comply with, the proposal's risk retention requirements. We also recommend the following as criteria to identify those bank-sponsored ABCP programs that are uniquely structured to provide safeguards to investors and the marketplace. We believe these criteria align the interests of sponsors with those of investors, consistent with the policy objectives of Section 15G of the Exchange Act, such that imposing additional risk

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[10] In the event that maturing ABCP cannot be refunded in the money markets, the administrator of the program (which is often the financial institution sponsoring the program) will draw upon the liquidity facilities in an amount sufficient to redeem all maturing ABCP.

[11] In some cases, the amount of pool-level credit enhancement for a given transaction is set dynamically, in that it increases to offset deteriorating pool performance.

[12] Program-level credit enhancement is often in the form of a letter of credit or a cash collateral account, effectively providing a five to ten percent subordinated cushion for the ABCP.

[13] *Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance; Regulatory Capital; Impact of Modifications to Generally Accepted Accounting Principles; Consolidation of Asset-Backed Commercial Paper Programs; and Other Related Issues,* 75 FR 4636 (Jan. 28, 2010).

[14] *Id.* at 4643.

retention requirements would be unnecessary. The criteria are the following:

(i) the sponsoring institution is a regulated banking institution;

(ii) the issuing entity is bankruptcy remote;

(iii) regulated liquidity providers have entered into a legally binding commitment to provide 100 percent liquidity coverage for all issued ABCP, at least 95 percent of which is provided by the sponsoring institution;

(iv) at least five percent program-wide, first loss credit enhancement is provided by the sponsoring institution of any partially-supported ABCP conduit in the form of an irrevocable and unconditional letter of credit, cash collateral, guarantee or other similar facility, or no credit enhancement is required for any fully-supported ABCP conduit; and

(v) monthly investor performance reports that include loan level detail are provided on a timely basis.

These criteria align the incentives of the sponsor and investors by ensuring that the risk of the ABCP conduit remains with the bank sponsor, and that the sponsor is responsible for substantially all of the liquidity and a key portion of any credit support for the conduit. In addition, the monthly investor reports provide an important monitoring mechanism. According to an assessment of this criteria performed by a rating agency for one of our members, the criteria would capture approximately 70 percent of the ABCP market in the United States. Importantly, the criteria would exclude SIVs, as well as those securities arbitrage programs that are not sponsored by a regulated banking institution and do not have available liquidity equal to at least the amount of ABCP outstanding.

We therefore request that the Agencies exclude or exempt bank-sponsored ABCP programs that meet these strict criteria from the proposed risk retention requirements, or deem these programs to satisfy the risk retention requirements. If, on the other hand, the Agencies adopt the proposed rules as written, it will be very difficult for existing ABCP programs to meet the conditions of the proposed risk retention option for ABCP programs. This will cause ABCP lending to slow significantly, and negatively affect both businesses seeking funding through this financing method and investors in ABCP.

Should the Agencies conclude that imposing further risk retention requirements on bank-sponsored ABCP programs is appropriate, we urge you to redefine the parameters for the proposed ABCP risk retention option, based on comments received, to better reflect current market practice and existing ABCP structures. For example, while originator-seller horizontal risk retention is a method that would work for certain ABCP programs, we believe that other risk retention methods should also

be permitted as part of the ABCP risk retention option. Such methods should include those otherwise permitted under the proposed rules, as well as credit enhancements that serve an analogous function to the risk retention requirements, such as letters of credit and cash collateral accounts, which are standard in the market.

II. Municipal Tender Option Bond Programs

The proposal is silent regarding municipal TOBs. We request clarification that TOBs are not within the scope of the proposal or, alternatively, that they be exempted from its requirements.[15] Although TOBs have certain features that are similar to those of ABS, market participants generally do not perceive TOBs as ABS. Nor do we believe that TOBs raise the concerns that Congress intended to address when it enacted Section 15G of the Exchange Act. The structural characteristics of TOB programs would make it difficult for their sponsors to satisfy the proposed risk retention requirements. If TOB sponsors were forced to restructure their programs significantly to comply with the proposed rules' requirements, the increase in the cost of TOB program sponsorship could adversely affect the state and local governments that indirectly receive funding through these programs.

A. Background

A municipal TOB program is created by a sponsor bank that deposits one or more high-quality municipal bonds into a trust which issues two classes of tax-exempt securities: a short-term security (the "floater") that is supported by a liquidity facility and an inverse floating rate security (the "residual").[16] The floater is a variable-rate demand security that bears interest at a rate adjusted at specified intervals (daily, weekly, or other intervals up to one year) according to a specific index or through a remarketing process. The liquidity facility supports a "put" or demand feature, allowing the floater holder to tender the security and receive, with specified notice, face value plus accrued interest, typically either from remarketing proceeds or a draw on the liquidity facility.[17] Floater holders bear limited and well-defined insolvency and default risks associated with the underlying bonds, and rely upon their largely unfettered put right to manage these risks. Tax-exempt money market funds are the principal holders of the floaters. The residuals generally are held by the entity that selects the underlying municipal bonds that serve as collateral for the trust. Holders of residuals are typically long-term investors, such as the TOB program sponsor bank or an affiliate, tax-exempt bond funds, closed-end funds, or other institutional investors in municipal bonds. Residual holders receive all interest

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[15] *See supra* note 8.

[16] TOBs generally are structured with a single long-term municipal bond in the trust but they may be structured with a pool of long-term municipal bonds.

[17] The liquidity facility is subject to termination upon certain major credit events affecting the issuer of the underlying municipal bonds (such as bankruptcy and ratings falling to below investment grade). Under these circumstances, the TOB trust would be collapsed and the floater holders would be paid from the sale of the collateral, or would receive the collateral if such proceeds were not sufficient to pay the holders in full.

payments from the underlying bonds that are not needed to pay interest on the floaters and expenses of the trust. Due to the operation of the liquidity facility, which provides holders of the floaters par amounts plus accrued interest upon demand, the residual holder bears all of the market risk associated with the TOB trust. Accordingly, the residual holder has a significant incentive to ensure that the underlying municipal bonds are of high credit quality.

B. TOBs Are Not the Types of Securities Section 15G Was Intended To Address

We do not believe that Congress, in enacting Section 15G, intended that the risk retention requirements apply to securitizations backed by municipal securities, such as TOBs. The legislative history indicates that Section 15G was directed toward securities generally considered by market participants to be traditional ABS, and especially toward mitigating risks associated with ABS backed by mortgages.[18]

TOBs have many features that distinguish them from the types of securities that 15G was intended to address. For example, the underlying collateral in a TOB trust is limited to municipal bonds, which have very different characteristics than the privately negotiated loans and trade receivables that serve as collateral for many types of ABS. These municipal bonds are of high quality, are typically rated in the top two long-term rating categories of nationally recognized statistical ratings organizations, and generally are publicly traded. In addition, a TOB trust typically holds securities of only one municipal issuer for which information is publicly available, resulting in greater transparency than in a typical ABS transaction. TOB trusts do not utilize tranching, and therefore have a simpler and more transparent structure than typical ABS.

Importantly, TOB programs are designed to create a short-term security with the same credit characteristics as the underlying long-term collateral. In fact, investors in TOB floaters and residuals consider themselves to be co-investors in the underlying bonds which collateralize a TOB trust for both credit quality and diversification purposes. This contrasts with typical ABS, in which the investor considers itself to be holding the trust for credit quality and diversification purposes. Unlike typical ABS programs, which are characterized by significant diversity in structures, TOB programs generally have the same basic structure. The TOB trust documentation extensively describes the program's

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[18] *See* S. Rep. No. 111-176, at 128 (2010) ("The Committee's investigation into the causes of the financial crisis identified abuses of the securitization process as a major contributing factor. Two problems emerged in the crisis. First, under the 'originate to distribute' model, loans were made expressly to be sold into securitization pools, which meant that the lenders did not expect to bear the credit risk of borrower default. This led to significant deterioration in credit and loan underwriting standards, particularly in residential mortgages . . . . Second, it proved impossible for investors in asset-backed securities to assess the risks of the underlying assets, particularly when those assets were resecuritized into complex instruments like collateralized debt obligations (CDOs) and CDO-squared. With the onset of the crisis, there was widespread uncertainty regarding the true financial condition of holders of asset-backed securities, freezing interbank lending and constricting the general flow of credit. Complexity and opacity in securitization markets created the conditions that allowed the financial shock from the subprime mortgage sector to spread into a global financial crisis . . .").

structure and the obligations of each of the trust's participants (*i.e.*, liquidity provider, remarketing agent, trustee), as well as information regarding the underlying collateral in the trust. Indeed, each trust is individually rated with a long-term rating based on the credit quality of the collateral and a short-term rating based on that of the liquidity provider, unlike typical ABS which are rated on the basis of the program's over-collateralization and generalized characteristics of the entire pool of collateral.

Neither Section 15G of the Exchange Act nor the proposal mentions TOBs, suggesting neither Congress nor the Agencies intended TOBs to be subject to the proposed risk retention requirements.[19] The exemption in Section 15G for ABS issued or guaranteed by states or local governments and the Agencies' proposed implementation of this exemption support the view that Congress did not intend to capture these and other municipal repackagings in Section 15G.[20] The Agencies specifically request comment in the proposal regarding whether their proposed exemption is under or over-inclusive.[21] We strongly believe it is under-inclusive, and that the Agencies should use their authority under Section 15G to exempt from the risk retention requirements municipal repackagings, such as TOBs, that are collateralized by one or more securities of the type described in proposed Rule § ____.21(a)(3).[22]

C. Applying the Proposed Risk Retention Requirements to TOBs is not in the Public Interest

As noted, TOB trusts, because they purchase and hold longer-term debt, are an important source of demand for state and local government bonds. It would be very difficult for TOB sponsors to meet the proposal's risk retention standards, due to the structural characteristics of TOB programs, which differ from the types of ABS the proposal clearly is intended to address. As a result, imposing risk-retention rules on TOB program sponsors would raise the costs of TOB program sponsorship. This would likely cause the demand for TOB issuance to decrease, potentially raising the costs of financing to state and local governments at a time when their finances are already under stress.

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[19] As additional support, we note that the Federal Reserve's October 2010 report to Congress on risk retention, which was mandated by the Dodd-Frank Act and offers suggested alternatives for rulemaking under Section 15G, considers approaches for a range of different types of ABS, but makes no mention of TOBs or other municipal repackagings. Federal Reserve, *Report to the Congress on Risk Retention* (Oct. 2010), available at http://www.federalreserve.gov/boarddocs/rptcongress/securitization/riskretention.pdf.

[20] Section 15G states that the Agencies' risk retention rules shall provide for "a total or partial exemption for any asset-backed security that is a security issued or guaranteed by any State of the United States, or 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 of 1933 by reason of section 3(a)(2) of that Act . . ." Section 15G(c)(1)(G)(iii). To implement this requirement, the Agencies have proposed an exemption from the risk retention requirements for municipal securities. Proposed Rule § ____.21(a)(3).

[21] Release at 105.

[22] Section 15G(c)(1(G)(i).

Subjecting sponsors of TOB trusts to the proposed risk retention requirements is unnecessary to achieve the Agencies' regulatory objectives. It could also significantly reduce the availability of TOBs for tax-exempt money market funds and closed-end funds, and disrupt the operations of long-term bond funds that invest in the residuals. For all of these reasons, we request confirmation that TOB programs are outside the scope of the proposal or will be exempted from the proposal's risk retention requirements.

III. Mortgage-Backed Securities

Funds invest in a variety of MBS, including agency MBS (*i.e.*, MBS guaranteed by the Federal National Mortgage Association ("Fannie Mae") or the Federal Home Loan Mortgage Corporation ("Freddie Mac")); RMBS; and CMBS. ICI, on behalf of its members, supports maintaining a strong securitization market for MBS that is subject to high, clearly defined standards. At the same time, we believe it is important for the Agencies, in tailoring the proposed risk retention requirements to different types of MBS, to be mindful of the consequences of adopting standards that are overly restrictive or do not adequately reflect current market practice.

A. Residential Mortgage-Backed Securities

Section 15G provides that the Agencies' risk retention requirements shall not apply to RMBS that are collateralized solely by QRMs.[23] Section 15G includes specific standards that the Agencies must consider in jointly defining what constitutes a QRM. ICI, on behalf of its members, supports a QRM standard that would exempt from the risk retention requirements only RMBS backed by very high quality loans. Some of our members support the Agencies' QRM standard as proposed, and believe that only the highest quality mortgages should qualify under the standard. Other members, however, are concerned that the Agencies' proposed standard may be somewhat too restrictive and could have negative implications for mortgage financing to credit-worthy households. They are concerned that an excessively strict QRM standard could result in a lack of liquidity in the QRM market, which would discourage participation in the market by investors, including funds, and, as a result, further limit mortgage funding.

[23] Section 15G(e)(4).

B. Commercial Mortgage-Backed Securities

Section 15G of the Exchange Act states that, with respect to CMBS, the Agencies may provide for a special risk retention option in which a five percent horizontal, first-loss position is held by a third-party purchaser, if certain specified conditions are met.[24] The Agencies have implemented this provision by proposing a rule that would permit a CMBS sponsor to satisfy its risk retention obligation if a third-party purchaser acquires such an interest, subject to certain conditions.[25] This option accurately reflects the common market practice of allocating the first-loss position in a CMBS transaction to a third-party purchaser, typically known as the "B-piece buyer." Certain funds that invest in CMBS may buy the B-piece and could, under the proposed rule, potentially be a third-party purchaser. Our members that manage funds that may serve in this role have concerns that certain aspects of how the risk retention option for CMBS would operate may discourage or preclude funds from serving in the role of third-party purchaser, as well as have detrimental implications for the operation of the CMBS markets as a whole, with consequences both for investors in those markets and the businesses that obtain funding through those markets.

One of the conditions of the proposed rule is that a third-party purchaser may not sell or hedge the interest it is required to retain under the rule.[26] While we understand this provision is intended to place the third-party purchaser in the same position as if it were the sponsor retaining the same horizontal, first-loss risk retention position,[27] requiring the B-piece buyer to retain its interest for the life of the transaction would strongly discourage funds from purchasing these interests. In lieu of requiring the B-piece buyer to retain its interest for the life of the transaction, we recommend that the Agencies propose the following tiered approach: (i) require the B-piece buyer to retain its interest for a one-year period in which it may not sell or hedge the interest; (ii) for the following four years, permit the B-piece buyer to transfer its interest only to a "qualified transferee" that must meet the same criteria under the rule as the B-piece buyer; and (iii) for the remainder of the transaction, not impose restrictions on transfer or hedging.

Under the Agencies' proposed CMBS option, a B-piece purchaser is intended to stand in the shoes of the sponsor for purposes of complying with the risk retention rules. Under our recommended approach, requiring the B-piece purchaser to hold its interest for a one-year period provides a sufficient amount of time to reveal whether there are any significant deficiencies or fraud in the underwriting process. Permitting transfer to a "qualified transferee" that satisfies the same criteria under the proposed rule as the B-piece buyer for the following four years seems fully consistent with the Agencies'

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[24] Section 15G(c)(1)(E).

[25] Proposed Rule § ____.10.

[26] Proposed Rule § ____.10(a)(6).

[27] Release at 47.

policy objective of including the transfer restriction in the proposed CMBS option because the qualified transferee could have served as the original B-piece buyer.[28] We believe this approach, by imposing a reasonable holding period on third-party purchasers, would address Congress' and the Agencies' concern that the securitizer or, in this case, an entity standing in its place, not be able to reduce its exposure to the credit risk of the securitized assets.[29]

Another condition of the proposed rule would require that a sponsor utilizing the CMBS risk retention option disclose to potential investors in the CMBS transaction (and to the Agencies, upon request) the identity of the third-party purchaser, provide a description of the third-party purchaser's experience in investing in CMBS, include any other information regarding the third-party purchaser or its retention of an interest in the transaction "that is material to investors in light of the circumstances of the particular securitization transaction," provide the amount of the residual interest that the purchaser will retain or has retained in the transaction, list the purchase price paid for the interest, and describe the material terms of the interest retained by the third-party purchaser, among other information.[30] We agree that a sponsor that is satisfying its risk retention obligations by means of a third-party purchaser should provide potential investors with information relating to the interest retained by that third party and therefore support most of the proposed disclosure requirements, many of which are consistent with current market practice. We believe, however, that the proposed requirement to disclose the purchase price paid for the interest should be eliminated. Such disclosure is inconsistent with market practice and requiring it would discourage investors from serving in the role of third-party purchaser. This information is typically confidential, and is unnecessary to disclose publicly, given that information would be disclosed about the amount of the interest held.

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We appreciate that tailoring risk retention requirements to reflect the diversity that exists across the ABS markets is a sizable undertaking, especially when it must be done jointly by six federal agencies. The joint nature of this rulemaking makes it all the more important, however, for the Agencies to develop workable standards for risk retention *prior* to the rules' adoption. The proposal states that the Agencies will jointly approve "any written interpretations, written responses to requests for no-action letters and legal opinions, or other written interpretive guidance concerning the scope or terms of section 15G and the final rules issued thereunder that are intended to be relied on by the

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[28] We further note that B-piece buyers are institutional buyers, and that these interests are traded only in the Rule 144A market.

[29] *See* S. Rep. No. 111-176, at 129 (2010) ("The regulations will prohibit securitizers from hedging or otherwise transferring the credit risk they are required to retain."); Release at 58.
[30] *See* proposed Rule § ____.10(a)(5).

[30] *See* proposed Rule § ____.10(a)(5).

public generally."[31] As a result, addressing any issues raised by the proposal will be even more difficult after the rules are adopted. If there is any way we may further assist the Agencies, please feel free to contact me directly at (202) 326-5815 or Sarah Bessin at (202) 326-5835.

Sincerely,

/s/

Karrie McMillan
General Counsel

cc: The Honorable Mary L. Schapiro
The Honorable Kathleen L. Casey
The Honorable Elisse B. Walter
The Honorable Luis A. Aguilar
The Honorable Troy A. Paredes

[31] Release at 17.