A·F·G·I
ASSOCIATION OF FINANCIAL GUARANTY INSURERS

Unconditional, Irrevocable Guaranty ®

July 28, 2011

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 2–3
Washington, DC 20219
RIN 1557–AD40
Docket Number OCC-2011-0002

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
RIN 7100–AD–70
Docket No. R-1411

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

Elizabeth M. Murphy, Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549–1090
RIN 3235–AK96
File Number S7-14-11

Alfred M. Pollard, General Counsel
*Attention:* Comments/RIN 2590–AA43
Federal Housing Finance Agency
Fourth Floor
1700 G Street, NW
Washington, DC 20552
RIN 2590–AA43

Department of Housing and Urban Development
Regulations Division, Office of General Counsel
451 7th Street, SW
Room 10276
Washington, DC 20410–0500
RIN 2501–AD53
Docket No. FR-5504-P-01

Re: Credit Risk Retention

Dear Sirs/Madams:

The Association of Financial Guaranty Insurers ("**AFGI**") appreciates the opportunity to provide its comments regarding the proposed rules (the "**Proposed Rules**") to implement the requirements of Section 941(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**")[1] to the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission, the Federal Housing Finance Agency and the Department of Housing and Urban Development (collectively, the "**Agencies**"). AFGI is the trade association for financial guaranty insurers and reinsurers.

As described in more detail below, AFGI seeks (i) clarification or confirmation from the Agencies that transactions undertaken to implement, terminate or restructure financial guaranty insurance obligations are not subject to the proposed risk retention rules and (ii) revision of the

[1] Credit Risk Retention, 76 Fed. Reg. 83 (April 29, 2011).

proposed resecuritization exemption under the risk retention rules to encompass resecuritizations of securities that add or remove financial guaranty insurance. AFGI supports the Proposed Rules' stated policy objective to align securitizers' economic interests with those of investors in asset-backed securities. As providers of financial guaranty insurance of scheduled payments of principal and interest on asset-backed securities ("**ABS**"), financial guaranty insurers have economic interests aligned with those of ABS investors.

**About Financial Guaranty Insurance**

AFGI is a trade association of insurers and reinsurers of municipal bonds, ABS and other financial obligations. Financial guaranty insurance is employed in the financial markets to help securitization sponsors and municipal issuers reduce borrowing costs and to provide investors payment default protection, risk management and improved liquidity for their investments. Financial guaranty insurance provided by AFGI members generally guarantees the timely payment of scheduled payments of interest and principal due on insured securities. Investors in insured securities may also benefit from the due diligence, surveillance and remediation activities performed by financial guaranty insurers. Unlike a trustee or a rating agency, a financial guaranty insurer has capital at risk, more closely aligning its interests with those of the holders of the insured securities. Financial guaranty insurers are state-licensed insurance companies subject to comprehensive regulation.

In ABS markets, insurance reduces borrowing costs for securitization sponsors, and offers wider market access and improved transaction execution. Similarly, in the public finance market, municipal issuers and their taxpayers benefit from lower financing costs when financial guaranty insurance is employed. AFGI estimates that, since the industry's inception in 1971, municipalities and their taxpayers have saved more than $40 billion in interest costs as a result of financial guaranty insurance.

**Broad Language in the Proposed Rules May Inadvertently Capture Some Financial Guaranty Insurance Transactions**

While the language of the Proposed Rules (and the underlying statutory language) must be broad to address the variety of transactions Congress intended to regulate, there is a risk that the breadth also captures transactions Congress did not intend to regulate. AFGI believes this is particularly true in the case of the customary financial guaranty insurance transactions described below.

*Secondary market financial guaranty insurance transactions.* For more than 30 years, financial guaranty insurers have insured securities originally issued without insurance, in transactions referred to as "secondary market transactions". These secondary market transactions typically cover only a portion of an original bond issuance (e.g., $50 million out of a total bond issuance outstanding of $300 million). Secondary market insurance is typically implemented by depositing with a custodian both the securities to be insured and the insurance policy insuring the deposited securities. The custodian, in turn, issues a "custody receipt" representing ownership of the security and the insurance policy. The custody receipt is typically assigned its own CUSIP and freely traded. In a no-action letter (Financial Security Assurance

Inc., March 30, 1988), the SEC staff stated it would not recommend SEC action if such custody receipts were issued without registration of the insurance policy or custody receipts under the Securities Act of 1933. Secondary market insurance may also be implemented by employing a trust, escrow or special purpose entity, in lieu of a custodian, to hold the securities to be insured and the insurance policy insuring the deposited securities.

*Termination of outstanding financial guaranty insurance.* Financial guaranty insurers employ trusts or similar arrangements to economically remove insurance coverage on securities insured in the primary market in which the insurance cannot, as a practical matter, be terminated prior to maturity of the insured securities. Termination of financial guaranty insurance is an important risk management tool for insurers seeking to reduce their outstanding insurance obligations. Although financial guaranty insurance policies by their terms are unconditional and irrevocable, individual insured securityholders may agree with an insurer to forego the benefits of their insurance policies (which may or may not involve a termination fee paid by the insurer), while still retaining their interest in the underlying securities.

In these circumstances, the insured securities are generally placed in a trust, and the trustee issues two types of certificates: one which represents an interest in the underlying securities (and is issued to participating investors), and one which represents an interest in any payments under the insurance policy (and is issued to the insurer). As a result, all insurance payments related to the deposited securities are returned to the insurer and the insurance is nullified as an economic matter (while the insurance relating to securities held by non-participating investors remains in place).

*Restructuring of distressed debt.* If an insured security defaults, the financial guaranty insurer may seek to refinance the defaulted insured securities. The insurer may accomplish such a refinancing by (i) paying the unpaid principal and interest on the defaulted insured securities under its insurance policy and (ii) contributing its rights for reimbursement from the original bond issuer to a new special purpose vehicle (the "**SPV**") established to issue insured refinancing securities. The SPV, in turn, issues insured securities and pays the proceeds to the insurer to compensate the insurer for payments made under the original insurance policy. Through this mechanism, the insurer is able to refinance the defaulted insured securities by, e.g., extending the maturity or reducing the coupon, while the insurer retains the credit risk related to the SPV's securities by virtue of its new financial guaranty insurance policy.

## Request for Clarification

Although the instruments issued in the transactions described above might superficially appear to meet the Dodd-Frank definition of "asset-backed security" ("a fixed-income or other security collateralized by any type of self-liquidating financial asset . . . that allows the holder of the security to receive payments that depend primarily on cash flow from the asset"), AFGI respectfully submits that these regulated insurance transactions are not the sort that Congress intended to capture in this regime.

In fact, the superficial similarities collapse upon closer examination of the implications of the Proposed Rules. If a custodial receipt in a secondary market transaction were considered an

ABS, would the sponsor be the investor seeking credit protection on the bond it already owns, or the insurer willing to provide that protection? And what would it mean for one of them to "retain not less than five percent of the credit risk", particularly in the case of the insurer, which already retains all the credit risk in the secondary market transaction?

AFGI urges the Agencies to clarify that transactions undertaken solely to manage financial guaranty insurance related to the underlying obligations should not be considered "securitizations" and the entities participating in them should not be considered "sponsors" or "securitizers" and should not be subject to the risk retention requirements of the Proposed Rules.

**Proposed Resecuritization Exemption**

AFGI recommends that the resecuritization exemption in the Proposed Rules (Section __.21(a)(5)) be revised as follows:

- *Application to Non-ABS.* The resecuritization exemption should apply to securities other than ABS, such as municipal or corporate bonds or other financial obligations. Insofar as resecuritization of a security other than an ABS would otherwise qualify for the resecuritization exemption, we submit that the same policy reasons that justify the inclusion of ABS within the resecuritization exemption also justify the inclusion of other securities. Such a broadening of the exemption is necessary, among other reasons, to ensure that the secondary market financial guaranty insurance transactions described above, which are not limited to ABS, would fall within the exemption.

- *Application to Securities Issued Prior to Effective Date.* The resecuritization exemption should apply to resecuritizations of ABS and other securities issued prior to the effective date of the Proposed Rules. While AFGI recognizes that pre-effective date ABS were not subject to the risk retention requirements of the Proposed Rules, it seems inappropriate to preclude resecuritization of those securities given the other protective requirements of the resecuritization exemption. Allowing the resecuritization exemption to apply to pre-effective date ABS would also ensure that the types of restructurings involving the addition or removal of financial guaranty insurance described above would fall within the resecuritization exemption even when undertaken with respect to securities issued prior to the effective date of the Proposed Rules.

- *Addition or Removal of Financial Guaranty Insurance Exempted.* For the reasons noted above, the resecuritization exemption should clarify that the addition or removal of financial guaranty insurance will not impair eligibility for the exemption.

The common characteristics of the transactions described above are that only a single class of underlying obligation (which may be a municipal or corporate bond, an ABS or other financial obligation) is deposited into a custodial or SPV arrangement and that the management of the financial guaranty insurance related to that obligation is the primary purpose of the transaction. The deposited obligation may or may not have been subject to or exempt from credit risk retention requirements (see Section __.21(a)(5)(i)(A) and (B) of the Proposed Rules), but given the nature of these transactions, that would not offend the policy objectives of the Proposed Rules. Furthermore, in transactions designed to economically terminate existing insurance of an obligation, the issuance of two types of trust obligations would not comply with Proposed Rules Section __.21(a)(5)(ii), but there would be only one class of interest which passes through all principal and interest payments received on the underlying obligation (see Section __.21(a)(5)(iii)), as the other class of interest would pass on only insurance payments.

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We thank the Agencies for the opportunity to comment on these matters. If you have any questions, please do not hesitate to contact me at bstern@assuredguaranty.com or (212) 339-3482.

Sincerely,

Bruce E. Stern, Chairman