Please note that the comments expressed herein are solely my personal views

Board of Governors of the Federal Reserve System
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Washington, DC 20551
United States
www.federalreserve.gov

Chris Barnard

17 October 2013

- 12 CFR Part 244
- Docket No. R-1411
- Credit Risk Retention

Dear Robert deV. Frierson.

Thank you for giving us the opportunity to comment on your proposed rule: Credit Risk Retention.

You are revising the proposed rule that you published in the Federal Register on April 29, 2011, in order to implement the credit risk retention requirements of section 15G of the Securities Exchange Act of 1934 (15. U.S.C. 78o-11), as added by section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Section 15G generally requires the securitizer of asset-backed securities to retain not less than 5 percent of the credit risk of the assets collateralizing the asset-backed securities. Section 15G includes a variety of exemptions from these requirements, including an exemption for asset-backed securities that are collateralized exclusively by residential mortgages that qualify as "qualified residential mortgages," as such term is defined by rule.

In general I support the proposed rule, which will certainly help to align incentives with risk and information and improve the transparency of, and confidence in, ABS markets. For completeness I also enclose the comment letter that I submitted to you in April 2011 on the previous version of the proposed rule.

Key changes from the previous version of the proposed rule

Calculation methodology: I support the proposal to base the 5% risk retention requirement on fair value in accordance with U.S. GAAP, rather than on par value. This is more prudent, market consistent and will better align incentives with risk. I agree that this change requires a rethink on the original proposal that the sponsor capitalize and retain excess spreads in a premium capture cash reserve account (PCCRA). However the new proposal to eliminate the PCCRA could result in a lower overall retention and still provide structuring opportunities. This should be considered further.

Flexibility in structuring: I support the proposal to allow any combination of vertical and horizontal first-loss interests to meet the 5% retention, rather than the rather artificial "all vertical", "all horizontal" or on a "50/50 basis". This change provides sponsors the flexibility to structure their credit risk retention to optimize efficiency and meet their business needs.

Representative sample option: I agree that this option should be eliminated as it is intransparent, subjective and impractical.

Sale, transfer and hedging restrictions: I am not convinced that the prohibition of sale, transfer and hedging should expire after specified time periods. Although I agree with you that "the primary purpose of risk retention - sound underwriting - is less likely to be effectively promoted by risk retention requirements after a certain period of time has passed and a peak number of delinquencies for an asset class has occurred", the duration restrictions are rather short. At least for ABS other than RMBS I would propose a three-year restriction, which would cover the main risk periods.

Qualified residential mortgages definition: I strongly support aligning the definition of qualified residential mortgage with "qualified mortgage" as defined by the Consumer Financial Protection Bureau. This is reasonable and appropriate, promotes market integrity, increases efficiency and reduces compliance costs and is consistent with the statutory intent.

Yours sincerely

C.R.B.

Chris Barnard

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Chris Barnard

07 April 2011

- 12 CFR Part 244
- Docket No. R-1411
- Credit Risk Retention

Dear Jennifer Johnson.

Thank you for giving us the opportunity to comment on your proposed rule: Credit Risk Retention.

The OCC, Board, FDIC, Commission, FHFA, and HUD (the Agencies) are proposing rules to implement the credit risk retention requirements of section 15G of the Securities Exchange Act of 1934 (15. U.S.C. § 78o-11), as added by section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). Section 15G generally requires the securitizer of asset-backed securities to retain not less than five percent of the credit risk of the assets collateralizing the asset-backed securities. Section 15G includes a variety of exemptions from these requirements, including an exemption for asset-backed securities that are collateralized exclusively by residential mortgages that qualify as "qualified residential mortgages" (QRM), as such term is defined by the Agencies by rule, and lower requirements for securitized commercial loans, commercial real estate loans and consumer automobile loans if the loans meet certain underwriting standards established by the banking agencies.

I generally support the proposals, which are long overdue. I agree with their main objectives, which are to align incentives with risk and information, and to improve transparency and confidence in ABS markets. These proposals build on and expand earlier provisions relating to certain ABS, and in total, should promote confidence and integrity in ABS markets.

The proposals are generally rules-based. Whilst this has the advantage of a certain objectivity and measurability, it does raise the possibility that securitizers will play the rules, by changing structures and forms, or via loopholes in the proposals. I would prefer a stronger principles-based approach, such that securitizers would have to retain at least 5% of the credit risk of the assets underlying the securities full stop, rather than merely comply with these point-in-time proposed rules.

Definition of sponsor and originator

I agree with the proposed definitions here. I also agree that the risk retention requirements should apply to the sponsor and not to the depositor. In answer to specific question number 7, where two or more entities each meet the definition of sponsor for a single securitization transaction, all sponsors should be required to retain credit risk in some proportional amount. This would prevent multiple sponsors from manipulating the credit risk retention requirements in their favour, to the detriment of investors.

Retention methods

All of the proposed retention methods meet the requirement that the sponsor retain an economic interest equal to at least five percent of the aggregate credit risk of the assets collateralizing an issuance of ABS. However, I think you have laboured the point regarding the representative sample method. In answer to specific question number 47, this is not a suitable alternative as a risk retention option, as it is open to manipulation and is difficult to audit. How would the sponsor use a "random selection process" to identify those loans from within the designated pool that will be included in the representative sample? This is not as simple as pulling numbers out of a hat. How should the "material characteristics" be chosen and defined? What is the null hypothesis and the assumed distribution? I would welcome further definitions and guidance here.

I strongly agree that there should be limitations on hedging, financing and transferring the retained risks. This would help to ensure that sponsors maintain "skin in the game", which is the intention of the proposals.

Premium capture cash reserve account

I agree that sponsors should be subject to additional risk retention requirements if they seek to capitalize or monetize excess spreads. This is basic economic theory. Capitalizing excess spreads is not prudent, market consistent, or realistic. Such risk premia should be accounted for as they are earned, and not anticipated in advance, otherwise the sponsor is effectively misrepresenting the economic substance of the ABS, usually by undervaluing its risk.

Qualified residential mortgages

I believe that there is scope for reduced credit risk retention requirements for ABS collateralized solely by low risk assets. However, we must be careful when defining what constitutes "low risk" here. The proposals employ such wordings as "lower risk of default" "sufficient credit quality", and "very high credit quality", when defining QRM, which is at first meaningless. The proposals then state that:

> A substantial body of evidence, both in academic literature and developed for this rulemaking, supports the view that loans that meet the minimum standards established by the Agencies have low credit risk even in stressful economic environments that combine high unemployment with sharp drops in house prices.

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I find this statement contentious and backwards looking. In any event I do not agree with all of the proposed eligibility criteria[1], particularly the maximum loan-to-value ratio of 80%, which is far too optimistic. I would propose that the eligibility criteria should be strengthened in order that QRM should genuinely be expected to be of very high credit quality, even under stress and shock conditions.

In summary, I welcome and support your proposed rule. I would only recommend that clarification and guidance should be provided for some of the subjective issues, and that the eligibility criteria for QRM should be strengthened, so that they genuinely would be expected to be of very high credit quality.

Yours faithfully

Chris Barnard

[1] However I fully support that the loan must be secured by a perfected first lien on the property, the conditions on payment terms and that the maximum interest rate that could be charged during the first five years of the loan should be used for calculating interest payments.