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Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

30 October 2013

Credit Risk Retention
(Release No. 34-70277)
Commission File No. S7-14-11

Dear Ms. Murphy:

Ernst & Young LLP is pleased to comment to the Securities and Exchange Commission (SEC or the Commission) on the reproposal, *Credit Risk Retention*, issued jointly by the SEC and other regulators (collectively, the Agencies), including the Federal Reserve and the Federal Deposit Insurance Corporation. Under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), the Agencies were required to establish rules requiring a securitizer to retain at least 5% of the credit risk of asset-backed securities (ABS). The proposal would apply to sponsors of an ABS securitizing entity.

The Agencies are seeking comment on whether to allow the use of a representative sample method, as provided in the 2011 version of the proposed rule. Although the reproposal does not allow for use of a representative sample, we encourage the Commission to re-evaluate providing an option to use the representative sample method (or other similar method of risk retention) to address concerns that the other risk retention options might cause sponsors to consolidate securitization entities. If the Agencies decide to allow for a representative sample method (or other similar method of risk retention), we refer the Agencies to our 1 August 2011 comment letter concerning the agreed upon procedure reporting requirement in the 2011 version of the proposed rule. Our remaining comments in this letter are limited to the possible consolidation accounting ramifications of the proposed risk retention options.

Consolidation considerations related to the proposed risk retention options

The Agencies are seeking comment on whether the proposed risk retention options address respondents' concerns that the proposal may cause sponsors to consolidate a securitization vehicle for accounting purposes.

Unlike the 2011 version of the proposed rule, if a sponsor elects to use a combination of a horizontal and vertical interest to retain risk in the securitization entity, we note that the revised proposal does not prescribe a particular proportion of horizontal or vertical interest that a sponsor must hold to satisfy the risk retention requirements. As a result, we do not believe the requirement for a sponsor to retain an interest, in and of itself, would automatically cause a sponsor to consolidate the underlying securitization vehicle under ASC 810, *Consolidations*. However, because a sponsor would be required to retain an interest, sponsors and accountants would continue to carefully evaluate the sponsor's interest in the context of the purpose and design of each securitization entity when applying the consolidation guidance. We also observe that the likelihood of consolidation would increase as a sponsor retains a greater portion of its required interest as a horizontal interest.

With respect to a sponsor's analysis of securitization entities under ASC 810, we note that:

- Securitization entities generally meet ASC 810-10's definition of a variable interest entity (VIE), because securitization entities typically do not have sufficient substantive at-risk equity and/or the equity holders, as a group, lack the ability to direct the activities that most significantly impact the VIE.

- To consolidate a VIE, an enterprise must have a controlling financial interest in the VIE that is demonstrated by having both (1) power to direct the activities that most significantly impact the VIE's economic performance and (2) benefits that could potentially be significant to the VIE.

- To meet the power criterion, a sponsor's contractual right to direct the VIE's most significant activities, which typically resides in a decision-maker fee arrangement, must be deemed a variable interest.

When evaluating the securitization entity for consolidation, the sponsor (or decision maker) would first consider whether its decision-maker fee arrangement represents a variable interest that provides the sponsor (or decision maker) with the ability to direct the activities of the securitization entity that significantly impact its economic performance. In determining whether the fee relationship constitutes a variable interest, the guidance in ASC 810-10-55-37 requires a sponsor to consider (among other criteria) whether it holds other interests (e.g., a retained interest) that would absorb more than an insignificant amount of the securitization entity's expected losses or expected residual returns. If so, the sponsor's decision-maker fee arrangement would be a variable interest.

Electing to retain a horizontal interest in a more subordinated class of securities or electing the horizontal cash reserve option (collectively, the horizontal risk retention option) may expose the sponsor to more than an insignificant amount of a typical securitization entity's expected losses or returns. Thus, under the horizontal risk retention option, the sponsor's decision-maker fee arrangement is more likely to be a variable interest. Consequently, the sponsor could meet the first characteristic of a controlling financial interest, because its variable interest conveys power to direct the activities that most significantly impact the securitization entity (power). In addition, the retained horizontal interest, aggregated with any other retained interests, may absorb losses that could potentially be significant to the securitization entity (benefits). In that circumstance, the sponsor would consolidate the securitization entity.

Under the horizontal risk retention option, a sponsor would be exposed to more expected losses than under the vertical risk retention option due to the subordinated nature of the horizontal interests. As noted above, when such exposure is more than insignificant, the sponsor may consolidate the securitization entity. If a sponsor chooses to satisfy its risk retention requirements through other approaches (e.g., vertical, combination of vertical and horizontal interest), the likelihood of consolidation may be reduced. Nonetheless, an analysis would be required to determine whether the fee relationship constitutes a variable interest, and if so, whether the sponsor is the primary beneficiary.

In all circumstances (including when a sponsor concludes its exposure from retained interests is insignificant), the sponsor still would need to consider the remaining criteria in ASC 810-10-55-37 to determine whether the fee relationship constitutes a variable interest. For example, one criterion requires that the fees payable by the entity must be at or above the same level of seniority as other operating liabilities of the entity (e.g., routine trade payables) for the arrangement not to be considered a variable interest. In certain securitization entities, the fees payable generally are subordinated to other operating liabilities. Therefore, this structure often causes the fee arrangement to be a variable interest, which increases the likelihood that the sponsor would consolidate the securitization entity.

The Agencies also should be aware that the Financial Accounting Standards Board (FASB) recently began redeliberating its 2011 exposure draft to amend certain aspects of ASC 810 to clarify when a decision maker (i.e., the sponsor) is acting in the capacity of a principal (i.e., should consolidate) or an agent (i.e., should not consolidate). The FASB's goal is to issue final guidance by the end of 2014.

Based on the Board's decisions to date, certain concepts within ASC 810 may change, including the evaluation of whether the decision-maker fees payable by the entity are subordinated to other operating liabilities of the entity. However, evaluating the purpose and design, as well other specific concepts within ASC 810, would remain relevant to the consolidation conclusion including (1) the sponsor's remuneration (decision-making fees), (2) exposure to variability and (3) certain rights held by others (e.g., kick-out rights). We understand an analysis under the Board's current proposal would involve a holistic evaluation of all three factors. While we generally believe the proposed guidance may allow a sponsor to have a greater amount of exposure to an entity's credit risk before concluding the exposure provides the sponsor with a controlling financial interest, we believe a sponsor's risk of consolidation would increase as a sponsor retains a greater portion of its required interest as a horizontal interest.

Related parties and de facto agents

We also note that the risk retention requirement appears to prohibit the sponsor from selling, transferring or otherwise encumbering its interest for a period of time after establishing a securitization entity. We think the Agencies should consider whether this requirement may have an unintended consequence of creating a de facto agency relationship between the sponsor and the other investors in the entity. A de facto agency relationship results in a higher likelihood the sponsor would consolidate the securitization entity.

ASC 810-10-55-37A requires a decision maker (i.e., sponsor) to consider not only its own interests but also the interests of its related parties and a broader group of parties known as de facto agents when evaluating whether the decision maker has power through a variable interest. As defined in ASC 810-10, de facto agents include parties that cannot sell, transfer or encumber their interests in the securitization entity without prior approval (lock-up arrangements) of another party. In these situations, both the constrained party and the party requiring the constraint are considered de facto agents. ASC 810-10 emphasizes the importance of understanding all facts and circumstances and considering substance in the overall evaluation. It does not provide explicit guidance to determine whether a restriction on transfer, if imposed by regulatory bodies or other non-variable interest holders presumably to benefit third-party investors, would meet this condition. In practice, some reporting entities and accountants may conclude that such restrictions create de facto agency relationships.

The consequence of such an accounting judgment would be that, when the sponsor's interest is aggregated with the interests of its de facto agents (i.e., in this example, all of the other investors in the securitization entity who benefit from the regulatory risk retention requirements), the sponsor would have power through a variable interest because the aggregate interests of the sponsor and investors would clearly be more than insignificant to the securitization entity's expected losses or returns. If the sponsor has both power and benefits, it would consolidate under ASC 810-10.

Therefore, if it is not the Agencies' intention for their transfer restrictions to create a de facto agency relationship between the sponsor and investors in the securitization, we recommend that the Agencies confirm in the adopting release that such restrictions do not create a de facto agency relationship between the sponsor and the other investors.

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We would be pleased to discuss our comments with the Commission or its staff at your convenience.

Very truly yours,

Ernst + Young LLP