November 23, 2010

The Honorable Timothy F. Geithner
Secretary of the Treasury
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue
Washington, DC 20551

John E. Bowman
Acting Director
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552

John G. Walsh
Acting Comptroller of the Currency
250 E Street, SW
Washington, DC 20219-0001

The Honorable Mary L. Schapiro
Chairman
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

The Honorable Sheila C. Bair
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429-9990

Re: Implementing Section 941 (Regulation of Credit Risk Retention) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 for Credit and Charge Card ABS

Ladies and Gentlemen:

The American Securitization Forum ("ASF")[1] submits this letter to express our views relating to implementation of Section 941 (Regulation of Credit Risk Retention) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Act") for asset-backed securities ("ABS") backed by credit and charge card receivables. ASF supports reforms within the securitization market and we commend the regulatory agencies for seeking industry input prior

[1] The American Securitization Forum is a broad-based professional forum through which participants in the U.S. securitization market advocate their common interests on important legal, regulatory and market practice issues. ASF members include over 330 firms, including issuers, investors, servicers, financial intermediaries, rating agencies, financial guarantors, legal and accounting firms, and other professional organizations involved in securitization transactions. ASF also provides information, education and training on a range of securitization market issues and topics through industry conferences, seminars and similar initiatives. For more information about ASF, its members and activities, please go to www.americansecuritization.com.

to proposing rules on this critically important issue. Over the past decade, ASF has become the preeminent forum for securitization market participants to express their views and ideas. ASF was founded as a means to provide industry consensus on market and regulatory issues, and we have established an extensive track record of providing meaningful comment to various regulators on issues affecting our market. Our views as expressed in this letter are based on feedback received from our broad membership, including our credit and charge card issuer and investor members.

We support efforts to align the economic interests of originators and securitizers with securitization investors and believe those efforts should encourage originators and securitizers to create and fund assets that conform to stated underwriting standards and securitization eligibility criteria, thereby making those parties economically responsible for the underwriting quality of securitized assets. We believe that risk retention can aid in achieving this goal so long as the requirements are tailored to each asset class, taking into consideration that the forms of credit risk retention may differ by asset type. This letter will address ASF's views concerning the implementation of Section 941 of the Act as it relates to credit and charge card ABS. We also have submitted, or intend to submit, letters addressing our membership's views relating to asset-backed commercial paper and ABS backed by other assets, including auto loans, student loans and residential mortgages.

Section 941(b) of the Act requires the Federal Deposit Insurance Corporation ("FDIC"), the Federal Reserve Board of Governors ("FRB"), the Office of the Comptroller of the Currency ("OCC") and the Securities and Exchange Commission ("Commission" and, collectively, the "Joint Regulators") to jointly implement rules to require any securitizer to retain an economic interest in a portion of the credit risk for any asset that the securitizer, through the issuance of an asset-backed security, transfers, sells, or conveys to a third party. Section 941(a) amends the Securities Exchange Act of 1934 (the "Exchange Act") to establish an alternative definition of "asset-backed security" (an "Exchange Act-ABS") that is broader than the existing definition set forth in Regulation AB and a definition of "securitizer" which is, in general, an issuer of Exchange Act-ABS or a person who organizes and initiates an Exchange Act-ABS transaction by transferring assets to the issuer.[2]

The general standards for risk retention are set forth in Section 941(c), which requires a securitizer to retain "(i) not less than 5 percent of the credit risk for any asset" or "(ii) less than 5 percent of the credit risk for an asset" if the originator of the asset meets underwriting standards to be prescribed by the Joint Regulators. The regulations prescribed under Section 941(b) must specify "the permissible forms of risk retention" and "the minimum duration of the risk retention." In addition, the regulations "shall establish asset classes with separate rules for securitizers of different classes of assets, including residential mortgages, commercial

---

[2] In a release of proposed rules relating to Section 943 of the Act, the Commission indicates its belief that the definition of Exchange Act-ABS includes securities that are typically sold in transactions exempt from registration under the Securities Act of 1933 (the "Securities Act") and that the definition of securitizer is not specifically limited to entities that undertake transactions that are registered under the Securities Act. *See* Release Nos. 33-9148; 34-63029, pp. 8-12; File No. S7-24-10, dated October 4, 2010.

mortgages, commercial loans, auto loans, and any other class of assets that the Federal banking agencies and the Commission deem appropriate" and, for each asset class established, the regulations "shall include underwriting standards established by the Federal banking agencies that specify the terms, conditions, and characteristics of a loan within the asset class that indicate a low credit risk with respect to the loan."

As noted above, we firmly believe that risk retention requirements should be specifically tailored for each major class of ABS. Securitization practices, including the forms of credit risk retention, differ in important respects across the different asset categories based on a variety of factors, including the nature and characteristics of the assets, the historical development of each asset class and the securitization structures themselves. Given this variability, any blanket, one-size-fits-all retention requirement would be arbitrary in its application to any particular asset type, and would not take into account appropriate variations in the forms of credit risk retention. This view is consistent with the Act's directive to implement "separate rules for securitizers of different classes of assets" and the primary recommendation of the Board of Governors of the Federal Reserve System (the "Board") in its recently-published Report to the Congress on Risk Retention (the "Federal Reserve Study"), in which it stated:

> "Thus, this study concludes that simple credit risk retention rules, applied uniformly across assets of all types, are unlikely to achieve the stated objective of the Act—namely, to improve the asset-backed securitization process and protect investors from losses associated with poorly underwritten loans. … Given the degree of heterogeneity in all aspects of securitization, a single approach to credit risk retention could curtail credit availability in certain sectors of the securitization market. A single universal approach would also not adequately take into consideration different forms of credit risk retention, which may differ by asset category. Further, such an approach is unlikely to be effective in achieving the stated aims of the statute across a broad spectrum of asset categories where securitization practices differ markedly. … In light of the heterogeneity of asset classes and securitization structures, practices and performance, the Board recommends that rulemakers consider crafting credit risk retention requirements that are tailored to each major class of securitized assets."[3]

ASF strongly supports the intent of Section 941 of the Act to encourage sound underwriting practices by improving the alignment of interests of originators and securitizers with investors. In implementing that intent, we strongly urge the Joint Regulators to consider the existing risk retention mechanisms in the credit and charge card securitization market. We also believe that a range of alternatives tailored to the credit and charge card securitization market will ensure that affordable credit will continue to flow from the credit and charge card ABS market over the longer term. In this letter, we respectfully submit our views concerning the types of mechanisms that should be available within credit and charge card securitizations to comply with the risk retention requirements.

[3] The Board of Governors of the Federal Reserve System, Report to Congress on Risk Retention, available at http://federalreserve.gov/boarddocs/rptcongress/securitization/riskretention.pdf, p. 3, 83-84.

## I. Risk Retention for Credit and Charge Card ABS

For the past two decades, virtually all credit and charge card securitizations have been completed using a master trust structure, where a single, revolving asset pool supports all outstanding securities issued by the master trust from time to time. The originator, which is typically also the sponsor-securitizer and the servicer (or an affiliate of these entities), designates credit or charge card accounts within its managed portfolio that satisfy specified eligibility criteria as eligible accounts and transfers the current and future receivables arising in those accounts, and the proceeds of those receivables, to the master trust. From time to time, the originator may designate additional credit or charge card accounts and transfer the receivables and proceeds relating to those accounts to the master trust, typically in contemplation of future issuances of ABS or to maintain minimum pool balances as required by the governing program documents.[4] All accounts designated to the master trust must satisfy the eligibility criteria specified in the governing program documents.

Notably, while the receivables arising in the accounts are transferred to the master trust, the accounts are not and instead continue to be maintained and managed by the originator. As the account owner, the originator continues to maintain its relationship with the cardholders and, as revolving accounts, the originator continues to make credit-granting and underwriting decisions in connection with ongoing extensions of credit in accordance with the account terms. In addition, servicing of the accounts is almost always performed by the originator or one of its affiliates. Ownership of the accounts, coupled with these ongoing relationships with the cardholders, evidence the ongoing interest of the originator in the economic performance of the assets, which significantly mitigates the risk that the interests of the originator and investors could become misaligned.

The receivables and other assets held by the master trust at any time are allocated between the investor interest and the seller interest. The investor interest is a proportional share in the assets of the master trust representing the aggregate interest of each series and class of ABS issued by the master trust. The securitizer is required by the governing program documents to maintain a minimum pool balance in excess of the aggregate investor interest.[5] The seller interest is equal to the amount of this excess and, like the investor interest, represents a proportional share in the assets of the master trust. The holders of the investor interest and the holder of the seller interest have the same priority on claims on the master trust assets. Each day, the servicer allocates finance charge collections, principal collections and charged-off receivables between the investor interest of each series and the seller interest, in proportion to the share it represents of the master trust. The seller interest represents a vertical slice of the risks and rewards of all the receivables in the master trust and is a quintessential form of credit risk retention that operates to precisely align the economic interests of securitizers with investors. In addition to being a highly effective incentive alignment mechanism, the seller interest represents a fundamental element of all credit

[4] In some cases, accounts designated to the master trust can subsequently be re-designated as removed accounts and the receivables and proceeds relating to those removed accounts can be reconveyed to the securitizer, which could arise in connection with charge-offs and account terminations or for other business reasons.

[5] The amount of this required excess pool balance varies from one program to another, but typically equals between 4 and 12 percent of the principal receivables in the master trust.

and charge card securitization structures. For these reasons, both our credit and charge card securitizer members and our investor members strongly believe that the seller interest is the appropriate form of risk retention for credit and charge card securitizations. It is, therefore, of paramount importance that the Section 941 implementing regulations include the seller interest as a permissible form of risk retention for these transactions.

While it is critical that the seller interest be included as a permissible form of risk retention, it should not be the exclusive form. Consistent with the recommendations of the Federal Reserve Study,[6] credit and charge card securitizers believe that certain additional risk retention options should be available and that a credit or charge card securitizer should be able to satisfy the risk retention requirement through any one, or a combination, of these options. For example, virtually all credit and charge card securitizers hold significant subordinate or first-loss positions in the capital structure of their transactions in the form of interest-only (IO) strips that represent an interest in excess spread and subordinate tranches that absorb credit losses before more senior tranches are affected.

*Excess Spread:* In addition to its allocable share of finance charge and principal collections and charged-off receivables, the credit or charge card securitizer typically holds an IO that represents a contingent interest in the finance charge collections allocated to the holders of the investor interest, to the extent of any surpluses – referred to as excess spread – available each month after covering payments and loss amounts allocated to the holders of the investor interest and any related servicing or other fees incurred by the master trust. By covering loss amounts, this stream of finance charge collections serves as credit support to the holders of the investor interest. As the contingent recipient of these cash flows, the credit or charge card securitizer has the incentive to maximize excess spread by increasing portfolio yield and minimizing credit losses, which directly aligns with the interests of the investors.

*Subordinate tranches:* In many cases, particularly in the current, distressed capital markets, the credit or charge card securitizer or an affiliate may retain the most subordinate tranche of the transaction. These subordinate tranches are structured to absorb credit losses before more senior tranches are affected and are, in fact, sized based on the amount of subordination needed to protect more senior tranches from multiples of expected losses. As observed in the Federal Reserve Study:

> "[A]n originator or securitizer can retain credit risk by retaining a portion of the subordinate piece of the security (a horizontal slice). Credit risk is concentrated in this security, so retaining even a small part of the subordinate piece exposes the seller to a relatively larger share of the deal's total credit risk."[7]

IO strips and subordinate tranches are first-loss exposures that are anticipated to provide enough credit support to absorb all reasonably anticipated losses and, to the extent held by the

---

[6] The Board includes as one of its recommendations in the Federal Reserve Study that the Joint Regulators should consider the potential for other incentive alignment mechanisms to function as either an alternative or a complement to mandated credit risk retention.

[7] *See* Federal Reserve Study at page 43.

securitizer, operate to further align the interests of securitizers with the interests of investors. Equally important, credit and charge card securitizers emphasize that these first-loss exposures represent risk retention mechanisms that investors may expect or demand as a condition to purchase credit or charge card ABS. If these risk retention mechanisms are not available as alternatives or complements to satisfy mandated risk retention, the costs of securitization could become uneconomical, which in turn would likely lead to a contraction of available credit for consumer finance and small business. Credit and charge card investors agree that these "horizontal slice" forms of risk retention should be available to issuers to meet risk retention requirements, but only in the case that the seller interest included in a transaction is less than 5% and an additional form of retention is needed to meet prescribed requirements.

While credit and charge card securitizers believe that the risk retention mechanisms discussed above are suitable for the credit and charge card securitization market as it exists today, they are very concerned that, if the risk retention requirements are not sufficiently flexible, they will impede market innovation and the inevitable evolution of securitization structures.[8] They believe that having a range of alternatives in addition to those discussed above, such as retention of randomly-selected exposures and contractual exposures, will ensure that market innovation is not constrained unnecessarily and, as noted above, that affordable credit will continue to be available to consumers and small businesses as the economy recovers and begins to grow. They also strongly believe that, particularly in the context of the master trust structure, they should not be required to hold their exposure in the same form throughout the life of a transaction, much less throughout the life of the master trust, so long as the securitizer maintains a specified minimum level of exposure and reports any material realignment in a current report on Form 8-K.

Finally, credit and charge card securitizers believe that their ongoing cardholder relationships and account management throughout each account's life, as well as their conditional interest in excess spread, align the interests of securitizers with investors, making credit and charge card securitizations particularly well suited to a baseline risk retention requirement that is less than 5%.

## II. "Qualified" Credit and Charge Card Receivables Adjustment

Section 941(c)(1)(B)(ii) of the Act states that the regulations prescribed under the general risk retention requirement set forth in subsection (b) "shall require a securitizer to retain less than 5 percent of the credit risk for an asset…if the originator of the asset meets the underwriting standards prescribed under paragraph (2)(B)." That paragraph sets forth that, for each asset class established under Section 941(c)(2)(A), the regulations prescribed under subsection (b) "shall include underwriting standards established by the Federal banking agencies that specify the terms, conditions, and characteristics of a loan within the asset class that indicate a low credit risk with respect to the loan." Section 941(c)(2)(A) specifically requires that regulations prescribed under subsection (b) "shall establish asset classes with separate rules for securitizers

[8] The Board includes as one of its considerations that "capital markets are, and should remain, dynamic, and thus periodic adjustments to any credit risk retention requirement may be necessary to ensure that the requirements remain effective over the longer term…." *See* Federal Reserve Study at page 85.

of different asset classes…."[9] Taken together, a literal reading of these provisions supports a mandatory downward adjustment of the baseline 5% risk retention requirement if the originator of a credit or charge card receivable meets underwriting standards prescribed under Section 941(c)(2)(B). Our credit and charge card securitizer members believe this adjustment is appropriate and believe the subject should be considered and addressed in the course of proposing Section 941 implementing regulations. Investors believe that the revolving nature of a master trust structure raises certain issues that would have to be addressed if any regulations are proposed to adjust the baseline risk retention requirement.

* * * *

ASF very much appreciates the opportunity to provide the foregoing views in connection with the Commission's rulemaking process. Should you have any questions or desire any clarification concerning the matters addressed in this letter, please do not hesitate to contact me at 212.412.7107 or at tdeutsch@americansecuritization.com, Evan Siegert, ASF Associate Director, at 212.412.7109 or at esiegert@americansecuritization.com, or ASF's outside counsel on this matter, Michael Mitchell of Orrick, Herrington and Sutcliffe LLP, at 202.339.8479 or at mhmitchell@orrick.com.

Sincerely,

Tom Deutsch

Tom Deutsch
Executive Director
American Securitization Forum

[9] While Section 941(c)(2)(A) does not explicitly identify credit and charge cards as its own asset class, that Section does direct that the implementing regulations establish such other classes of assets as the Federal banking agencies and the Commission deem appropriate. In addition, the Federal Reserve Study includes credit cards as one of nine asset classes identified and assessed in relation to the Act's risk retention provisions.