

7 April 2012

Department of the Treasury  
1500 Pennsylvania Avenue, N.W.  
Washington DC 20220

Federal Housing Finance Agency  
Constitution Centre  
400 7th Street, S.W.  
Washington DC 20024

Board of Governors of the Federal Reserve System  
20th Street and Constitution Avenue, N.W.  
Washington DC 20551

Federal Deposit Insurance Corporation  
550 17th Street, NW  
Washington DC 20429

Department of Housing and Urban Development  
451 7th Street, S.W.  
Washington DC 20410-0500

Securities and Exchange Commission  
100 F Street, N.E.  
Washington DC 20549-1090

Office of the Comptroller of the Currency (OCC)  
250 E Street, S.W.  
Mail Stop 2-3  
Washington DC 20219

Dear Sirs

## **Credit risk retention – RIN 1557-AD40; 7100-AD 70; 3064-AD74; 3235-AK96; 2590-AA43; 2501-AD53**

On behalf of the Association for Financial Markets in Europe / European Securitisation Forum (**AFME / ESF**), described in Annex I, we appreciate the opportunity to provide this letter in connection with the notice of proposed rulemaking on credit risk retention (the **Proposed Rule**) (RIN 1557-AD40; 7100-AD 70; 3064-AD74; 3235-AK96; 2590-AA43; 2501-AD53).

As requested, this letter summarises key areas of concern with respect to the Proposed Rule from the perspective of AFME members. In particular, this letter provides further information on certain matters raised in our response letter dated 19 July 2011<sup>1</sup> and in

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<sup>1</sup> [http://www.federalreserve.gov/SECRS/2011/October/20111027/R-1411/R-1411\\_071911\\_82446\\_471858155990\\_1.pdf](http://www.federalreserve.gov/SECRS/2011/October/20111027/R-1411/R-1411_071911_82446_471858155990_1.pdf)

our follow-up letter to the Securities and Exchange Commission dated 29 November 2011<sup>2</sup>, which matters were further discussed at the meetings held in February 2012 with representatives from the Department of the Treasury, Federal Housing Finance Agency, Federal Reserve System, Federal Deposit Insurance Corporation and the Department of Housing and Urban Development and at the meeting held in November 2011 with representatives from the Securities and Exchange Commission.

We wish to thank the relevant agencies for meeting with AFME and certain member representatives. We very much appreciated the agencies taking the time to see us.

### Key issues

#### *Mutual recognition*

As a starting point, we wish to reiterate that, in our view, any discussion of the key issues which arise under the Proposed Rule from the perspective of AFME members would not be complete without noting that we strongly favour a mutual recognition and acceptance process with respect to retention. We regard such a process as necessary to preserve the global nature of the ABS markets and to enhance global liquidity.

While a comparison of the EU retention requirements and the Proposed Rule reveals few points which directly conflict,<sup>3</sup> the differences between the regimes are significant. These differences will affect the ability of market participants to practically comply with both regimes in the context of certain transactions (particularly those transactions which are less well suited to retention via the "base case" holding options such as via a first loss position or a vertical slice). In general, in order to comply with both regimes (which will be necessary for cross-border market access), market participants (EU and U.S. alike) would need to identify the common points between the two regimes and the more onerous compliance standard in each instance. Being limited in general to compliance via only those options and methods which work under both regimes, rather than just one regime, market participants will effectively be unable to rely on much of the flexibility provided under any one regime (unless two separate interests are retained, which will raise significant transaction efficiency concerns in most contexts).

We acknowledge that a recognition process gives rise to certain potentially complex considerations and that work would be required to ensure that the adopted process operates as intended. We encourage the agencies to undertake this work (together with the EU authorities as appropriate, whom we have also been in touch with) in keeping with calls for international coordination.

#### *Specific key issues*

Notwithstanding the above, it is our understanding that there are constraints (political and otherwise) with respect to building in a mechanism for mutual recognition at this

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<sup>2</sup> <http://www.sec.gov/comments/s7-14-11/s71411-318.pdf>

<sup>3</sup> Although there are examples of this – e.g., under the EU requirements, in transactions involving multiple non-affiliated originators, retention is required by each originator with reference to the proportion of the total securitised exposures (or by the sponsor, which definition would be relevant primarily in the context of ABCP programme sponsors). In contrast, under the Proposed Rule, one sponsor would be required to comply on behalf of the other sponsors. To the extent that specific conflicts arise, we note that it would not be possible for both regimes to be complied with, thereby resulting in an effective restriction of cross-border market access.

time. Bearing this in mind, AFME members have identified certain more specific key issues in respect of the Proposed Rule.

Appropriate measures to resolve the specific issues identified by members would assist in addressing our concerns and would assist with preserving cross-border market access (but would not achieve the same degree of resolution and certainty that would come with a proper recognition process). Access to the U.S. market has played a significant role in the recovery and relative strength of certain EU ABS markets, including recent UK RMBS and credit card issuance.

As discussed in our meetings with you, a significant proportion of such transactions has been denominated in U.S. dollars, and we consider that this U.S. dollar segment is illustrative in general of the placement levels being sought with respect to U.S. investors. Please see Annex II for further information on this.

In short, the specific issues identified by members relate to:

- the lack of flexibility for mortgage master trusts under the seller's interest holding option;
- the lack of flexibility and other concerns under the originator-seller holding option for eligible ABCP conduits;
- certain challenges and areas of uncertainty with respect to the proposed foreign transactions safe harbour;
- the disproportionate effect of certain requirements in an EU deal context; and
- the uncertainty regarding the scope of relevant transactions.

Each of these points is discussed in further detail below.

Further analysis

Relevant issue	Reasons for concern	Suggested course of action
<b><i>Lack of flexibility for mortgage master trusts under the seller's interest holding option</i></b>	<p>Under the current proposals, the seller's interest holding option would be available only in the context of <i>revolving asset</i> master trusts and would not be available in the context of <i>revolving pool</i> master trusts involving <i>non-revolving assets</i> (such as UK mortgage master trusts).</p> <p>Taking into account the principles behind the retention requirements (i.e. alignment of interests), the justification for this difference in treatment (based on the nature of the underlying assets) is not clear. We note that, in UK mortgage master trust transactions, the seller's interest will</p>	<p>Amendments should be made to the seller's interest holding option to also accommodate revolving pool master trusts. Our suggested amendments to the Proposed Rule are outlined in our letter dated 29 November 2011 (linked above). Items to be addressed include:</p> <p>- removal of the restriction on the availability of the seller's</p>

<sup>4</sup> <http://www.sec.gov/comments/s7-14-11/s71411-318.pdf>

Relevant issue	Reasons for concern	Suggested course of action
	<p>not at any time be prioritised over amounts paid to the funding entity (which amounts in turn may be used to make payments to investors in the notes). Neither are cashflows and losses applied in a manner which would result in a disproportionate reduction of the seller's interest when compared to the position held by the funding entity (and in turn, held by investors).</p> <p>Unless changes are made, the proposed limitation contemplated by the Proposed Rule will operate in a disproportionately restrictive manner for certain EU market participants and in particular for UK RMBS originators and issuers. We note that there are challenges with respect to making the other retention holding options work in an efficient manner in a master trust context and, in general, it would be undesirable for sponsors to retain separate positions to satisfy each of the EU and the U.S. regimes.</p> <p>Recent U.S. placement levels for UK mortgage master trust transactions have been significant (see Annex II for details) and it is essential that market access on a cross-border basis remains available.</p> <p>Please see our letter of 29 November 2011<sup>4</sup> for further background on UK mortgage master trust structures.</p>	<p>interest holding option to revolving asset master trust transactions only;</p> <ul style="list-style-type: none"> <li>- amendments to Section 7(a), the "seller's interest" definition and (to the extent it is referred to) the "securitised assets" definition to remove any requirement that the securitised assets be held directly by an issuing entity;</li> <li>- amendments to the <i>pari passu</i> requirement in the "seller's interest" definition to provide sufficient flexibility for UK structures which involve an interposed funding entity and which permit the funding entity to be paid certain amounts in priority in certain circumstances (which amounts may in turn be used to make payments to investors in the notes).</li> </ul>
<p><b><i>Lack of flexibility and other concerns under the originator-seller holding option for eligible ABCP conduits</i></b></p>	<p>The proposed requirements with respect to the originator-seller holding option are very prescriptive and do not reflect a large number of existing conduit arrangements (including conduits which provide funding for EU originated assets). For example, the conditions proposed to apply in respect of "eligible ABCP conduits" would require all of the interests issued by the intermediate SPV to be transferred to one or more ABCP conduits or retained by the originator-seller, which does not take account of the fact that in many cases such SPVs may also sell interests to other third parties (e.g. to other funding banks). In addition, the conditions would also require all of the interests issued by the intermediate SPV to be collateralised solely by assets from a single originator-seller, which does not reflect the common practice of such</p>	<p>Amendments should be made to the originator-seller holding option to ensure that it represents a feasible option which permits sufficient flexibility for existing conduit arrangements. Suggested items to be addressed include:</p> <ul style="list-style-type: none"> <li>- providing flexibility for (unfunded) programme wide credit enhancement arrangements to qualify as a valid retained interest;</li> <li>- amending the proposed conditions for "eligible ABCP conduits" to permit greater</li> </ul>

	<p>SPVs acquiring assets originated or acquired by multiple originators. Taking into account the principles behind the risk retention requirement, the rationale for setting the conditions in this restrictive manner is not clear.</p> <p>Moreover, certain further aspects of the current proposals give rise to significant issues. For example, under the current proposals, it would be necessary for public disclosures to be made with respect to the originator-sellers, contrary to usual ABCP conduit disclosure practices which reflect the confidentiality requirements of such originator-sellers. In addition, under the current proposals it would be necessary for all securitisation transactions in connection with a conduit to meet the risk retention requirements (including those entered into prior to the effective date). It will be extremely difficult for compliance to be achieved in respect of existing transactions (which would involve obtaining necessary consents).</p> <p>While many of the issues identified with respect to the proposed originator-seller holding option are not unique to EU market participants, the issues from the perspective of such market participants are further complicated by the fact that the existing EU retention regime expressly permits the required interest to be retained via certain (unfunded) programme wide credit enhancement arrangements (including, e.g., a standby letter of credit). Given the reliance placed by ABCP investors on these arrangements and the credit exposure assumed by sponsors when providing relevant contractual commitments, we consider that the principle of interest alignment which underpins the retention requirements should be regarded as satisfied by programme wide credit enhancement arrangements.</p> <p>Unless greater flexibility is provided in respect of the originator-seller holding option, it will not be possible for this option to be used by EU market participants, other than in limited circumstances. A lack of a feasible holding option for ABCP conduits would limit the funding available to originator-sellers for real economy assets.</p> <p>A significant proportion of the ABCP which provides funding for EU originated assets is funded in the U.S. market.</p>	<p>flexibility and to reflect the full range of existing arrangements. Further comments in this regard are raised by the originator, sponsor and dealer members of the Securities Industry and Financial Markets Association (SIFMA) in the response provided by SIFMA to the Proposed Rule,<sup>5</sup> which we endorse;</p> <ul style="list-style-type: none"> <li>- amending the proposed conditions for "eligible ABCP conduits" such that the requirements apply in respect of transactions entered into from the effective date only and do not apply in respect of pre-existing transactions;</li> <li>- removing the proposed public disclosure requirement with respect to the identify of each originator-seller; and</li> <li>- the proposed definition of ABCP should be amended to refer to ABCP with maturities up to 397 days (rather than 270 days) in order to ensure that the originator-seller holding option is available for CP with a longer maturity, which is expected to be of increasing importance under coming liquidity regulations under Basel III.</li> </ul>
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<sup>5</sup> <http://www.sifma.org/issues/item.aspx?id=25925>

<p><b><i>Challenges with respect to the proposed foreign transactions safe harbour</i></b></p>	<p>As a starting point, we welcome in principle those sections of the Proposed Rule which are intended to clarify and establish certainty with respect to the application of the requirements in respect of non-U.S./foreign transactions – i.e. the safe harbour provisions. Notwithstanding this general support, concerns have identified in respect of the proposals.</p> <p>We note that the proposed safe harbour conditions refer to, amongst other things, no more than 10 per cent. of the dollar value by proceeds of the ABS interests in the transaction being sold to, or for the account of, U.S. persons (the "proceeds trigger"). As a practical matter, it is extremely difficult to forecast in advance, with any level of certainty, the proportion of a new issue that will be placed with U.S. investors (or indeed any investor base). Moreover, we note that access to the U.S. market is a significant factor for certain transactions (e.g. UK mortgage master trusts and ABCP conduits, as discussed above).</p> <p>As a result, based on the current proposals, in practice, EU market participants would likely need to assume that each transaction involving a U.S. offering will need to be compliant with the U.S. retention regime (as well as the EU retention regime if it is desirable to ensure the securities can also be held by EU regulated investors, which will be the usual position). This will result in the restriction of cross-border market access unless a feasible method of achieving compliance under each of the regimes can be identified in the context of the relevant transaction (see above for our comments on this in the context of UK mortgage master trusts and ABCP conduits).</p> <p>Concerns have also been raised that aspects of the proposed safe harbour are unclear.</p>	<p>The practical difficulty that will arise for market participants seeking to rely on the safe harbour in the context of transactions involving any placement into the U.S. provides further support for the need to address the retention compliance issues raised above in the context of UK mortgage master trusts and ABCP conduits.</p> <p>In addition, amendments should be made to the safe harbour proposals to clarify that:</p> <ul style="list-style-type: none"> <li>- the 10 per cent. proceeds trigger with respect to sales to U.S. persons turns only on sales forming part of the primary distribution process (and not any secondary market trading activity);</li> <li>- the ABS interests to be taken into account for the purposes of the proceeds trigger calculation (i.e. the denominator figure to be used) include any interests retained by the sponsor or originator; and</li> <li>- relevant sales of ABS interests for the purpose of assessing compliance with the proceeds trigger exclude any intra-group placements, including any sales to a U.S. based subsidiary or affiliate of the sponsor (possibly subject to a minimum holding condition).</li> </ul>
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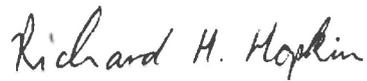
<p><b><i>Disproportionate effect of certain requirements in an EU deal context</i></b></p>	<p>Certain requirements contemplated by the Proposed Rule provide for U.S. transactions only and, as a result, present compliance challenges for, or would operate in a disproportionately onerous manner in the context of, non-U.S. transactions.</p> <p>In particular, the proposed limits referred to in the context of the horizontal cash reserve account and the premium capture cash reserve account, which would restrict cash investments in such accounts to U.S. Treasury securities and deposits in certain FDIC insured institutions would be onerous, costly and impractical for an EU originated transaction given the currency mismatch it would create and other practical problems.</p>	<p>Amendments should be made to the proposals to provide flexibility for reserve account amounts to be held in other sufficiently liquid and secure assets which are more closely connected to, and in the currency of, an asset origination jurisdiction in respect of the relevant transaction.</p> <p>This could be built in via provision for reserve account amounts to be held in a wider range of specified government issued or guaranteed securities and deposits of a regulated credit institution whose home country supervisor has adopted capital standards consistent with the Capital Accord of the Basel Committee, as amended, provided the institution is subject to such standards.</p>
<p><b><i>Uncertainty regarding the scope of relevant transactions</i></b></p>	<p>Certain threshold definitions used for the purposes of the Proposed Rule (namely, the definition of "asset-backed security" and the corresponding definition of "security" in the Securities Exchange Act) are widely cast and unclear in certain respects. There is some uncertainty with respect to the transactions intended to fall within the scope of the Proposed Rule, aspects of which have heightened significance for EU market participants.</p> <p>For example, questions have been raised as to whether the Proposed Rule would apply in respect of certain covered bond products, such as structured covered bonds. It seems unlikely that covered bond arrangements would be regarded by the U.S. agencies as targeted transactions given that such arrangements already provide for full alignment of interests with investors, however, any uncertainty in this regard would be unhelpful to the covered bond market in general.</p> <p>Concerns have also been raised that certain other EU originated arrangements may be within the</p>	<p>To remove any doubt as to the position with respect to covered bonds in general, confirmation should be provided that covered bonds (including structured covered bonds) are not within scope.</p> <p>In general, while we appreciate that there are constraints with respect to the ability of the U.S. agencies to determine the scope of application of the retention requirements, we note that it would be helpful if the agencies sought to apply the retention requirements in a manner which reflects the original legislative principles behind the requirements.</p>

	scope of the Proposed Rule (e.g. if they involve a U.S. offering) which would not be caught by the EU retention regime, including untranching and repackaging transactions (i.e. corporate debt repackaging arrangements). The rationale for regarding such simple repackaging transactions as within scope is not clear given that they do not give rise to potential "originate to distribute" or related interest misalignment issues in the same manner as securitisations. Similar concerns arise in part in respect of actively managed CLOs.	
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Your consideration of these issues is appreciated.

We would be happy to set up a conference call to discuss the matters referred to above if that would be helpful.

Yours faithfully



Richard Hopkin  
Managing Director,  
Association for Financial Markets in Europe

## **Annex I**

AFME represents a broad array of European and global participants in the wholesale financial markets, and its 197 members comprise all pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME was formed on 1 November 2009 by the merger of the London Investment Banking Association and the European operations of the Securities Industry and Financial Markets Association.

AFME provides members with an effective and influential voice through which to communicate the industry standpoint on issues affecting the international, European, and UK capital markets. AFME is the European regional member of the Global Financial Markets Association (GFMA) and is an affiliate of the U.S. Securities Industry and Financial Markets Association (SIFMA) and the Asian Securities Industry and Financial Markets Association (ASIFMA). For more information, visit the AFME website, [www.AFME.eu](http://www.AFME.eu).

AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76.

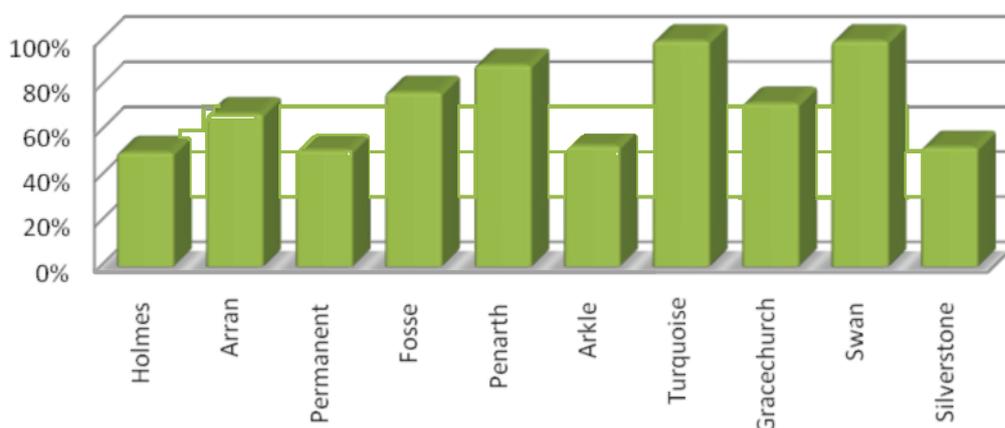
## Annex II

### UK RMBS & Cards issuance with USD tranches Jan 11 - Mid Mar 2012

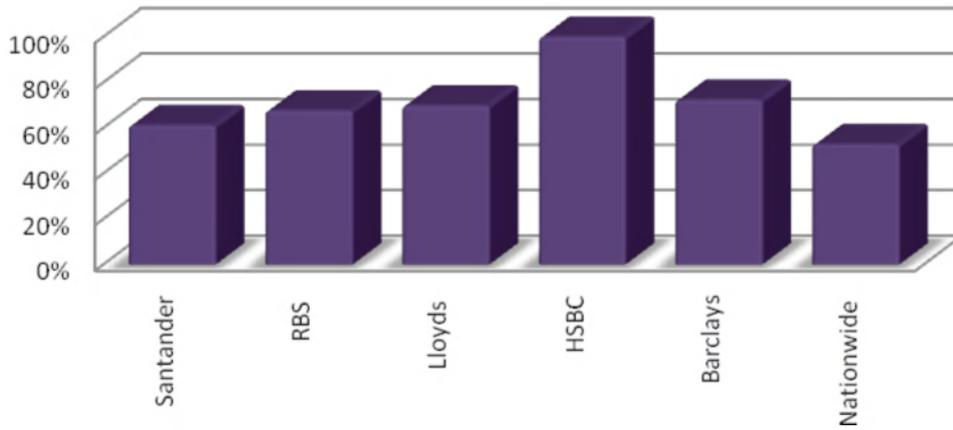
Date	Issuer	Seller	Collateral	AAA EUR mn	of which USD (in EUR)	% USD
2-Feb-11	Holmes	Santander	RMBS	2,400	869	36%
6-Apr-11	Arran	RBS	RMBS	4,282	740	17%
14-Apr-11	Permanent	Lloyds	RMBS	4,136	1,795	43%
18-May-11	Fosse	Santander	RMBS	4,276	2,650	62%
2-Jun-11	Penarth	Lloyds	CARDS	659	518	79%
21-Jul-11	Arkle	Lloyds	RMBS	2,734	2,111	77%
15-Sep-11	Holmes	Santander	RMBS	2,730	2,342	86%
6-Oct-11	Turquoise	HSBC	CARDS	372	372	100%
7-Oct-11	Gracechurch	Barclays	CARDS	748	748	100%
10-Oct-11	Arran	RBS	RMBS	3,262	2,790	86%
13-Oct-11	Silverstone	Nationwide	RMBS	12,851	2,359	18%
26-Oct-11	Permanent	Lloyds	RMBS	3,557	2,121	60%
11-Nov-11	Gracechurch	Barclays	RMBS	2,767	2,110	76%
15-Nov-11	Penarth	Lloyds	CARDS	443	443	100%
29-Nov-11	Fosse	Santander	RMBS	1,302	1,202	92%
21-Dec-11	Swan	Lloyds	RMBS	383	383	100%
13-Jan-12	Arran	RBS	CARDS	947	947	100%
18-Jan-12	Holmes	Santander	RMBS	2,646	777	29%
3-Feb-12	Arkle	Lloyds	RMBS	4,733	1,406	30%
5-Mar-12	Gracechurch	Barclays	CARDS	842	342	41%
15-Mar-12	Silverstone	Nationwide	RMBS	1,800	1,570	87%

### UK RMBS & Cards issuance with USD tranches Jan 11 - Mid Mar 2012

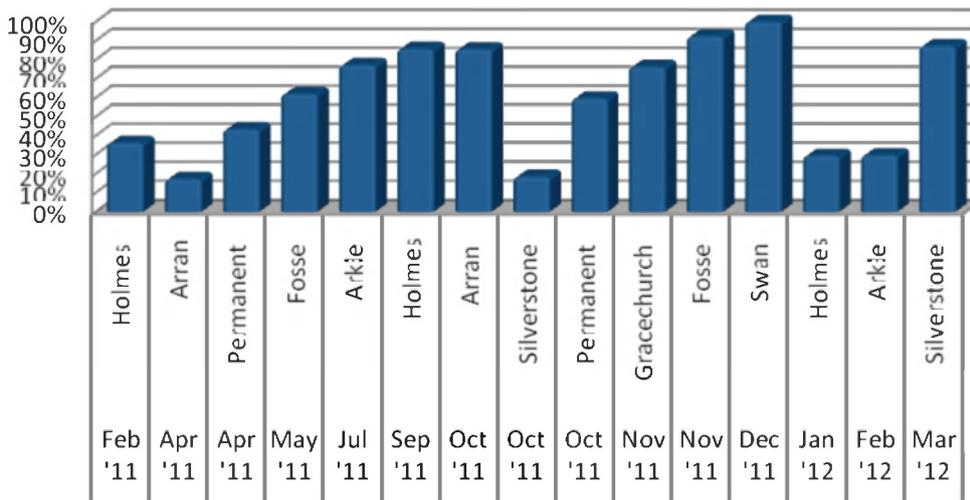
**% of total issuance with USD tranches actually denominated in USD - by programme**



**% of total issuance with USD tranches actually denominated in USD - by Seller**



**% of each issuance with USD tranches actually denominated in USD -RMBS**



**% of each issuance with USD tranches actually denominated in USD - Cards**

