JPMORGAN CHASE & CO.

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July 14, 2011

SUBMITTED ELECTRONICALLY

Office of the Comptroller of the Currency
250 E Street, SW., Mail Stop 2-3
Washington, DC 20219

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
Attention: Elizabeth M. Murphy, Secretary

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Attention: Jennifer J. Johnson, Secretary

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

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

Department of Housing and Urban Development
Regulations Division
Office of General Counsel
451 7th Street, SW, Room 10276
Washington, DC 20410-0500

Re: Proposed Rule, Credit Risk Retention
OCC Docket No. 2011-0002; Federal Reserve Docket No. R-1411; FDIC RIN 3064-AD74; SEC File No. S7-14-11; FHFA RIN 2590-AA43

Ladies and Gentlemen:

JPMorgan Chase &Co. ("JPMorgan Chase") is pleased to submit this letter in response to the above-referenced proposed rule on credit risk retention published on April 29, 2011 (the "Proposal") by the Board of Governors of the Federal Reserve System (the "Board"), the Office of the Comptroller of the Currency (the "OCC"), the Federal Deposit Insurance Corporation (the "FDIC"), the Securities and Exchange Commission (the "SEC"), the Federal Housing Finance Agency ("FHFA"), and the Department of Housing and Urban Development ("HUD") (collectively, the "Agencies").

JPMorgan Chase is a leading global financial services firm actively involved in many aspects of the asset-backed securities ("ABS") market. Through several subsidiaries, JPMorgan

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JPMorgan Chase Bank, N.A.

Chase is an issuer and, in some cases, a servicer of many types of ABS, including residential and commercial mortgage-backed securities (respectively, "RMBS" and "CMBS") and ABS backed by credit card receivables, auto loans and student loans, among others. JPMorgan Chase Bank, National Association is an administrator of three asset-backed commercial paper ("ABCP") conduits, which, as of June 30, 2011, had aggregate outstanding ABCP of approximately $22.25 billion. Our subsidiary, J.P. Morgan Securities LLC ("J.P. Morgan"), is a broker-dealer registered under the Securities Exchange Act of 1934, as amended (the "Exchange Act") and is a leading underwriter/placement agent and dealer in the ABS markets. As part of our Asset and Wealth Management business, J.P. Morgan Investment Management Inc. ("J.P. Morgan Investment Management") is a significant investor in many sectors of the ABS markets on behalf of our clients. In addition, our Chief Investment Office ("CIO") invests in the ABS markets as principal. We are also a servicer for residential mortgage loans and auto loans owned by unaffiliated third parties and are active in providing derivatives to ABS issuers and investors. In addition to these activities in the ABS markets, we act as sponsor, underwriter, placement agent and/or dealer with respect to other structured products, such as collateralized loan and debt obligations and municipal tender option bond transactions.

In each of these businesses and across securitized and structured products, JPMorgan Chase has a leading market position. For example, JPMorgan Chase is the third largest originator and servicer of residential mortgage loans in the United States, with over 10% market share. In addition, as an issuer in 2010, JPMorgan Chase was the second largest bank originator of automobile loans and leases in the United States, the second largest originator of credit card receivables in terms of general purpose credit card receivables outstanding and sales volume, and the largest sponsor in the CMBS market. In addition, prior to the collapse of the securitization market during the recent residential mortgage crisis, JPMorgan Chase was one of the largest issuers of private-label RMBS in the United States. As an underwriter and dealer, J.P. Morgan ranked #1 in the ABS and CMBS league tables at the end of the first quarter of 2011. Finally, JPMorgan Chase is the #1 bookrunner in syndicated loans.

First and foremost, JPMorgan Chase recognizes the Agencies' extraordinary efforts to assemble the Proposal and commends the Agencies and their staffs for seeking to address, through the Proposal, certain deficiencies in the ABS markets that may have contributed to the collapse of these important markets over the last several years. ABS provide an extremely important source of funding in the domestic and international credit markets, increasing the availability of credit to consumer and corporate borrowers alike. JPMorgan Chase supports the public policy goals of more closely aligning incentives to ensure the quality of securitized assets and agrees that improvements are necessary in order to bring the securitization markets back to full health. However, we have issues with the breadth and certain details of the Proposal, which we discuss more fully below. The Proposal will impose new, and in some cases onerous, requirements on ABS sponsors and we are very concerned that if adopted in its current form, the Proposal will significantly and negatively impact the viability of an effective securitization market and the availability of consumer and corporate credit.

Therefore, we urge the Agencies to take the time needed to carefully devise a practical and lasting regulatory framework that is faithful to the principles behind the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). Dodd-Frank was the culmination of an exceptional legislative effort intended to effect comprehensive change in the financial markets. The resulting language reflects important compromises that the Agencies must heed rigorously. The Agencies, therefore, should carefully tailor the final rules against the language in Dodd-Frank to ensure that they properly reflect Congressional intent.

Although there are many aspects of the Proposal that we feel need to be modified, this letter is not intended to address all of the matters in the Proposal that are of concern to us. We actively participated in the preparation of the comment letters being submitted to you by the American Bar Association ("ABA"), the American Securitization Forum ("ASF"), the Commercial Real Estate Finance Council ("CREFC"), the Loan Syndications and Trading Association ("LSTA") and the Securities and Financial Markets Association ("SIFMA") (together, the "Industry Comment Letters"), and in general we concur with and support the analysis, commentary and recommendations expected to be contained in the Industry Comment Letters, particularly as to matters not covered in this letter. We note in this letter any significant positions from the Industry Comment Letters which we would like to stress.[1] You should not infer from our choice of discussion topics in this letter that we are any less concerned about the other issues in the Proposal which are being brought to the Agencies' attention by these groups and other members of the financial and legal communities. However, there are certain items in the Proposal which are of particular concern to us and we also felt that we could provide the Agencies with additional information on how the Proposal would affect JPMorgan Chase and our perspective on its impact on the relevant markets if adopted in its current form.

We want to emphasize that our comments reflect the collective views of JPMorgan Chase in its capacity as sponsor and servicer, J.P. Morgan in its capacity as a broker-dealer and J.P. Morgan Investment Management and CIO in their capacity as investors, and are consensus positions intended to bridge the various viewpoints of all of the JPMorgan Chase lines of business that participate in these markets. We hope that this consensus approach to our comments more accurately reflects the views of all market sectors, and are our attempt to propose changes that are fair and balanced and will be easier to implement for all market participants.

[1] We would like to note that we did not have an opportunity to review the final versions of all of the Industry Comment Letters before submitting this letter today. We understand that some of these letters, or portions thereof, will be filed after the date of this letter. Our statements herein referring to comments and recommendations made in the Industry Comment Letters are based on the close to final drafts which we reviewed. In the event any of such letters subsequently filed change in any material respect, we may submit a supplement to this letter to address any such changes.

This comment letter is divided into the following 9 sections:

1. General Comments
2. QRM/RMBS
3. CMBS
4. Auto ABS
5. Credit Card ABS
6. Student Loan ABS
7. ABCP
8. CLOs
9. Municipal Tender Option Bond Transactions

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1. GENERAL COMMENTS

Forms of Allowable Risk Retention

JPMorgan Chase applauds the Agencies' inclusion of multiple risk retention options in the Proposal. This approach is fundamental to the preservation of a regulatory environment that encourages flexibility, innovation and tailored solutions to individual financial structures. JPMorgan Chase encourages the Agencies to incorporate into the final regulation all reasonable risk retention techniques proposed by other commentators so long as they are market neutral and result in rules that are simple, consistent and easy to monitor. Flexibility will also be helpful to sponsors seeking to meet multiple risk retention regimes. For example, the European Union in Article of 122a of the Capital Requirements Directive ("Article 122a") provides more flexibility in meeting risk retention requirements than that permitted by the Proposal, permitting, for example, horizontal risk retention in the form of overcollateralization.

Increased Cost of Borrowing

As noted more specifically in our comments as to each asset class below, if adopted in its current form, the Proposal is likely to result in higher borrowing costs for consumer and corporate borrowers.

"Crowding Out" Effect

We note that if securitization sponsors retain a vertical, horizontal or L-shaped piece, the retained interests would be on balance sheet for the life of the issue and would require additional capital to be held against the retained interests, which would reduce the securitization sponsor's return on equity. At some point this would restrict the capacity of even the largest securitization sponsors to continue to issue ABS. As discussed in more detail below, this would argue for the benefit of setting an expiration date for the restrictions on transfer of the retained interests.

Accounting Considerations

The Proposal provides a number of permitted approaches and methods for meeting the risk retention requirements. The use of each approach or method will vary depending on the particulars of the product being securitized. In applying each of these methods, one thing that needs to be considered is the potential impact that these approaches would have on the accounting consolidation analysis.

The accounting guidance for these transactions is "ASC 810, Consolidations" (formerly SFAS 167, Consolidation of Variable Interest Entities"). The guidance requires an assessment of all involvement with variable interest entities ("VIEs") to determine whether there is a controlling financial interest, which includes both 1) the power to direct the activities of a VIE that most significantly impact the VIE's economic performance; and 2) the obligation to absorb losses of the VIE that could potentially be significant to the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE.

While the concept of "potentially significant" has not been defined, industry practice and interpretations have developed regarding quantitative and qualitative considerations used to apply the concept of "potentially significant." The proposed credit risk retention threshold of 5% in the Proposal generally falls within industry practice to not be considered "potentially significant." Therefore, we believe that the consolidation analysis and conclusions would generally be consistent with current practice. However, the introduction of any additional credit risk retention in excess of the stated criteria (for example, the additional requirement to establish a premium capture cash reserve account ("PCCRA")) would put stress on the consolidation analysis and could cause firms to consolidate entities where their interests would otherwise be deemed not to be significant. Besides the market impact that a PCCRA requirement could have (as discussed more fully below), it could result in many more, if not all, securitizations that contain this account to be consolidated, especially when combined with control of servicing. We believe that this is a significant unintended consequence that would have a much broader and much more negative impact than anticipated by the Agencies.

2. QRM/RMBS

Our key comments relating to QRM and RMBS can be summarized as follows:

- The definition of a Qualified Mortgage ("QM") under the Ability-to-Repay Test in the Truth in Lending Act ("TILA") should be finalized before the Agencies' finalize the Proposal and the Qualified Residential Mortgage ("QRM") exemption as intended by Dodd-Frank.

- Servicing standards should not be part of the QRM definition and should not be adopted by making them part of the mortgage documents. JPMorgan Chase supports the adoption of reasonable uniform servicing standards that apply to all mortgages and all servicers.

- The premium capture provisions, as currently structured, are broader than necessary to achieve their purpose and as a result would adversely affect the availability of mortgage products nationwide, would result in significantly higher interest rates for borrowers, and should be eliminated or fundamentally redesigned. We propose changes to the provisions that would preserve their intended function while mitigating unintended negative consequences.

- The Proposal's flexible approach to allowable forms of risk retention should be retained. The 5% risk retention requirement, in and of itself, is not expected to drastically increase interest rates for residential mortgage loan borrowers.

- The Agencies' overall approach to defining QRMs is appropriate with some modifications. Underwriting for QRMs should be based on loan-to-value ratios and credit scores, with a single back-end debt-to-income ratio that achieves the goals of Dodd-Frank.

- The final risk retention rules should allow for the termination of the risk retention requirements for RMBS after three years.

- The final rules should allow "commingling" of QRMs and non-QRMs that are QMs under TILA in the same securitization, without treating such securitization as if it were backed entirely by non-QRM mortgages. Otherwise, QRMs, which are very high quality loans with low risk of default, would be subject to risk retention simply because non-QRMs that are still QMs are in the same pool.

- The Agencies should be mindful of the effect of the timing of the final risk retention rules. If the effective date precedes Federal Housing Administration and Government Sponsored Enterprise ("GSE") reform there is a substantial risk that FHA and the GSEs will realize high concentrations of non-QRMs.

The Agencies Should Finalize the Risk Retention Regulation After the Ability-to-Repay Rule Under the Truth in Lending Act is Finalized

To properly implement Congressional intent, the Agencies must define a QRM after the Consumer Financial Protection Bureau ("CFPB") defines a QM under TILA. Nowhere is Congressional intent more clear than with respect to limitations on the definition of a QRM. Dodd-Frank plainly requires that the Agencies, "in defining the term 'qualified residential mortgage' … <u>shall define that term to be no broader than the definition of 'qualified mortgage'</u> … as the term is defined under Section 129C(c)(2) of the Truth in Lending Act, as amended by the Consumer Financial Protection Act of 2010, and regulations adopted thereunder."(Section 941(b); emphasis added.)

As indicated by this language, it is clear that Congress intended that QRMs be a subset of QM. On May 11, 2011, the Board proposed amendments to Regulation Z to define QMs ("the Qualified Mortgage Proposal"). Public comments on the Qualified Mortgage Proposal are due on July 22, 2011, the day after authority to finalize the Qualified Mortgage Proposal shifts from the Board to the CFPB. Moreover, there is no deadline for the CFPB to issue a final rule on QM. JPMorgan Chase believes it is not feasible for mortgage lenders and securitizers to understand the full impact of the risk retention proposal until such time as the QM definition is finalized.

Finalizing the QRM definition before the QM definition creates the potential for necessitating corrective rulemaking for the QRM definition, a process that could take significant time as a result of the need to coordinate rulemaking among the six Agencies. This disjointed approach could result in uncertainty for sponsors and investors by calling into question the risk retention obligations for loans that were securitized (if any are securitized) after the effective date of the final risk retention rules. Accordingly, the Agencies should not finalize the QRM definition until after the CFPB issues a final rule on ability-to-repay and QM.

Moreover, JPMorgan Chase has an overriding concern regarding the interplay between the QRM and QM definitions. The Board's proposed ability-to-repay rule provides two options for QMs. The first alternative contemplates a complete "safe harbor" from liability for both the creditor and assignee. The second alternative contemplates only a rebuttable presumption of compliance, under which the creditor or assignee will be held liable if the borrower can show that there was no ability-to-repay. JPMorgan Chase believes that the market would be served best if the CFPB adopted a broad and unambiguous safe harbor for QMs and the Agencies retained the current scope of QRM in order to promote responsible lending.

Including Servicing Standards in the Mortgage Documents is Inconsistent with Dodd-Frank

JPMorgan Chase strongly supports the adoption of uniform national mortgage servicing standards pursuant to the Agencies' general regulatory powers, rather than including servicing standards within individual sets of loan documents. Servicing standards should apply equally to all mortgage loans and all mortgage servicers. All residential mortgage borrowers, servicers and investors should benefit from uniform, consistent and predictable servicing standards applied to the mortgage industry as a whole. Limiting servicing standards to mortgage loans of the highest credit quality is counter-intuitive and misguided.

Servicing standards do not belong in the Proposal, which focuses on risk retention in the securitization process and seeks to exempt from risk retention loans of the highest credit quality. Section 941(b) of Dodd-Frank directs the Agencies to define the term "'qualified residential mortgage' . . . taking into consideration underwriting and product features that . . . result in a lower risk of default." Servicing standards are not among the underwriting and product features identified in Dodd-Frank "that historical loan performance data indicate result in a lower risk of default." The only way in which servicing standards could be considered underwriting or product features is by forced inclusion as terms in the mortgage documents.

If the Agencies wish to address servicing standards, they should do so through separate, targeted and coordinated guidance or by way of rulemaking under their general regulatory powers. In fact, the Proposal acknowledges the efforts currently underway by the Board, the OCC, the FDIC, the Office of Thrift Supervision, FHFA, HUD, CFPB and Treasury to develop a uniform set of nationally applicable mortgage servicing standards to address more completely the servicing issues identified in the Proposal. The interagency efforts to develop uniform servicing proposals also contemplate reforms beyond those outlined in the Proposal, such as reform of compensation arrangements. Any document-based servicing standard that would apply on top of a national servicing standard would be counterproductive and weaken the goals of uniformity and predictability sought by Dodd-Frank.

Lastly, in the current market structure, the mortgage servicer often is different from the securitizer. Embedding servicing standards in mortgage loan documents will impair the free transferability and liquidity of servicing and thereby affect a servicer's ability to manage servicing and capital costs.

The Premium Capture Provisions Should Be Redesigned

Premium Capture Should Not Apply to Vertical Risk Retention

We understand that the purpose of the premium capture provisions is to discourage securitizations that are structured to monetize excess spread, and we agree with the goal of ensuring that structuring cannot dilute the risk retention requirement. The economics of a vertical retention, however, cannot be changed through structuring, because any structural changes in one class of securities will be exactly offset by structural changes in other classes of securities, and vertical risk retention holds an equivalent percentage of each. As such, this retention form cannot be manipulated, is outside of the stated goal of the premium capture provisions, and should not be subject to premium capture. While the examples we will discuss below are based on RMBS, we would propose that vertical risk retention used by any ABS asset class should not be subject to a premium capture.

For example, suppose that a securitization can be structured one of two ways: "Structure A" is a sequential structure whereby excess spread is only released to the residual holder after all other securities are retired. In this structure, if the excess spread was sufficient to cover all losses over the life of the deal, the residual holder will receive the remaining cash after all other securities have been paid in full, and if the excess spread was insufficient to cover all losses over the life of the deal, the residual holder will receive nothing. "Structure B" allocates all excess spread each month to a senior interest-only ("IO") class and, as a result, its subordinate class (Class B) has less credit enhancement and lower market value, and the senior IO in Structure B has a commensurately higher market value than that of the residual in Structure A. The table below shows the impact of changing the structure on vertical risk retention as compared with horizontal risk retention:

Structure A (Sequential Pay): Vertical vs. Horizontal Risk Retention

		Market Value		Vertical Retention		Horizontal Retention	
Class	Balance	(%)	($)	(%)	($)	(%)	($)
A	95	100	95	5%	4.75	0%	0
B	5	80	4	5%	0.2	100%	4
Residual	n/a	3	3	5%	0.15	100%	3
Gross Execution			102	**Total retained**	**5.1**	**Total retained**	**7**
Costs			1.00				
Net execution			101.00	**as % of net**	**5.05%**	**as % of net**	**6.93%**

Structure B (Senior Interest-Only Strip): Vertical vs Horizontal Risk Retention

		Market Value		Vertical Retention		Horizontal Retention	
Class	Par	(%)	($)	(%)	($)	(%)	($)
A	95	100	95	5%	4.75	0%	0
A-IO	n/a	4	4	5%	0.2	0%	0
B	5	60	3	5%	0.15	100%	3
Gross Execution			102	**Total retained**	**5.1**	**Total retained**	**3**
Costs			1.00				
Net execution			101.00	**as % of net**	**5.05%**	**as % of net**	**2.97%**

As this example illustrates, changing the structure has no impact on vertical risk retention, because any change made to any interest in the structure is equally offset by a change in one or more other interests in the structure, and the vertical retention holds an equal share of each interest.

Another issue that vertical retention highlights is that the PCCRA calculation, as proposed, could be construed to be circular. For example, if a sponsor elected a 5% vertical retention and a PCCRA was required in the amount of X dollars, then the gross proceeds of the securitization, which is now funded by an additional X dollars of hard cash, would increase by X, of which 95% would be included as "gross proceeds" for the purposes of calculating the PCCRA amount. This in turn would require that the PCCRA amount is increased by 95% of 95% of X, and so on. The result of this circularity would be that a dollar of premium loan execution would result in a PCCRA funding requirement of twenty dollars.[2] We do not believe this is the intended outcome of the premium capture provision.

The economics of vertical risk retention cannot be manipulated through structuring. As such, this form of retention falls squarely outside of the purpose of the premium capture provisions, which is to discourage securitizations that are structured to monetize excess spread, and should not be subject in any manner to premium capture.

The Premium Capture Provisions Should Define "Net Closing Costs" To Include All Costs Related To the Transaction and to the Origination or Sale of its Assets

The premium capture provisions are intended to achieve their purpose by prohibiting sponsors from receiving compensation in advance for excess spread income expected to be generated by securitized assets over time. However, a sponsor must pay various costs, both directly and indirectly related to the final securitization transaction, before a profit can be realized. These costs include taxes[3], SEC registration fees, rating agency fees, rate-lock and other hedging costs, operational costs in originating the mortgage loans, underwriting fees, and legal, accounting and other direct deal expenses. We propose that "net closing costs" should be defined to include any cost related to the origination or sale of the securitized assets, or related to the

[2] $1 + .95*1 + .95*.95*1 + .95*.95*.95*1… = $20.

[3] For example, REMIC transactions trigger an immediate gain-on-sale tax liability upon closing, to the extent the REMIC securities are sold.

securitization transaction itself, that would be applicable under generally accepted accounting principles ("GAAP") to reduce the net income realized from the securitization transaction. Again, while the examples we will discuss below are based on RMBS, we would propose that "net closing costs" in connection with any ABS asset class should be defined in this manner for this purpose.

Without this clarification, the proposed provisions could be interpreted to require a sponsor to maintain a PCCRA in the case of an unprofitable securitization. For example, consider a mortgage loan that was committed with a 60-day rate lock period. Upon locking the rate, the lender would hedge the interest rate risk such that if interest rates decrease, the hedge will incur a loss that offsets the increase in the price of the mortgage loan. In order to originate this loan, assume the lender had to pay its staff and incur other overhead expenses of 0.10%. Now assume that rates did decrease, the loan was now worth 100.50%, and the lender must pay 0.50% to cover the hedge loss. The lender has now paid 0.60% in direct costs, owns a loan worth 100.50%, and will lose 0.10% upon securitization. If PCCRA does not consider the hedge and other costs in its calculation, it could require 0.50% of "premium" to be captured, even though the lender did not receive any up-front compensation for the transaction (and, in fact, incurred an up-front loss).

The same example would hold true for mortgages that were purchased at a premium. Taxes have a similar effect: if a REMIC securitization was executed with a 50 basis point premium net of all costs, then a sponsor who retained a 5% vertical interest in the transaction and sold the other 95% could have a tax liability of approximately 19 basis points,[4] in direct reduction of any "compensation" received by the sponsor.

Properly accounting for costs is essential to achieving the purpose of PCCRA without having the unintended consequence of drastically reduced liquidity in the mortgage loan market, which as a result could significantly raise mortgage rates and further depress housing prices.

The Representative Sample Method Is Impractical and Should Be Expanded to Include a Participation Class

We commend the flexibility that the Proposal provides for meeting risk retention through the use of a representative sample ("Representative Sample Method") which is based on an economic interest that is representative of the securitized pool. We are concerned, however, that as proposed, the Representative Sample Method cannot be employed in practice. For example, the proposal requires that the sample be chosen randomly, but also requires that the sample be of equivalent risk as the securitized pool. In order to pick a sample of equivalent risk, a sponsor could be required to pick the random sample several times, each of which, it could be argued, undermines the level of "randomness" reflected in the sample selection. Furthermore, the definition of "equivalent risk" is sufficiently vague that a sample pool could reasonably be argued to be of equivalent risk or not of equivalent risk. Without clear guidance on how to meet these competing requirements, a sponsor choosing the Representative Sample Method could be

[4] Assuming a 40% tax rate, 50 basis points * 95% * 40% = 19 basis points.

put in the position of being required to meet conditions that cannot be met with reasonable certainty.

Recognizing that the requirements of the Representative Sample Method are intended to ensure that the retained interest is representative, we propose that the Representative Sample Method be broadened to include the retention of an unstructured pass-through participation class (a "Retention Class"), which represents a 5% economic interest in all loans included within the transaction and receives 5% of all cash flows from the loans in the securitization. As such, the Retention Class would be subject to the same credit, prepayment, and other risks that impact the entire collateral pool, and would have the same economic profile as a representative sample, without having any specific tranches that are subject to time tranching, credit tranching or coupon stripping. We believe that this approach would fully achieve the purpose of the Representative Sample Method in a manner that is cost-efficient, clearly defined, and impervious to manipulation.

If Mortgage Origination Is Financed Through Securitization Structures Requiring a PCCRA, the Inefficiencies of Such Structure Would Require Higher Mortgage Rates

We estimate that newly-originated non-Agency 30-year fixed rate residential mortgage collateral could be securitized at approximately 90 basis points above par today. In order to match these securitization economics when applying the proposed premium capture provisions, we estimate that an increase to the borrower's interest rate of approximately two full percentage points[5] would be required. This effect would be additive to other effects described herein, and could be higher for lower-credit borrowers. As discussed more fully below, a rate increase of this magnitude would have significant impact on credit availability and home affordability for borrowers.

If Mortgage Origination Is Financed Through Securitization Structures *Not* Requiring a PCCRA, Sponsors Would Incur Significantly Higher Capital Costs That Would Require Higher Mortgage Rates to Offset

The Proposal's comments state that the Agencies expect that few, if any, securitizations would be structured to monetize excess spread at closing and, thus, require the establishment of a premium capture cash reserve account.

However, the alternatives to a PCCRA requirement that we discuss herein would be equally costly. For servicer-sponsors who originate loans that are serviced by an affiliate of the

[5] Assumes a current coupon 30-year fixed-rate mortgage at a 5.25% rate with gross securitization proceeds (as a percentage of unpaid balance) of 101.40, direct transaction costs of 0.50, other related costs (such as origination, acquisition, and/or hedging) of zero, tax rate of 40%, and that funds in the PCCRA are i) invested each month at a rate equal to the lesser of 2.00% and the rate on such date per the 1-year CMT forward curve as of June 2011, ii) released in 30 years, and iii) funded by and solely owned by the sponsor. Under these assumptions, excluding the impact of consolidation, hedging costs, or other factors discussed herein, we calculate that mortgage rates would need to increase by approximately 190 basis points in order for the sponsor's equity holders to realize the same economics when applying the proposed premium capture provisions as would be realized without such provisions.

sponsor (such as JPMorgan Chase and many of the other largest mortgage originators in the country), increasing the retained interest in order to avoid PCCRA would result in consolidation under GAAP for transactions that would otherwise have been accounted for as a sale, regardless of what form of risk retention the sponsor chose. Consolidation for these types of transactions would have severely negative implications for such sponsor's balance sheet, income statement and regulatory capital treatment, would lower the amount of capital available to homeowners and the liquidity of mortgage loan trading, and as a result, would require such lenders, under today's regulatory capital requirements (which could increase in the future), to increase mortgage rates by approximately 300 basis points.[6]

Non-regulated mortgage originators, an integral part of the "shadow banking system," would also need to increase rates due to the premium capture provisions, though for different reasons than discussed herein. In the event that the required rate increase for those entities is less than the required increase for the regulated servicer-sponsors, the premium capture provisions would have the effect of tilting the playing field in favor of mortgage origination through non-regulated "shadow banking" entities. In either case, mortgage rates would rise significantly.

The Premium Capture Provisions Would Raise Hedging Costs Significantly, Leading to Higher Mortgage Rates

The premium capture provisions would substantially raise hedging costs due to the asymmetrical impact that the premium capture provisions would have in response to interest rate changes. For example, consider a sponsor who originated or purchased a loan at par and securitized six months later. During this six-month period, the interest rate risk to which the sponsor would be exposed would typically be hedged with Treasuries or swaps, such that any change in the loan value due to an unexpected interest rate change would be offset by a corresponding change in the value of the hedge.

With the introduction of the proposed premium capture provisions, however, the interest rate risk would become asymmetrical: a decline in interest rates during that period would cause the value of the securitization to increase, thus raising the required premium capture amount. Realization of this captured premium, which could take decades, would reduce the present value of this premium to a fraction of the premium amount.[7] However, an increase in rates, which would lower the loan's value to below par, would not cause any premium capture amount account to be created, since the securities would be sold below the par value of the loans.

To hedge this asymmetrical impact on value due to fluctuations in interest rates, the sponsor would need to use hedging instruments which are significantly more expensive than

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[6] Assumes that required regulatory capital equals 100% of the securitized portfolio at 100% risk weighting applied at a 10% capital ratio and requires equity-like yields.
[7] For example, the present value of one dollar deferred for 30 years and discounted at 4% annually equals approximately 0.30.

those currently used. We estimate that these increased hedging costs, which would ultimately be transferred to the borrower, could raise mortgage rates by approximately 40-45 basis points.[8]

The Premium Capture Provisions Treat Identical Economic Interests Differently

The proposed premium capture provisions treat vertical retention, which provides a perfect economic representation of the ABS interests, differently from representative sample retention, which provides an approximate economic representation of the ABS interests. If any differentiation is appropriate, then arguably, vertical retention should be subject to a lower retention requirement because it is always a perfect economic representation of the ABS interests.

The Effects on Liquidity of the Premium Capture Provisions Would Undermine Federal Monetary Policy Decisions

Market interest rates and mortgage loan prices generally move in opposite directions. As a result, the proposed premium capture provisions, which would lower the liquidity of premium loans, would reduce the capital available for lending when a policy decision to lower rates results in the creation of premium loans. This would be counter to the effect that is generally intended by such policy decisions. Thus, the premium capture provisions would dilute the impact of the U.S. government's federal interest rate policy decisions by reducing the capital available for mortgage loans when interest rates are lowered and by increasing the capital available for mortgage loans when interest rates are raised.

Economic Impact of the Premium Capture Proposal

For the reasons outlined above, we believe the proposed premium capture provisions would result in an increase in mortgage rates, potentially up to or even in excess of 200 basis points. This increase in borrowing costs would be borne by the consumer and would negatively impact affordability and, as a result, housing prices. To illustrate, the below table shows the impact of a 2 percent rate increase on a hypothetical borrower of a 30-year fixed-rate mortgage today:

	Current Loan Amount	Premium Capture Effect	Breakeven Loan Amount
Loan Amount	500,000	500,000	400,000
PropertyValue	625,000	625,000	500,000
Loan to Value	80%	80%	80%
Rate	5.25	7.25	7.25
Monthly Income	9,861	9,861	9,861
Mortgage Payment	2,761	3,411	2,729
DTI	28%	35%	28%

[8] For example, we estimate that using options instead of Treasuries and swaps for hedging could increase the cost of a six-month hedge by approximately 200 basis points upfront, which we estimate to be approximately equivalent to 40-45 basis points per year in rate.

As this table illustrates, in order to maintain the same level of borrower affordability (as measured by DTI) with the higher mortgage rate, the property value must be reduced by approximately 20%. A reduction of that magnitude would have a severely negative impact on home prices and ultimately on the U.S. economy.

We Believe That the Premium Capture Provision Should Be Eliminated or Significantly Modified

Risk Retention can be accomplished in other forms without having such a negative impact for both issuers and borrowers. To the extent that Premium Capture is contained within the final rules, we believe that it could be better tailored to serve its purpose without incurring the severe negative consequences that the Proposal would create. In particular, for the reasons discussed above, we would recommend:

- Eliminating the application of premium capture for vertical retention and the Representative Sample Method.
- Defining "net closing costs" to include all costs related to the transaction and its assets that would be applied under GAAP to determine net income.
- Broadening the Representative Sample Method to include the retention of a 5% pass-through participation class.
- If premium capture is not eliminated for vertical retention (and we believe it should be, for the reasons discussed above), then in the calculation of the capture amount, excluding cash reserve account amounts from gross proceeds so that the calculation is not circular, and using the same multiplier for vertical retention as is used for its economic equivalent, the Representative Sample Method: 100 percent.

We believe that these changes will have the following benefits, which will support the goal of achieving a strong and vibrant housing market:

- Ensure that the sponsor's retained interest is of meaningful significance, aligns the interests of the sponsor and the holders of the issued securities, and achieves the purpose and fulfills the mandate of Dodd-Frank.
- Ensure that structuring choices do not undermine risk retention economics.
- Increase the amount of capital available for lending, by allowing a sponsor to continue to achieve sale accounting treatment for securitizations that currently qualify for such treatment.
- Protect borrowers from significant rate increases.

- Ensure that risk retention requirements are not circular and treat identical economic interests in the same fashion.

The Qualified Residential Mortgages' Proposed Underwriting Criteria Are Generally Appropriate, With Some Modifications

Congress directed the Agencies to define the term "'qualified residential mortgage' . . . taking into consideration underwriting and product features that . . . result in a lower risk of default." See Section 941(b) of Dodd-Frank. In proposing the eligibility requirements for QRMs, the Agencies expressed several goals and principles. First, the Agencies stated that QRMs should be of the highest credit quality, given that Congress exempted QRMs completely from the credit risk retention requirements. Second, the Agencies recognized that setting fixed underwriting rules would exclude from QRM some mortgages to potentially creditworthy borrowers. The Agencies believed that the benefit of providing fixed and simple eligibility requirements rather than codifying the trade-offs used in underwriting outweighed the cost of excluding such mortgages from QRM. Third, the Agencies sought to preserve a sufficiently large population of non-QRMs to enable the market for securities backed by those mortgages to be relatively liquid. Fourth, the Agencies sought to implement standards that would be transparent and verifiable to participants in the market. Finally, the Agencies sought to address the requirement that the definition of a QRM be no broader than the definition of QM.

The Agencies asked for comment on their overall approach to the definition. They also asked for comment on the impact of the proposed eligibility requirements on the securitization market, pricing, credit availability, and the impact on low- and moderate-income borrowers, among other issues. While JPMorgan Chase believes that the overall approach is appropriate, certain of the specific eligibility requirements are not sufficiently tailored to the goals and principles expressed by Congress and the Agencies and should be modified or removed.

The Agencies' Overall Approach to Defining QRM is Sound

JPMorgan Chase generally supports the efforts of the Agencies to define QRM as outlined in the Proposal. We recognize the benefit that tighter underwriting standards can bring to the mortgage origination market. The failures of mortgage originators who did not uphold high credit standards are well documented.

JPMorgan Chase has determined that the price differential in private label securitizations, based on the 5% risk retention requirement alone, will be minimal, and as a result should have little impact on borrowers who are able to qualify for standard or "plain vanilla" mortgages. As more fully discussed elsewhere in this comment, JPMorgan Chase believes that non-QRMs will only be priced 10 to 15 basis points higher in yield than comparable QRMs in private label securitizations without credit risk retention. In addition, it is certainly understandable that the underwriting requirement for a QRM loan will be set high, given that QRMs are supposed to be the least risky types of mortgages that can be made. It is for this reason that we believe the Agencies should take all appropriate steps to make sure that a vigorous non-QRM market exists following the issuance of the final risk retention rules. This will help ensure that reasonably priced mortgage options are available for low and moderate income borrowers and other underserved populations.

The QRM Eligibility Requirements Should be Adjusted in Some Areas

The definition of a QRM is limited to home purchase loans and refinancings secured by a borrower's principal dwelling. These loans must meet 13 specific eligibility requirements in order to qualify as a QRM, as well as all of the statutory limitations for a QM under TILA. The Agencies state that the 13 criteria for QRM are factors that should result in lower risk of default and/or reduce the likelihood of "payment shock" to borrowers. JPMorgan Chase agrees that many of the requirements identified by the Agencies are significant factors in determining risk of default. For example, the loan-to-value ratio ("LTV") of a mortgage is clearly a factor in performance. JPMorgan Chase proposes, however, that certain eligibility requirements are either too restrictive as proposed or do not have a meaningful bearing on loan performance. As discussed in further detail below, JPMorgan Chase believes that changes to the following eligibility criteria would better further the Agencies' stated goals.

The LTV Ratios are Appropriate; However, the Rate and Term Refinancing Loan-to-Value Ratio Should be the Same as the Ratio for Home Purchase Loans

The Agencies have proposed three LTV ratios for different types of loans. For purchase mortgages the LTV may not exceed 80%, for rate and term refinance mortgages the LTV may not exceed 75%, and for cash-out refinance mortgages the LTV may not exceed 70%. JPMorgan Chase believes that the LTV limits proposed for purchase mortgages and cash out refinances are appropriate but advocates changing the ratio for rate and term refinances for the reasons discussed below.

As the Agencies have acknowledged, loans originated with LTVs above 80% could be considered prudent and appropriate. Nevertheless JP Morgan Chase does not recommend increasing the proposed thresholds for purchase mortgages and cash out refinance mortgages for the following reasons:

First, the 80% and 70% thresholds for purchase mortgages and cash-out refinance mortgages support the Agencies' goals of providing clear and simple eligibility requirements that will also have a positive impact on loan performance;

Second, in our experience, the proposed LTV ratios correlate with lower risk of default; and

Third, LTV ratios should generally be conservative, given that even the best and most accepted methods of collateral valuation cannot ensure complete accuracy of value.

However, JPMorgan Chase has concluded that rate and term refinancings perform much like purchase mortgages and, therefore, it would be appropriate to set a maximum LTV of 80 percent for rate and term refinance loans. In general, borrowers tend to pursue rate and term refinance transactions that improve their relative position with respect to their payment obligations, interest rates or remaining terms. This should generally result in a lower risk of default. Other credit risk factors being the same, borrowers who refinance to reduce their rates but who do not cash out equity demonstrate their commitment to the home and should be subjected to the same maximum LTV requirement as for a home purchase loan.

While it has been suggested that Dodd-Frank was not intended to allow the Agencies to utilize factors such as LTV to define a QRM, we find this argument to be unsubstantiated. The fact that Congress decided not to include a reference to LTV ratios in §941 of Dodd-Frank does not in any manner diminish the Agencies' authority to include LTV ratios when implementing their statutory authority to define the characteristics of a QRM. Moreover, JPMorgan Chase believes that LTV ratios are an appropriate element in loan underwriting and, therefore, in defining low risk loans that should be eligible for QRM status.

The Agencies Should Incorporate Credit Scores into the Credit History Requirements

JPMorgan Chase supports the use of borrower credit history in defining QRMs, but believes the Agencies should adopt an approach that allows the lender, at its option, to use a validated credit scoring model in place of the proposed credit criteria. The Proposal's rules-based approach runs the risk of including unacceptably high risk borrowers in QRM, and at the same time, excluding mortgage loans with lower risk characteristics from QRM. Credit scoring almost universally outperforms binary rules-based approaches in predicting default risk, because scoring algorithms can weigh credit bureau attributes with other transaction-level risk characteristics. Credit scores consider statistically significant features of the borrower's credit behavior that would not be considered in the Proposal. Specifically, the number of recently observed credit inquiries, the utilization rate on revolving debt, and the age and depth of the credit file all tend to appear as attributes in credit scores but are not included in the Proposal's rules-based matrix.

The superior performance of credit scoring in identifying loans with a high default risk is observed in our own experience. For example, we have seen a measurable improvement in loan performance beginning with 660 FICO scores, with even greater improvement occurring when scores exceed 700 FICO. Indeed, credit scoring is widely incorporated in other underwriting guidance because of its superior performance in predicting risk of default. Guidelines currently maintained by FHA and the GSEs, as well as prior prudential guidance from the federal banking regulators, all acknowledge the predictive value of high quality credit scoring models. In some instances, credit scores are explicitly incorporated into these underwriting matrices.

We recognize the Agencies' reluctance to embed a specific scoring system in regulations. Accordingly, JPMorgan Chase urges the Agencies to explore whether credit scoring algorithms and associated cutoffs could qualify for use in the QRM definition without endorsing a specific credit score model. JPMorgan Chase offers its assistance to the Agencies should they decide to explore this approach to credit history.

<u>**The Agencies Should Adopt a Single Debt-to-Income ("DTI") Ratio**</u>

JPMorgan Chase supports a DTI measure in conjunction with the maximum LTV ratios and credit history criteria, but believes a single back-end DTI of 42 percent would better achieve the goals of Dodd-Frank than the proposed DTI ratios. DTI is meaningful because the more a borrower's income must be used to service all recurring debt, the more likely a brief interruption in income or a large unexpected expense could compromise his or her ability to maintain mortgage payments. The Proposal caps monthly housing debt (front-end DTI) at 28% of monthly gross income and total monthly debt (back-end DTI) at 36% of monthly gross income. Recognizing the lack of empirical data supporting the use of DTI in evaluating risk, the Agencies looked at historical trends and certain limited loan performance data and determined that the ratios were consistent with the goals of the Proposal.

JPMorgan Chase believes the proposed DTIs would not measurably improve performance of loans included in QRM, and at the same time they would exclude many low-risk loans from QRM. In contrast, a single and more generous back-end ratio would better predict risk of default without unnecessarily excluding sound loans from QRM. Distinguishing between front-end and back-end DTI is not very meaningful in the current economic environment. Borrowers today do not give priority to their mortgage debt over other recurring obligations, as they once did. Thus, for newly originated mortgages the front-end DTI provides very limited predictive value in comparison to the additional predictive value offered by the back-end DTI.

Therefore, JP Morgan Chase supports elimination of the front end ratio altogether, and advocates only a back end DTI ratio. We have observed that for loans meeting the Proposal's maximum LTV ratios and credit criteria, loan performance begins to deteriorate when DTIs exceed 42 percent. A single DTI ratio of 42 percent would better ensure that high credit quality loans are included in the QRM, as intended by Dodd-Frank, than the proposed ratios. JPMorgan Chase notes, however, that if the final rule allows a higher LTV and lower FICOs than the current Proposal, the Agencies also should reduce the back-end DTI ratio to an appropriate percentage based on loan performance data.

We note that a White Paper prepared by the Mortgage Bankers Association ("MBA") cites data intended to demonstrate that DTI ratios have little impact on default rates. Specifically, the MBA argues that elimination of the DTI ratios from the QRM definition will expand the number of loans qualifying on QRMs significantly while defaults would increase by only a small percentage. JPMorgan Chase believes the MBA's data raise important public policy considerations and should be given close scrutiny by the Agencies. However, JPMorgan Chase does not believe that DTI should be eliminated from the QRM definition altogether, because this could result in loans with very high DTIs being classified as QRMs. These borrowers are significantly more likely to experience overwhelming payment stress given the existence of obligations in addition to the mortgage loan. That being the case, JPMorgan Chase continues to believe that a single back-end DTI ratio of 42% is appropriate.

The QRM Definition Will Not Drastically Increase Interest Rates for Loans That Are Subject to Risk Retention

The Agencies stated that their aim was to define QRM to include only the highest credit quality loans without unnecessarily increasing costs for creditworthy borrowers whose loans would not meet the high QRM criteria. Based upon a preliminary analysis, JPMorgan Chase believes that the 5% risk retention element, standing alone, is not expected to drastically increase the cost of credit for residential mortgage loans that do not meet the QRM definition. However, we are concerned about, the cumulative impact of risk retention and the PCCRA on securitizations and borrowers.

In the current market, borrowers with adverse credit risk profiles are already subject to higher credit costs such as GSE guarantee fees and mortgage insurance premiums. Similarly, it is expected that borrowers whose loans are subject to the 5% risk retention will bear the resulting costs, including the higher liquidity costs and capital costs associated with these loans. For example, assuming a 5% risk retention for a portfolio of loans, the loans in the portfolio will be subject to a 6% weighted capital requirement, which translates to an additional capital burden of approximately 30 to 40 basis points. This increased capital cost will, in turn, require an increase of roughly 10 to 15 basis points in yield versus a comparable loan in a private label securitization without credit risk retention.

This estimate of a minimal impact is consistent with an estimate suggested by Chairman Bair of the FDIC in a recent address to the Council on Foreign Relations and by Board Vice Chair Janet Yellen in a recent speech at the 2011 Federal Reserve Bank of Cleveland Policy Summit. In JPMorgan Chase's view, these increases are not significant and are consistent with the Agencies' goals.

JPMorgan Chase believes that the larger and more significant issue the Proposal poses is the absolute cost of risk retention to the industry and borrowers. In particular, as discussed above, JPMorgan Chase is concerned that the combination of the risk retention requirement, the imposition of the proposed PCCRA, and the originating lender's continued servicing of the loans will, in the aggregate, result in such a large level of risk retention that it will jeopardize the true sale treatment of mortgage securitizations. The loss, or even the threat of loss, of true sale treatment will endanger the entire securitization market. If this occurs, lending costs will increase and the availability of residential mortgage credit will be severely constrained. Accordingly, JPMorgan Chase strongly urges that the final regulation establish a risk retention level and a rule for premium recapture that will not risk the true sale treatment of residential mortgage securitizations.

JPMorgan Chase Supports a Prudent Expansion of the QRM Definition That Includes Relaxed LTV and DTI Standards

As discussed above, JPMorgan Chase believes that the Agencies' overall approach to defining QRMs is sound. However, JPMorgan Chase is concerned that tighter underwriting requirements could inappropriately restrict access to mortgage credit for low and moderate income communities, minority neighborhoods, first time homebuyers and other vulnerable groups. JPMorgan Chase believes that the Agencies should explore whether these potential adverse effects could be avoided by calibrating the LTV ratio and other criteria, such as DTI or credit scores, contained in the Proposal.

JPMorgan Chase believes the Agencies should consider whether it is possible to develop a QRM definition with a more relaxed LTV ratio, up to 90%, with private mortgage insurance, while adjusting other underwriting criteria to ensure that QRMs remain relatively low risk assets across a range of LTV values. The importance of developing a more flexible approach that increases homeownership opportunities to more borrowers of diverse income, racial and ethnic groups should be balanced by a full understanding of the potential increase in the frequency of defaults that is likely to result. This will help ensure development of a responsible and balanced approach that affords a meaningful level of protection to consumers and investors alike.

The Final Rule Should Allow Issuers to Include QRMs with QMs in the Same Pool

The proposed risk retention rule states that all of the mortgage loans in a securitization must be QRMs or qualifying government loans in order to avoid the 5% risk retention requirement. By its terms, the proposal would impose the 5% risk retention requirement on all loans in the securitization if any of those loans were QMs but did not qualify as QRMs or government loans. While this proposal generally follows Section 941 of Dodd-Frank, it has the effect of depriving QRMs and government-insured loans from the risk retention exception that they would otherwise enjoy, solely because they are included in the same securitization as loans that qualify only as QMs. In these situations, it would be a simple mathematical calculation to apply the 5% risk retention requirement solely to the QMs in the securitization that did not also qualify as QRMs or government loans. This approach will give lenders – particularly, community banks and other smaller lenders – the flexibility of bundling a wide range of high quality, relatively safe mortgage loans in a single securitization without losing the risk retention exemption for those loans that also qualify as QRMs or government loans. Accordingly, we request that the Agencies permit QMs to be included in a securitization with QRMs and government loans, with the 5% risk retention requirement being applied solely to the QMs that do not also qualify as QRMs or government loans. If the Agencies are concerned about this approach, JPMorgan Chase urges the Agencies to consider an alternative under which a specified percentage of the securitization may consist of QMs that do not qualify as QRMs or government loans without losing the exemption from risk retention for those loans that otherwise would qualify.

The Final Rule Should Permit Termination of Risk Retention after Three Years

JPMorgan Chase recommends that, after a three-year period, the risk retention requirements terminate and the securitization sponsor be allowed to sell its retained interests. This would provide a powerful incentive for sound loan originations by rewarding good underwriting practices with a reduction in the large capital and liquidity costs required by the Proposal.

JPMorgan Chase estimates that risk retention when fully implemented will require the industry to set aside $250 to $300 billion of liquidity and $15 to $20 billion of capital to support the 5% risk retention requirements. We believe that these costs can be mitigated by approximately 50% if the period of risk retention is limited to three years. JPMorgan Chase has observed that underwriting defects often surface in the first three years of a loan's life and that deterioration in loan performance after three years is usually attributed to customer life or financial events unrelated to the original loan's underwriting quality, such as death, divorce, illness, or unemployment. This suggests that a three year risk retention period will appropriately meet the Congressional purpose in enacting Section 941 of Dodd-Frank.

In reviewing proposals to terminate risk retention requirements after a reasonable seasoning period, the Agencies should consider how significant enhancements to securitization disclosures being implemented by the industry (for example, under the ASF's Project Restart or as a result of Dodd-Frank) will increase the availability of performance data and support transparent pricing before and after retained interests are free to trade.

The Limitation on Points and Fees Should be Removed from the Risk Retention Rule and Implemented by the CFPB in the "Qualified Mortgage" Rulemaking under TILA

The proposed definition of QRM limits the points and fees payable by the borrower in connection with the loan to three percent of the total loan amount. The Agencies imported this points and fees limitation from the definition of QM in TILA as amended by Title XIV of Dodd-Frank. They stated that the points and fees test must be included in QRM "to ensure that the standard applicable to QRMs would be no broader than those that may potentially apply to QMs." 76 FR 24090, 24126 (Apr. 29, 2011). However, the Agencies' action is unnecessary, as the CFPB's final QM rule will apply to all loans that could potentially be QRMs, thereby ensuring that QRMs would meet the points and fees test included in QM.

More importantly, the Agencies' points and fees test is inconsistent with, and stricter than, the points and fees test in QM. Specifically, the QRM points and fees test does not adjust the points and fees limit for small loans and does not permit exclusion of bona fide discount points. The Agencies offer no justification for the stringency, which will result in some loans of extremely high credit quality being barred from QRM treatment contrary to Congress' intent. In addition, the different points and fees tests for QRM and QM will result in additional compliance burden and cost without any offsetting benefits to the marketplace or consumers. Accordingly, the points and fees test should be removed from the risk retention rule and should be implemented through the QM rulemaking.

The Agencies Must Provide Guidance on Key Provisions of the QRM Definition to Provide Certainty to Originators, Sponsors and Supervisory Agencies

The definition of QRM contains some key terms and provisions that require clarification. Without clarification, originators and sponsors will face compliance costs that are inappropriate for loans that Congress clearly intended to be readily originated and securitized. JPMorgan Chase requests clarification in the final rule on the issues discussed below, and we also respectfully request that the Agencies commit to issuing interpretations on a regular, timely basis and with opportunity for interested parties to comment before finalizing any guidance. This could be accomplished under the auspices of the FSOC or another interagency body the Agencies deem appropriate.

Definition of "refinancing"

Section ___.15(a) defines a "refinancing" for purposes of QRM as a home-secured loan that "satisfies and replaces" an existing home-secured loan. This definition should be revised to recognize transactions which accomplish the equivalent of a refinancing without satisfying and replacing the existing loan. These transactions are often referred to as "modifications, extensions, and consolidation agreements" or "MECAs." MECAs are used extensively in New York, Florida, and Texas, to allow borrowers to effectively refinance their loans while legitimately avoiding increased state and local recording taxes and other burdens on refinancings. Notably, federal regulators consider MECAs as part of a financial institution's lending activities under the Community Reinvestment Act. *See, e.g.*, Interagency Questions and Answers Regarding Community Reinvestment Act, §___.22(a)(2)-3, 75 FR 11642, 11655 (Mar. 11, 2010). There being no indication that Congress intended to exclude MECAs from QRMs, we urge the Agencies to include them provided they otherwise meet the QRM definition.

Requirement for an Appraisal

Under Section ___.15(b)(11), the Agencies' proposal requires the use of a formal appraisal for all loans that are to meet the QRM test. This is inconsistent with federal prudential standards and regulations that allow the use of an appropriate evaluation (e.g. an automated valuation model) for residential mortgages of $250M or less. Automated valuation models are highly predictive of actual value and are routinely used by loan originators for smaller loans in order to reduce unnecessary costs and delays for consumers. Moreover, requiring appraisals for QRMs is inconsistent with Section 1471 of Dodd-Frank, which mandates the use of an appraisal only for *higher-risk mortgages*, even when the loan is for $250M or less. This indicates that lenders originating QRMs, which are by definition low risk, should be able to use evaluations in lieu of formal appraisals when otherwise authorized by law. Therefore, we urge that use of these evaluations be permitted for QRMs, consistent with current federal prudential standards.

Clarification of Credit History Requirements

A QRM must meet the credit history requirements in Section ___.15(d)(5). As discussed above, we support the use of an acceptable credit scoring model. However, if the Agencies retain the credit history requirements, several items require clarification. We request that the Agencies clarify the following terms: (1) "90 days from closing" should be calculated in a manner consistent with widely accepted underwriting guidelines, including the GSE's guidelines; (2) "Closing" means when the borrower(s) become obligated on the transaction, not funding; ; (3) "Credit report" has the same meaning as a "consumer report" in Section 603(d) of the Fair Credit Reporting Act, 15 USC1681a, and any implementing regulations; and (4) "Past due in whole or in part" should be interpreted to allow a de minimis past due amount to be ignored for QRM purposes.

3. **CMBS**

JPMorgan Chase generally supports the position on the Proposal taken by the CREFC in its comment letter, including the criteria for a qualifying commercial real estate loan.

General Risk Retention Requirement

JPMorgan Chase supports the goals of risk retention, but believes that there are some problems with the Proposal as it applies to CMBS, particularly the PCCRA. Dodd-Frank mandates retention of 5% of the credit risk of assets transferred into a securitization transaction, as does the Proposal, which would indicate that the 5% relates to no more than the par (or face) value of the issue. However, the Proposal relating to the PCCRA goes beyond that. In addition, the provisions regarding retention of the first-loss position in a CMBS issuance by a third party purchaser (the "B-Piece Buyer") and the qualifying CRE loans are particularly troublesome.

Premium Capture Cash Reserve Account

JPMorgan Chase strongly opposes the idea of a PCCRA for CMBS because it would reduce credit available for commercial properties and cause substantial declines in commercial property values. The requirement for a PCCRA would also remove the major source of the sponsor's compensation and incentive to securitize and could shut down the CMBS market altogether. The consequences of severely diminished, or of the elimination of, CMBS issuance would result in higher costs of financing for borrowers. In addition, the fact that the PCCRA acts as the first loss piece unnecessarily imposes a substantial burden on securitization sponsors for which they are not being compensated and is a further disincentive to securitize.

The PCCRA goes beyond the risk retention requirements of Dodd-Frank. There is no need for a PCCRA if a third party B-Piece Buyer has the retention risk since the purpose of the PCCRA, according to the Proposal, is to prevent a securitization sponsor from structuring issues so as "to effectively negate or reduce the economic exposure it is required to retain." If a CMBS sponsor monetizes the excess spread, it does not diminish the risk the third party B-Piece Buyer has agreed to assume.

In addition, based on discussions with the Federal Reserve Bank of New York ("FRBNY"), there appears to be an inconsistency between the Proposal and the intent of the drafters (or at least of the FRBNY) regarding the retained risk amount being based on the market value or net proceeds of the issue as opposed to the par value or face amount of the issue. JPMorgan Chase requests that the Agencies clarify whether the PCCRA for purposes of risk retention is determined based on par value (i.e., face amount) as per the Proposal or market value (i.e. net proceeds) as indicated by the FRBNY.

The underlying assumption by the Agencies/FRBNY, that the PCCRA is intended to prevent excessive monetization of excess spread which reduces the market value of the first loss position below its face value and to ensure that it has adequate value, does not take into account the fact that the purchase of a first loss B-piece at a steep discount to par is mandated by the B-Piece Buyer's yield requirements and entirely appropriate given the B-Piece buyer is taking the first loss on the assets and is exposed to greater risk of loss.

Another misconception on the part of the Agencies/FRBNY is that the existence of excess spread is an indication of aggressive underwriting and lending at above market interest rates and a method to circumvent the risk retention rules. In fact, the agreed-upon interest rate by the borrower and the originator is the market rate for commercial mortgage loans at the time of origination, whereas the securitization yields are market rates for CMBS at the time of securitization, i.e., different market rates in different markets. Furthermore, the monetization of excess spread has been a hallmark of CMBS securitizations at all times prior to the Proposal.

Finally, the Agencies/FRBNY are correct that the PCCRA will make securitization of excess spread unappealing to securitization sponsors but are mistaken in their view that the excess spread will be at the bottom of the waterfall, i.e., distributed to the B-Piece Buyer in terms of additional yield/increased value or to the residual holder. The reality is that securitization sponsors will not securitize if there is insufficient profit.

JPMorgan Chase recognizes, however, the Agencies' concern that risk retention could be "gamed" by sponsors issuing bonds at substantial premiums, or that B-Piece Buyers would not have sufficient "skin in the game" given their purchase of the B-Pieces at a deep discount to par. JPMorgan Chase therefore recommends that PCCRA be eliminated in the final rules, but that potential manipulation of the price of the B-Piece can be prevented through a requirement that the B-Piece have a coupon equal to the lesser of (i) 10-year Treasuries plus 1.0% or (ii) the net weighted average coupon ("WAC") of the loan pool. Currently, investors are buying conduit CMBS B-Pieces with coupons that are approximately equal to 10-year Treasuries plus 50-100 basis points, which is slightly below the WAC of the loan pools.

We further recommend that if the PCCRA is not eliminated in the final rules, another viable alternative would be that, in addition to the base 5% risk retention (based on par) held by the B-Piece Buyer, the CMBS sponsor would retain the greater of 5% of the market value (net of closing costs) or par value of the securitization, in each case after taking into account the proceeds of the sale of the B-Piece to the B-Piece Buyer. This would be accomplished by the additional retention by the CMBS sponsor of a pari passu loan participation or pass-through interest in the entire pool of loans in an amount equal to the greater of:

(i) 5% of the par value of all of the principal-paying classes issued in the CMBS transaction minus the proceeds of the sale of the B-Pieces sold to a B-Piece Buyer; and
(ii) 5% of the market value (i.e., gross proceeds of sale) of all of the classes issued in the CMBS transaction, less the net closing costs permitted to be deducted under GAAP (e.g., taxes, hedging costs, rating fees, legal and accounting fees) minus the proceeds of the sale of the B-Pieces sold to a B-Piece Buyer.

This additional retention ensures that even if the sponsor issues bonds at a substantial premium, the combined retention by both the sponsor and the B-Piece Buyer accomplishes the goal of meaningful risk retention that complies with the intent of Dodd-Frank, but permits the sponsor to realize the value from the sale of the loans up front, as opposed to waiting until the maturity of the transaction in the form of a PCCRA. We should note, however, that this additional retention by the sponsor will cause origination spreads to increase by as much as 50 basis points and will ultimately make commercial mortgage borrowing more expensive for the borrower.

Risk Retention and PCCRA in Investment Grade Issues

We note that the specific exemption for CMBS risk retention by a B-Piece Buyer generally would only apply to "conduit" CMBS issues by which originators of commercial mortgage loans aggregate loan pools of 10-100 loans for securitization. The conduit business is only a part of annual commercial mortgage loan originations and securitizations. The B-Piece Buyer concept is not directly applicable to single borrower CMBS backed by a single mortgage loan or related mortgage loans made to a single borrower ("Single Borrower CMBS") or to floating rate CMBS products. These transactions usually involve the origination and securitization of one to ten loans, each with 50-65% LTV ratios that are made in conjunction with mezzanine loans, as discussed below, and do not issue below investment grade subordinated classes or unrated first loss classes.

Single Borrower and floating rate CMBS issues usually are accompanied by substantial amounts of mezzanine debt in excess of 5% of the proceeds of the CMBS issue. The LTV of the CMBS issue would typically be 50-65% while the combined LTV of the CMBS issue and the mezzanine loans would be 75-80%. The mezzanine debt is secured by the ownership interests in the mortgage loan borrower and sequentially thereafter by the ownership interests in each mezzanine loan borrower, i.e., there are multiple mezzanine loans and related borrowers. These mezzanine loans are priced at par and are often sold at the same time as the related CMBS. The convention in the market has been that the mezzanine loan buyers and their counsel essentially perform the same kind of, or even more comprehensive, due diligence on the mortgage loan and mezzanine loan collateral than B-Piece Buyers do with respect to the CMBS collateral because the mezzanine loans are not directly secured by the mortgaged property.

The loss record on Single Borrower and floating rate CMBS transactions is that all losses have been absorbed by the mezzanine loan holders and no losses have been borne by the CMBS holders. The mezzanine loans are effectively acting on a reverse sequential basis as the first loss pieces. These facts strongly argue for allowing mezzanine loans in Single Borrower and floating rate CMBS transactions to satisfy the risk retention requirement and against any PCCRA requirement since this first loss protection is already being provided on a par purchase price basis by the mezzanine lenders.

Qualifying Commercial Real Estate Loan ("QCREL")

We believe that the criteria set forth in the Proposal are, for the most part, not workable in the marketplace. Taken together the debt service coverage ratio ("DSCR"), LTV and 20-year straight line amortization requirements are such that almost no loans intended for securitization heretofore originated would qualify for the exemption. Twenty year straight line amortization would be viewed extremely negatively by borrowers taking out lower LTV loans because the increased amortization significantly reduces cash flow to the property owner. Lower LTV borrowers like to maintain leverage for the term of ownership.

We note that in CMBS the borrower is a single purpose entity ("SPE") and would not have a 2 year borrowing history as required by the Proposal and that the originator is not capable of estimating the ability of the borrower to pay two years prior to and after the loan closing since the loan is non-recourse.

We propose that the requirements for a QCREL have the following characteristics:

DSCR:	1.25x
LTV:	65%
Debt Yield:	9.25%
Maturity:	5- 10 years
Amortization Term:	30 years or less (scheduled, not straight line)
LTV at Maturity:	55%
Combined LTV:	80%*
Delinquent:	Never

* Combined LTV means the first mortgage loan and any subordinate or mezzanine loan as a percentage of appraised value of the underlying mortgaged property.

We are also of the view that the requirement that the LTV be limited to 60% if the loan's capitalization rate is less than the 10 year swap rate plus 300 basis points fails to take into account other reasons why a borrower would invest in the property, such as upside potential. We believe that the Proposals' underlying assumption that the LTV constraint will prevent speculation and cheap financing does not address the causes of the financial crisis.

We suggest that pro rata credit be given for pools with some percentage of loans that qualify as QCRELs in which case the risk retention in a deal could be calculated as either the product of 5% and 1 minus the percentage of the pool based on principal balances of loans that qualify as QCRELs or reducing risk retention over time by formulas based on the percentage of the pool that qualifies as QCRELs. This will encourage lenders to make incremental steps toward reducing loan amounts and allow the CMBS market to evolve toward better pool quality.

Lastly, the buyback obligation for QCRELs should be clarified so that there would be no such buyback obligation if the default is due to economic conditions rather than faulty underwriting by originators.

Third Party Risk Retention

Our opinion is that although the provision for the B-Piece Buyer to hold the risk retention piece is welcome, it unfortunately is not workable because of the conditions that must be satisfied, in particular restrictions on financing, hedging and transfer for the life of the transaction, servicing control rights and disclosure of the B-piece purchase price and the B-Piece Buyer's experience. In particular, the restrictions on transfer for the life of the transaction will make for fewer B-Piece Buyers in the market now than a few years ago. Fixed income managers and real estate investors typically cannot raise money with no liquidity options without paying significant premiums. The ultimate effect is likely to be that B-Piece Buyers may not agree to the retention of risk provisions, which could be the death knell for CMBS issuance.

B-Piece Buyer's Cash Investment

As discussed above regarding the lack of clarity as to the intent behind the PCCRA, if the intent is that the B-Piece Buyer's cash investment be equal to 5% of the proceeds of the securitization issuance amount, such a requirement is likely to have extremely negative consequences for both the B-Piece Buyer and securitization sponsor and ultimately borrowers. B-Piece Buyers typically buy 5% of the face amount of the issue, which equates to the below investment grade bonds in today's market. However, the purchase price paid in cash is at a steep discount to the face amount of the certificates in order to achieve the B-Piece Buyer's yield requirements. That discount translates into their purchase price being approximately 2.5% of the face amount of the issuance. A requirement that the purchase price equal 5% of market value/proceeds of the issue means that the B-Piece Buyer would have to buy all of the Non-Rated, B, BB, BBB- and BBB rated bonds. This change would effectively double the amount of high yield B-piece capital needed to support the same issuance volume. In order to achieve their yield requirements, the price paid would be significantly less than the purchase prices being paid by traditional investment grade buyers of BBB and BBB- securities.

Because the proposed regulations impose transfer, financing, hedging and special servicing restrictions on the retained risk holder, B-Piece Buyers (if they agree to accept the restrictions) will require, at a minimum, that the additional bonds they are required to purchase yield at least as much as the B-pieces they now buy. Assuming an issue with 2% of proceeds in excess of par and a B-Piece Buyer's 17% yield requirement, J.P. Morgan's CMBS trading desk estimates that in order to maintain the economics to the securitization sponsor and the B-Piece Buyer, the commercial mortgage collateral would have to have an average coupon at least 47 basis points higher than that required for collateral in a current CMBS issue. This additional cost would be borne by borrowers.

Transfer and Hedging

The restriction on transfer and limited hedging of the B-piece for the life of the transaction and the prohibition of financing through the securitization sponsor will be major negatives for B-Piece Buyers. Either the relatively few B-Piece Buyers currently in the market will exit the market or increase their yield requirements to the detriment of borrowers and ultimately the economic viability of the CMBS market. We would propose that the B-piece could be transferred to “Qualified Institutional Buyers” (within the meaning of Rule 144A under the U.S. Securities Act of 1933 (the “Securities Act”)) or institutional investors that are “accredited investors” within the meaning of Rule 501(a)(1), (2), (3) or (7) of Regulation D under the Securities Act, as long as the transferee is subject to the same provisions as those applicable to the B Piece Buyer at issuance. In addition, we would propose that the retention requirement expire after three years if there have been no losses as a result of loan modifications or liquidations which would be indicative of quality originations. We believe that most B-piece investors would agree to a three year hold period. B-pieces provide protection against principal loss to investment grade bond buyers and no additional capital is required to be posted by the B-Piece Buyer. An important distinction is that the risk retention should reside with the B-piece itself rather than the initial B-Piece Buyer, i.e., that the holder of the B-piece takes the B-piece subject to the restrictions rather than assuming them.

Operating Advisor

If the special servicer and B-Piece Buyer are affiliated and the B-Piece Buyer is to exercise servicing control rights, the Proposal requires that an operating/trust advisor must have the right to advise the special servicer and to recommend replacement of a special servicer affiliated with the B-Piece Buyer unless more than 50% of certificateholders disagree, which is a very high standard to meet given voting participation to date. This imposition of power to the operating/trust advisor is contrary to what the B-Piece Buyer has offered investors to date and significantly alters the risk versus reward equation to first loss investors. We note that the Proposal does not indicate whether eligibility to vote includes appraisal reductions or not, which matter should be addressed in the final rules. We recommend that the operating/trust advisor’s right to recommend replacement of the special servicer be exercised only after the B-piece position is reduced to less than 25% of its original principal balance (after taking into account appraisal reductions) and then only after a majority of principal balance certificate-holders (after appraisal reductions) agree. This is JPMorgan Chase’s current approach in CMBS and it is working to the satisfaction of both investment grade investors and B-Piece Buyers.

We also recommend that only after the B-piece position is reduced to less than 25% of its original principal balance (after taking into account appraisal reductions), 25% of principal balance certificateholders could recommend replacement of the special servicer subject to approval by principal balance certificateholders registered to vote with either 51% or 66 and 2/3% of voting rights (after realized losses and appraisal reductions) . This is JPMorgan Chase’s current approach in CMBS and it is working to the satisfaction of both investment grade investors and B-Piece Buyers.

The current market is also very different with respect to the operating/trust advisor's right to consult on major servicing decisions if the special servicer is an affiliate of the B-Piece Buyer. It should be noted that the Proposal does not state whether the consultation is or is not binding on the special servicer. We believe that it should be non-binding and subject to the special servicer acting in accordance with the servicing standard while the B-piece investor is exercising control. We recommend that only after the B-piece position is reduced to less than 25% of its original principal balance (after taking into account appraisal reductions) the special servicer would be required to (i) consult on a non-binding basis with the operating/trust advisor with respect to asset status reports and (ii) act in the best interests of all certificateholders in accordance with the servicing standard.

B-Piece Buyer's Purchase Price

JPMorgan Chase believes that B-Piece Buyers will likely object to disclosure of their purchase price for the 5% retained piece since it could reveal the B-Piece Buyer's pricing parameters to its competitors. We recognize that such disclosure is of interest to investment grade buyers but note that it has not heretofore been considered material for disclosure purposes because of the confidential and proprietary nature of the information.

B-Piece Buyer's Financial Resources

While we recognize that the requirement for B-Piece Buyers to have adequate financial resources to back losses is in Dodd-Frank, we would ask the Agencies to clarify the intent. The B-piece investment will already have been made at the time of issuance and there would be no further cash outlays in the event of losses allocable to the B-piece. It is a funded type of risk retention, as opposed to a guaranty or letter of credit which requires that the issuer have the financial wherewithal to meet its future obligations. Otherwise it is unclear what would be considered "adequate" in this context.

B-Piece Buyer Compliance

In our view it is not feasible for a securitization sponsor or depositor to monitor on an ongoing basis the B-Piece Buyer's compliance with the conditions (especially the restriction on hedging) proposed by the Agencies. A more realistic approach would require the B-Piece Buyer to certify compliance on an annual basis.

B-Piece Buyer Experience

While the identity of the B-piece buyer would continue to be disclosed, JPMorgan Chase questions the need for disclosure of the B-Piece Buyer's experience in CMBS investing. In existing securitizations a qualified special servicer is the entity whose experience is most relevant to investors and that experience is already disclosed in public and private offering documents. The experience of the B-Piece Buyer has not heretofore been viewed as material for disclosure purposes and it is unclear what its relevance would be given that investors that have not previously invested in CMBS B Pieces may nevertheless be very capable of analyzing the investment.

Assumptions and Methodologies

The requirement that material assumptions and methodologies used to determine the aggregate dollar amount issued, including estimated cash flows and discount rate used, is inapposite in that the principal balance of the certificates sold to investors will equal the aggregate initial principal balance of the mortgage loans and CMBS transactions do not utilize overcollateralization as is the case with covered bonds and other structures. Furthermore, the offering circulars for CMBS issues already provide buyers of interest-only bonds with the pre-tax yield to maturity based on assumed purchase prices and constant prepayment assumptions which are the material disclosures needed by potential purchasers. The discount rates used to determine the expected proceeds of the interest-only bonds do not appear to be material to investors.

L-Shaped Retention

We have some concerns with the L-Shaped Retention as set forth in the Proposal. Based on discussions with the FRBNY there appears to be an inconsistency between the Proposal and the intent of the drafters (or at least of the FRBNY) regarding the securitization sponsor holding all 5% of the required retention as in the Proposal. According to the FRBNY, the securitization sponsor could hold a 2.5% vertical piece and the B-Piece Buyer could hold a 2.5% horizontal piece. If the latter approach was intended, then the Proposal should be so clarified as we believe this greater flexibility would be attractive to securitization sponsors and B-Piece Buyers.

If the securitization sponsor held a vertical piece and a B-Piece Buyer held the bottom horizontal piece as in an L-shaped retained position, and assuming 2% of proceeds in excess of par and a B-Piece Buyer's 17% yield requirement, J.P. Morgan's CMBS trading desk estimates that in order to maintain the economics to the securitization sponsor and the B-Piece Buyer, the commercial mortgage collateral would have to have an average coupon at least 21 basis points higher than that required for collateral in a current CMBS issue. This additional cost would be borne by borrowers.

Duration of Risk Retention Requirement

JPMorgan Chase does not believe that risk retention should be for the entire term of the securitization. The cumulative effect on securitization sponsors and B-Piece Buyers will be to diminish their balance sheet capacity to issue and invest. As stated above, we believe that most securitization sponsors and B-Piece Buyers would agree to a minimum hold period not to exceed three years. Poorly underwritten loans are likely to manifest themselves within the first three years, which should be the period of risk retention.

Sharing of Risk Retention

JPMorgan Chase thinks that the realities of the market are such that securitization sponsors should have the ability to share risk retention with other sponsors in addition to loan contributing originators, and in amounts less than 20%. CMBS are often issued with multiple sponsors contributing loans into a transaction (those are all considered "sponsors" for purposes of Regulation AB). It would not be equitable for any one sponsor to be required to hold the risk retention relating to loans originated by other sponsors in the transaction.

Representative Sample

JPMorgan Chase proposes that a retained 5% pari passu participation in each mortgage loan qualify as an alternative form of risk retention. That would be the most exact alignment of interests with investors and would be a particularly useful alternative in transactions with no B Piece Buyer, as described above. The requirement in the Proposal that a representative sample pool consist of 1,000 loans would eliminate most, if not all, CMBS issues done to date. The 1,000 loan requirement works for pools of smaller consumer loans but not a CMBS pool because commercial mortgage loan balances are so much larger. We propose that a representative sample for CMBS could more easily be met through the use of pari passu participations in each loan

Representations and Warranties

JPMorgan Chase is of the view that the requirement that the loan seller explain why loans are included in a pool if there are exceptions to representations (i.e., identifying compensating factors or immateriality) is a major undertaking that outweighs any benefit to investors insofar as there are so many exceptions that are the result of negotiations with borrowers. Exceptions to the representations and warranties are a normal and customary result of the underwriting process and we believe that disclosing the exceptions is sufficient for an investor to make an informed investment decision and notes that in today's CMBS transactions, all the representations and warranties and all exceptions thereto are fully disclosed.

4. AUTO ABS

JPMorgan Chase, through its various subsidiaries and lines of business, is an active participant in the automobile loan industry, ranging from being an originator and servicer of automobile loans, to being an issuer, underwriter and investor in asset-backed securities secured by such automobile loans ("Auto ABS"). While we agree in principle with the concept of risk retention, there are several critical modifications that must be made to the Proposal as they relate to Auto ABS in an effort to make the rules practical and workable, while maintaining the vibrancy of the market for Auto ABS. JPMorgan Chase has been actively engaged in the comment letter process being organized by each of the ASF and SIFMA, and, as a result, we support certain key positions and rationale (as described below) contained within each of the ASF and SIFMA comment letters (collectively, the "ASF/SIFMA Comment Letters") with respect to the Proposal and its application to automobile loans and Auto ABS.

Maintain Core Transaction Structure

Since 1996, Chase Auto Finance ("CAF"), the automobile financing division of JPMorgan Chase, in its capacity as an originator (through various affiliates) and a servicer of principally "prime" automobile loans[9], has been involved with the issuance of 23 prime auto loan securitizations totaling almost $32 billion. It is important to note that CAF originates all of its automobile loans as if it were holding the loans in its portfolio until maturity. Similarly, all of its prime automobile loans are serviced in accordance with the exact same criteria and procedures regardless of whether those loans are securitized or held in its portfolio. CAF feels strongly that all its automobile loans have been originated and serviced in accordance with the highest standards. Of equal importance is that CAF has maintained "skin in the game" in each of its auto loan securitizations in the form of retained subordinated residual interest (the bottom of the waterfall, or first-loss position). Indeed, none of CAF's auto loan securitizations has resulted in any principal losses or missed interest payments to investors. In addition, Auto ABS generally has had sound historical performance. This shows that securitization structures used in the industry, and specifically those structures like CAF's which include retention of a subordinated residual interest in its present form, already provide an appropriate alignment of interests between issuers and investors. We firmly believe that if the Proposal is not modified in such a way so as to accommodate existing prime Auto ABS structures whereby the retention of a subordinated residual interest in its current form clearly satisfies all, or a portion, of the risk retention requirements, then the resulting costs to modify the typical Auto ABS structure (such as CAF's structure), including costs relating to the re-programming or overhaul of internal systems for purposes of complying with the Proposal, would be prohibitively high and would force CAF to reconsider its future use of Auto ABS.

Most Auto ABS do not have a "loss allocation" mechanism. These securitizations treat all amounts received during a collection period as a single pool of distributable cash, subject to a single priority of payments – or "waterfall" – from which note interest, note principal, swap

[9] In general, we characterize "prime" automobile loans as automobile loans with a FICO score of 680 or above.

payments, service-provider fees, credit enhancement funding and other securitization expenses are paid. To the extent that there are losses, those losses only reduce collections to be distributed, which may result in non-payment of certain waterfall priorities, but do not result in a "write-down" of any ABS interests. While a subordinated residual interest is not explicitly allocated losses, its placement at the bottom of the waterfall means that it is the first ABS interest in an Auto ABS to have its distributions reduced or eliminated in a particular period to the extent there are losses on the related asset pool or other cash flow disruptions. Therefore, we firmly believe that, if an Auto ABS lacks an explicit loss feature, the subordinated residual interest adequately ensures that horizontal risk retention is being achieved by the sponsor holding the first-loss, most subordinated ABS interest. As a result, the Proposal needs to be modified to account for Auto ABS structures that do not have loss allocation mechanisms and make clear that the sponsor of such Auto ABS may satisfy horizontal risk retention by holding the related subordinated residual interest.

In order for issuers of Auto ABS to utilize the horizontal risk retention option, we believe that the Proposal needs to be modified to reflect that, in Auto ABS, there is generally no distinction between scheduled or unscheduled payments of principal and interest. Currently, throughout the industry all prime Auto ABS collections, regardless of whether they are scheduled or unscheduled, are pooled as available funds. The Proposal, however, would essentially mandate that a separate waterfall be incorporated into currently used Auto ABS structures to accommodate the allocation of scheduled and unscheduled principal collections. We believe it would be highly intrusive and, more importantly, costly to revise existing Auto ABS structures to facilitate the separate tracking and treatment of scheduled and unscheduled principal payments. In addition, we feel that it could potentially create confusion in the Auto ABS market as investors and rating agencies, among others, would need to analyze and evaluate significant structural changes. Accordingly, we strongly support the recommendation in the ASF/SIFMA Comment Letters that allows Auto ABS subordinated residual interest to receive distributions on the pool assets in any period, regardless of whether the principal payments are scheduled or unscheduled, so long as the senior ABS holders have all received their required periodic principal and interest payments, all issuing entity fees and expenses have been paid, all credit enhancement that is funded or maintained with cash flow from the pool assets is at its then-required level and an "allocable share" of the amount by which the related securitization's asset balance has declined since the closing date has been used to pay down senior ABS interests.

We firmly believe that, with respect to prime automobile securitizations ("prime" as determined on a pool level basis), excess spread, i.e., residual interest, calculated under the "Discounted Cashflows Approach"[10] should be able to satisfy all, or a portion, of the risk retention requirements. In most retail automobile securitizations, excess spread, by itself, has been more than sufficient to absorb all losses on the underlying securitized automobile loans. As a result, residual interests, which are held by the sponsor or its affiliate throughout the life of the transaction, provide adequate "skin in the game" for issuers of Auto ABS.

[10] We interpret this to mean the discounted present value of future cash flows on the related ABS interests.

We firmly believe that cash reserve accounts, which we utilize in our auto loan securitizations, should be permissible as a form of risk retention. A cash reserve account is a form of credit enhancement that is available to fund shortfalls in payment on Auto ABS interests.

We support the recommendation in the ASF/SIFMA Comment Letters that would allow issuers to hold a combination of exposures to satisfy the risk retention rules. We also support the ASF/SIFMA Comment Letters suggestion that cash that is in a securitization reserve account available to fund shortfalls in payments on the ABS interests should be a permissible form of risk retention, distinct from Horizontal Risk Retention.

Qualifying Automobile Loans

While we appreciate the concept of a "qualifying automobile loan," the qualifying requirements are not remotely consistent with our current automobile loan origination practices, and, as a result, we would not be able to use the qualifying auto loan exemption contained in the Proposal. Moreover, it appears that no automobile loan originator currently originates automobile loan pools that would meet the exceedingly stringent requirements set forth in the Proposal.

We are working with the ASF to develop comments and suggestions on the proposal for the securitization of qualifying automobile loans. As a result, we may submit a supplemental response letter that could, among other things, recommend certain revisions to the Proposal in an effort to make the qualifying automobile loan exception more practical and workable.

Overall, the Auto ABS market has been, and continues to be, a stable and vibrant sector of the securitized capital markets as evidenced by the investors' continued willingness to purchase Auto ABS at reasonable spreads. In general, Auto ABS has performed as expected and, is consistent with investors' expectations. We strongly feel that the Proposal has failed to consider the numerous positive features of Auto ABS and the unique aspects and performance of Auto ABS. In sum, we believe that the Proposal, without significant clarification and modification, could force issuers of Auto ABS to the sidelines, which would effectively stifle liquidity for auto loan lenders, auto makers, auto dealerships and all the related micro economies, and, in the end, result in a lack of affordable or available credit to consumers.

5. **CREDIT CARD ABS**

The credit card securitization market has been and continues to be an important diversified source of funding for JPMorgan Chase. JPMorgan Chase is one of the largest originators and servicers of VISA and MasterCard credit cards in the United States. Through its subsidiaries and their predecessor institutions, JPMorgan Chase has been an active securitizer of credit card receivables since 1990, with securitized credit card receivables reaching a peak of $89.3 billion as of June 30, 2009, and of $41.4 billion as of March 31, 2011. JPMorgan Chase is also a prominent underwriter, market-maker and investor of credit and charge card ABS.

JPMorgan Chase has actively participated in and strongly supports the comments and recommendations submitted by the Credit Card Issuer Subforum of the ASF. However, we would like to take this opportunity to re-emphasize and highlight several issues relating to the Proposal, the resolution or clarification of which would be critical to the continued viability of the credit card and charge card ABS market and the continued participation and commitment to the market by the credit card or charge card ABS sponsors, including JPMorgan Chase.

It is important to note that there are fundamental structural features inherent in existing revolving credit card master trust structures which align the interests of the credit card originators/securitizers with those of the investors, including the retention by the sponsors (or its consolidated affiliates) of the seller's interest, interest in the excess spread and certain subordinated investor interests issued by the master trust. The effectiveness of these risk retention mechanisms already imbedded in existing credit card master trust structures is evident in the consistent performance of credit card and charge card ABS, particularly during the recent financial crisis. Historically and currently, JPMorgan Chase, through its subsidiaries, has always maintained and continues to maintain more than 5% of credit risk exposure in each of its credit card master trusts in the form of seller's interest, even in the absence of any regulatory requirements. In addition, JPMorgan Chase, through its subsidiaries, also holds the interest in excess spread and retains meaningful amount of subordinate ABS issued out of its credit card master trusts. JPMorgan Chase strongly believes that the final risk retention rules should take into account current market practices and be tailored to reflect and preserve these existing structural features, which are commonly considered by issuers and investors alike to be effective forms of risk retention. Moreover, the Proposal as currently drafted would require significant amendments to existing master trust structures which could have a material adverse impact on ABS investors. Any amendment that would have a material adverse impact on ABS investors under program documentation requires investor consent and will be, for all practical purposes, highly difficult, if not impossible, to execute. Therefore, it is critical that the final risk retention rules enable credit card and charge card securitizers, including JPMorgan Chase, to continue to utilize their existing credit card master trust structures without any material amendment.

Definition of Seller's Interest

The Proposal defines "seller's interest" as an ABS interest "…that is pari passu with all other ABS interests issued by the issuing entity with respect to the allocation of all payments and losses prior to an early amortization event (as defined in the transaction documents)." This "pari passu" requirement is inconsistent with virtually all of the existing credit card master trust structures, including JPMorgan Chase's master trust structures. Generally, during revolving periods, the allocation of collections and losses is pro rata between the seller's interest and investor interests. However, during other periods (for example, scheduled principal accumulation period, or scheduled amortization period), the allocation of principal collections to the investor interests is generally fixed pursuant to the master trust program documents. And in some cases, collections allocated to the seller's interest during these non-revolving periods may be subordinated to those allocated to the investor interests. The fixing of the allocation percentage and the subordination of collections allocable to the seller's interest are mechanisms intended to provide for orderly and timely payment of the investor interests, without affecting the seller's interest's pro rata exposure to the credit risk of the receivables. To ensure that "the definitions of a seller's interest…are…to be consistent with market practices…" pursuant to the stated intent in Section III.B.4 of the Proposal, JPMorgan Chase requests that the definition of seller's interest be revised to allow for the seller's interest to be pari passu with or subordinate to the aggregate investor interests issued by the issuing entity.

Measurement of Seller's Interest

Paragraph (a) of §_.7 of the Proposal has the general requirement that at the closing of and throughout the life of the securitization transaction "…the sponsor retains a seller's interest of not less than five percent of the unpaid principal balance of all the assets owned or held by the issuing entity…." JPMorgan Chase believes clarification to this requirement is warranted to ensure that it is consistent with market practice and does not impose unnecessary administrative and operational burden on sponsors.

The seller's interest fluctuates continuously due to the revolving nature of credit card receivables and the issuance and maturities of investor interests from time to time. In addition, all credit card master trust program documents already require minimum seller's interest tests to be performed periodically at certain pre-determined time intervals, a practice that is widely accepted by ABS industry participants. Therefore, we support ASF's suggested revisions to paragraph (a) of §_.7 of the Proposal to clarify that the required seller's interest should be measured (i) based on the assets and liabilities of the master trust as of a current point in time, and (ii) as of the dates in accordance with the related master trust program documents.

Retention of Seller's Interest by "Consolidated Affiliates"

Section III(D) of the Proposal "permits a transfer [of credit risk exposure required to be retained] to one or more consolidated affiliates because the required risk exposure would remain within the consolidated organization and, thus, would not reduce the organization's financial exposure to the credit risk of the securitized assets." We agree with and appreciate such a reasonable approach taken by the Agencies on the transfer of required risk retention within a consolidated organization. But we are concerned that the definition of "consolidated affiliate" could be misinterpreted and we believe it will need to be revised to align with the intent stated above and to be workable. We would like to propose that the definition of "consolidated affiliate" be revised as follows:

> **Consolidated affiliate** means, with respect to a sponsor, an entity (other than the issuing entity) the financial statements of which are consolidated with those of~~:~~ ~~(1)~~ the sponsor ***as part of the same parent consolidated group or organization*** under applicable accounting standards~~; or~~
> ~~(2) Another entity the financial statements of which are consolidated with those of the sponsor under applicable accounting standards~~.

<u>Forms of Risk Retention in Credit and Charge Card ABS</u>

JPMorgan Chase strongly believes that, besides the seller's interest, other forms of risk retention as permitted under the Proposal should be and are intended to be options available to credit card and charge card securitizers to satisfy the risk retention requirements. Moreover, securitizers should be permitted to satisfy the risk retention requirements through a combination of different forms of risk retention, both at the close of a transaction as well as on an ongoing basis, so long as the aggregate retained credit exposures are at least 5%.

In addition to the seller's interest, all credit card and charge card securitizers also retain the first-loss position in the form of excess spread and, in many cases, all or a portion of the subordinate classes or tranches of ABS, which are structured to absorb credit losses before more senior tranches are impacted. The retention of the seller's interest and the subordinate interests described above expose the credit card and charge card securitizers to a ratable or more than ratable share of credit risk of the receivables in the master trust, and is, therefore, an effective tool to align the interests of the securitizers and investors. JPMorgan Chase requests that, for the purpose of determining the form and amount of required risk retention, a credit card or charge card securitizer should be permitted to take credit for, at the very least, the retained subordinate classes or tranches of ABS so long as such securitizer (and its consolidated affiliates) is the holder of (i) the seller's interest and the first-loss positions, such as excess spread, and (ii) all other interests that are subordinated to such retained subordinate classes or tranches. A securitizer should also be allowed to change the forms of risk retention throughout the life of a transaction and of a master trust, so long as the securitizer (and its consolidated affiliates) maintains the required amount of risk retention in aggregate and provides adequate disclosure. Such flexibility is important to allow securitizers to adapt and adjust to market and structural innovations, underlying product developments and changing investor demands. JPMorgan Chase also supports all the technical revisions to the definition of "Eligible Horizontal Residual Interest" which ASF proposes in its comment letter. Those revisions are essential to providing credit card and charge card securitizers the flexibility and the ability to combine the different forms of risk retention as discussed above.

Issuance Trust Structure – Two-Tiered Issuance Platforms with Multiple Asset Pools

To facilitate the adoption of the delinked issuance technology in response to changing investor demand and to allow for an efficient structure which securitizes revolving assets from multiple legacy master trusts which an ABS sponsor has acquired over time, JPMorgan Chase and several other major credit or charge card securitizers established issuance trust structures with multiple tiers and/or multiple asset pools about a decade ago and have been well-received by ABS investors due to its structural flexibility to accommodate specific investor preferences. The issuance trust is typically a statutory trust that issues securities in the form of notes, backed by a pool of credit card receivables or collateral certificates representing interests in one or more legacy credit card master trusts, or both. As an example, the Chase Issuance Trust, JPMorgan Chase's primary credit card securitization issuing entity, following the merger of Bank One and JPMorgan Chase in 2004, held a collateral certificate issued by the First USA Credit Card Master Trust (a legacy credit card master trust of Bank One), a collateral certificate issued by the Chase Credit Card Master Trust (a legacy credit card master trust of JPMorgan Chase), and a pool of credit card receivables. The notes issued out of the Chase Issuance Trust were, therefore, backed by credit card receivables in two master trusts (via the collateral certificates) and in the issuance trust itself.

The issuance trust structure is an efficient, flexible structure that has been used by many credit or charge card securitizers for almost a decade and is well-understood by ABS investors and other industry participants. However, the Proposal, in its current form, does not contemplate these revolving asset securitization structures which include multiple tiers and/or multiple asset pools backing a single issuing entity. JPMorgan Chase agrees with and strongly supports the recommendations of and remedies suggested by the ASF and the ABA, including the clarification that the issuance trust and any underlying master trusts should be treated as a single issuing entity and a unitary issuance platform, and the revisions to the definitions of "issuing entity" and "revolving asset master trust".

All of the existing credit or charge card master trust programs have fundamental structural features that have long been recognized by ABS issuers and investors as effective forms of risk retention. The preservation of these fundamental risk retention features, through the clarifications specified above and the others identified by the ASF and the ABA in their comment letters, is critical to enabling JPMorgan Chase, along with other credit card and charge card securitizers, to continue to use existing master trust programs in an efficient and vibrant securitization market and to facilitate the availability of consumer credit.

6. STUDENT LOAN ABS

JPMorgan Chase, through its various subsidiaries and lines of business, has participated and/or currently participates in the student loan industry as a lender to students, an issuer of asset-backed securities secured by student loans ("Student Loan ABS"), an adviser to clients in the student loan industry, a broker-dealer participating in the Student Loan ABS market and an investor in Student Loan ABS. JPMorgan Chase has been actively engaged in the comment letter process being organized by the ASF, as well as other trade and industry groups, and we support the positions and rationale contained within the ASF comment letter with respect to the proposed risk retention rules and their application to student loans and Student Loan ABS.

In particular, we strongly believe that the Proposal should be modified to include a general class exemption for Student Loan ABS secured by student loans that have been originated in accordance with the Federal Family Education Loan Program under Title IV of the Higher Education Act ("FFELP"). Essentially, student loans that have been originated under FFELP are guaranteed by the federal government. Mindful that the Proposal already contemplates exemptions for other federally insured or government guaranteed loans, we are of the opinion that FFELP Student Loan ABS should equally be exempt from the risk retention requirement set forth in the Proposal.

In the absence of a general class exemption for FFELP Student Loan ABS, we believe that a reduction in the risk retention requirements is warranted due to the negligible credit risk afforded by the guaranty of 97% to 100% of defaulted principal and accrued interest under the FFELP guaranty programs administered by the U.S. Department of Education. In the end, we firmly believe that the absence of these critical modifications to the Proposal will have significant negative implications on the Student Loan ABS market, which would ultimately result in constrained credit and increased economic cost to students and would reduce the ability to restructure currently illiquid instruments, such as auction rate securities, held by investors.

7. ABCP

JPMorgan Chase appreciates the Agencies' efforts to provide ABCP conduit sponsors with an alternative risk retention method (the "ABCP Conduit Risk Retention Option") that reflects the unique structure of ABCP conduit programs. We understand that the Agencies did not intend to change the way the ABCP conduit market operates with this Proposal; however, we believe that significant modifications to the Proposal are required for the ABCP Risk Retention Option to be a workable alternative. We also ask that the Agencies consider adding provisions to the horizontal risk retention section that would permit ABCP conduit sponsors to satisfy risk retention requirements for ABCP conduits through the sponsor's continued provision to the conduits of certain types of unfunded program support facilities, including, specifically, letters of credit.

JPMorgan Chase acts as administrator and as the primary liquidity and program support provider for three ABCP conduit programs, and has been a leading administrator of ABCP conduits since 1988. Our ABCP conduits provide an important source of financing for JPMorgan Chase customers, who utilize the financing they receive from the conduits for their working capital needs, including payroll, financing inventory and providing financing to consumers and small businesses. Since inception, the JPMorgan Chase ABCP conduits have provided more than $303 billion in financing to JPMorgan Chase customers; as of May 30, 2011, the JPMorgan Chase ABCP conduits had approximately $20 billion ABCP outstanding and approximately $31 billion in outstanding commitments to its customers.

Each transaction funded by the JPMorgan Chase ABCP conduits includes a liquidity facility covering 100% of the ABCP issued by the conduit in connection with the underlying transaction. JPMorgan Chase currently provides all of the transaction specific liquidity facilities to the conduits (at times, a small percentage has been provided by other financial institutions). In addition, JPMorgan Chase provides a letter of credit to each conduit, sized in an amount for each conduit that equals or exceeds 5% of such conduit's outstanding ABCP, that can be drawn on to repay ABCP in the event that funds from the liquidity facilities or collections from the receivables pools are insufficient to provide for timely payment of ABCP.

Eligible ABCP Conduit Risk Retention Option

We believe that it is important for the final rules to continue to give ABCP conduit sponsors the option to satisfy risk retention requirements by looking to the credit enhancement provided by the underlying originators/sellers in each conduit transaction. JPMorgan Chase actively participated in the development of the ASF Comment Letter, and we believe that letter provides a very thorough analysis of changes that should be made to the Proposal to ensure that the ABCP Conduit Risk Retention Option is a viable alternative for risk retention, so we will not attempt to reiterate all of those changes in this letter. However, there are a few issues that we would like to highlight.

First, the Proposal would force ABCP conduits to require that underlying originators/sellers satisfy the risk retention requirements using the eligible horizontal risk retention option. ABCP conduits fund a wide variety of assets, including assets that traditionally use other forms of risk retention that are recognized by the Proposal as acceptable forms of risk retention. We do not believe that any policy objectives would be served by limiting originators/sellers into ABCP conduits to fewer alternatives for risk retention than they would have were they to fund in the term ABS markets. If ABCP conduits are required by these rules to accept only horizontal risk retention from originators/sellers, many of our customers would no longer desire conduit funding, and without sufficient demand for ABCP conduit facilities, conduits would no longer be viable funding sources.

Second, the Proposal provides that the sponsor is responsible for the originator/seller's compliance with the risk retention requirements. However, conduit sponsors are not in a position to ensure that originators/sellers comply with those requirements, nor are conduit sponsors able to know whether an originator/seller has violated risk retention requirements. Accordingly, we believe that the final rule should make clear that the sponsor will satisfy its obligations under the risk retention rules if it includes appropriate representations, warranties and covenants with respect to risk retention in transaction documents.

Disclosure Requirements

We also strongly support the ASF Comment Letter's comments and proposals with respect to disclosure requirements for ABCP conduits relying on the ABCP Conduit Risk Retention Option. We want to emphasize that including a requirement to disclose the underlying seller/originator's identity to investors would preclude conduit sponsors from using the ABCP Conduit Risk Retention Option. Existing transactions with customers include confidentiality provisions which prohibit the disclosure of the customer's name to ABCP investors, and we believe that many current users of ABCP conduit funding would no longer view ABCP conduit facilities as desirable if the conduit were required to disclose the customer's identify to ABCP investors. Furthermore, ABCP investors typically rely on the credit quality of the ABCP conduit sponsor and provider(s) of program support facilities, and therefore are willing to purchase ABCP without knowing the identity of the underlying originators/sellers. We note that in the ASF comment letter on Regulation AB, we provided a detailed disclosure that ABCP conduits can make (and most currently do make) to ABCP investors. ABCP investors voiced their support for our suggestions on Regulation AB disclosure, and those suggestions explicitly excluded identifying originators/sellers by name.

We support the provisions in the Proposal that would require ABCP conduits to disclose customer names to the Agencies upon request, so long as the disclosure of names to the Agencies is made on a confidential basis. We do not believe that ABCP conduit customers would object to the non-public disclosure of their names to the Agencies or other regulators, and in fact, the confidentiality provisions in existing transactions already permit such disclosure.

Current Risk Retention Methodologies Should Be Reflected in Final Rules

Since current ABCP conduit structures already provide for meaningful risk retention by ABCP conduit sponsors in the form of program support facilities such as letters of credit, we believe that the eligible horizontal risk retention option should include provisions that would allow ABCP conduit sponsors to satisfy the risk retention requirements through the continued provision of these program support facilities. At a minimum, we believe that letters of credit issued by the sponsor of an ABCP conduit or one of its affiliates to a conduit should be a recognized way for ABCP conduit sponsors to satisfy risk retention requirements.

JPMorgan Chase, like many conduit sponsors, provides an irrevocable letter of credit (a "Program Letter of Credit") to each conduit that can be drawn on to repay ABCP in the event that funds from the liquidity facilities or collections from the receivables pools are insufficient to provide for timely payment of ABCP. The Program Letters of Credit are sized in an amount for each conduit that equals or exceeds 5% of such conduit's outstanding ABCP. However, because the Program Letters of Credit are unfunded, they do not meet the requirements of any of the risk retention options set forth in the Proposal.

We believe that requiring ABCP conduit sponsors to modify their current form of risk retention by funding their program support facilities does not further the purpose of the risk retention requirements, and will have an adverse impact on the ABCP conduit market. We have always had significant incentives to ensure that transactions funded by the conduits are carefully underwritten, because we must approve each of the Program Letters of Credit and liquidity facilities provided to the conduits in a manner consistent with safe and sound banking practices. For years, JPMorgan Chase also has included these letters of credit and liquidity facilities in its calculation of regulatory capital. As a result, the interests of JPMorgan Chase, as conduit sponsor, and ABCP investors have always been substantially aligned; in fact, no credit losses have been incurred by ABCP investors in our 23 year history as an administrator of ABCP conduits, and we are not aware of any credit losses being incurred by any ABCP investor in a conduit with 100% liquidity support[11].

We understand that some of the Agencies are concerned that the true "first loss" for ABCP conduits is the transaction specific credit enhancement that each originator/seller is required to provide for its transaction. However, we believe that ABCP investors traditionally have not relied primarily on the individual transaction specific credit enhancement, but instead on the liquidity facilities and, to the extent that the liquidity facilities failed to provide sufficient funds to repay ABCP (because, for example, the underlying transaction specific credit

[11] We are aware of the credit losses incurred by ABCP investors in programs that did not benefit from 100% liquidity support, and we agree with the Agencies' efforts to limit the use of the Eligible ABCP Conduit Risk Retention option to ABCP conduits with 100% liquidity coverage. We also support the Agencies applying the 100% liquidity coverage requirement to ABCP conduit sponsors that desire to provide risk retention in the form of unfunded program support facilities such as letters of credit, and we support the adoption by the Agencies of criteria to ensure that the program support facilities are comparable to letters of credit and are provided by regulated entities.

enhancement was insufficient) the ABCP investors have relied on the letters of credit or other program support provided or arranged by the ABCP conduit sponsor. We therefore believe that it would be appropriate for the Agencies to view program support facilities, such as the Program Letters of Credit, as an acceptable form of risk retention.

We also understand that some of the Agencies' have concerns with unfunded risk retention as an alternative; however we believe that unfunded commitments to ABCP conduits that lack any conditions to funding properly incent the risk retention provider to engage in sound underwriting of the conduit's assets. Furthermore, letters of credit provided by sponsoring banks to ABCP conduits which allow for no "outs" to funding are very different from other unfunded exposures that have failed to fund during the recent financial crisis, such as:

- Canadian liquidity: Liquidity facilities provided by Canadian banks to their ABCP conduits that issued only in the Canadian market were structured differently from liquidity facilities provided to U.S. issuing ABCP conduits. These Canadian liquidity facilities included "market out" provisions that only required funding by the liquidity providers if it could be proven that there was a market wide disruption in funding. In 2007, several Canadian liquidity providers failed to fund under these facilities. This was due to the fact that there were several other Canadian conduits that were able to issue ABCP and therefore the liquidity providers argued that there was not a "market wide" disruption in funding. By contrast, the Program Letters of Credit provided by JPMorgan Chase to our ABCP conduits have no conditions to funding, other than the presentment of a drawing request specifying the amount of funds requested and the date on which the funds are requested.

- Representations and Warranties: We understand the Agencies were also concerned with the failure of parties to honor repurchase obligations with respect to breaches of representations and warranties. However, while an investor would need to demonstrate that a representation had been breached in order to obtain any protection from these provisions, program credit support in the form of letters of credit may be drawn to provide funds at any time, without any condition other than the presentation of a draw request.

- Monoline Financial Guarantees: A letter of credit, particularly a letter of credit provided by the sponsor of an ABCP conduit, can also be distinguished from a monoline financial guarantee provided by an entity that is not affiliated with the sponsor of the ABCP conduit. Financial guarantees issued by monoline insurance companies are, in contrast to letters of credit, a more recent development and the law is less well-settled as to the certainty of payment. Furthermore, since financial guarantees evolved as an instrument in the insurance market, the insurance companies have been able to successfully raise

> defenses to payment typically available to insurers and guarantors (but not to letter of credit issuers) in order to avoid payment on a financial guarantee.[12]

In contrast to the unfunded commitments described above, letters of credit are widely and uniformly recognized as imposing on the issuing bank a strict obligation to fund, for which defenses to payment that may be asserted by monolines or other guarantors or insurers (including private mortgage insurers) are not available. When the issuing bank is presented with complying documents – whether in the form of a sight draft or a certificate – that issuing bank has a virtually unconditional obligation to honor the request for drawing[13]. If the documents presented by the beneficiary otherwise comply with the terms of the letter of credit, neither the breach by the applicable parties on any underlying commercial contract nor the bankruptcy of any such party will provide the issuing bank with any defense to honoring its commitment under the letter of credit. Only in the face of material fraud by the beneficiary of the letter of credit will the law begin to allow a defense to payment, and then only in limited circumstances that would be inapplicable to a funding request or "presentation" under the Program Letters of Credit, since the applicant under the Program Letters of Credit is the applicable JPMorgan Chase conduit, the issuer is JPMorgan Chase Bank, National Association, and the beneficiary is JPMorgan Chase Bank, National Association, as administrative agent for the conduit.[14]

Additionally, Article 122a explicitly recognizes unfunded program support facilities as acceptable risk retention forms for ABCP conduits, which would put ABCP conduit sponsors that are U.S. financial institutions, like JPMorgan Chase, at a significant competitive disadvantage to their non-U.S. regulated counterparts if the final U.S. risk retention rules do not recognize unfunded program support facilities as an acceptable form of risk retention. For new ABCP conduit programs, and beginning January 1, 2014 for existing ABCP conduit programs, a U.S. ABCP conduit's European investors or affiliates of European investors will be forced to meet the requirements of Article 122a. Failure to align the risk retention rules will put an additional burden on U.S. ABCP conduits, which will be forced to meet two very different requirements for risk retention.

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[12] We also note that some of the defenses to payment that may be raised by monolines, such as fraud or misrepresentation by the party requesting the financial guarantee, would not be defenses that could be raised by a letter of credit issuer that is also the sponsor of the ABCP conduit (or that is affiliated with the sponsor of the ABCP conduit), since any information that the sponsor has about the investment would also be available to the letter of credit provider.

[13] "[A]n issuer ***shall honor*** a presentation that … appears on its face strictly to comply with the terms and conditions of the letter of credit." (Uniform Commercial Code (the "UCC"), Section 5-108(a)) "An issuing bank is ***irrevocably bound*** to honour as of the time it issues the credit." (Uniform Customs and Practice for Documentary Credits (No. 600)(the "UCP")). "When an issuing bank determines that a presentation is complying, it ***must honour***." (UCP Article 15).

[14] In the face of a complying presentation, even in the case where "a required document is forged or materially fraudulent, or honor of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant," the issuer is required to honor the letter of credit in certain specified cases and in all others may, acting in good faith, honor the demand for payment. (UCC Section 5-109).

For these reasons, we believe that it is appropriate that the final rules include provisions that would enable ABCP conduit sponsors to satisfy the risk retention requirements through the continued provision of letters of credit or other similar unfunded, unconditional commitments to the conduits.

8. CLOs

We concur with the submissions of other commenting parties that Dodd-Frank does not authorize imposing risk retention requirements upon an investment adviser or any other participant to "traditional" collateralized loan obligation funds (which we define below as "CLOs"). We base this upon the language of Dodd-Frank and its legislative history. There is simply no evidence that CLOs or syndicated loans were the intended target of this regulation.

If the Agencies ultimately designate the investment adviser or any other CLO transaction participant (each, a "Participant" and, collectively, the "Participants") as a "securitizer" for purposes of risk retention, an unnecessary burden will be imposed on the Participants which, in turn, will threaten the viability of an industry that provides necessary capital to businesses that employ millions of Americans across the country without any support from Dodd-Frank's plain language or its legislative history. To further support our position, we have also provided some background on CLOs which highlight how CLOs are distinct from other forms of securitizations in the way in which such transactions are initiated, the motivation of the parties involved and in respect of the creation and acquisition of the assets. We then set forth our analysis of the plain language of relevant portions of Dodd-Frank and related legislative history as it pertains to CLOs.

Introduction

To begin, we would like to distinguish between "Balance Sheet CLOs" and "Traditional CLOs" (also referred to as "Arbitrage" or "Open Market" CLOs). Our comments apply solely to Traditional CLOs and not to Balance Sheet CLOs or any other collateralized debt obligation transaction, for reasons set forth below.

Balance Sheet CLO

A Balance Sheet CLO is a securitization of credit exposure to corporate entities, predominantly loans to companies. In a Balance Sheet CLO, a financial institution, such as a bank or an insurance company, has a portfolio of loans that the financial institution securitizes. Balance Sheet CLOs are typically intended to achieve one or more of the following purposes: (i) improved funding, where the cost of capital for the CLO's tranches are less expensive than the funding the owner of the loans could achieve on an unsecured basis, (ii) diversification of funding, (iii) risk reduction or (iv) regulatory capital relief. The financial institution transfers the portfolio of loans to an SPV in exchange for a cash payment. The SPV funds the purchase of the portfolio of loans by issuing securities representing various tranches of risk. In many instances, the financial institution selling the portfolio also purchases a portion of the various tranches of risk. Typically either the senior-most or junior-most tranche of the securitization is retained by the financial institution, depending upon what purpose the financial institution is trying to achieve with the securitization. Any tranches or portions thereof not retained by the financial institution are sold to third party investors via the capital markets. There is typically no investment adviser reviewing the portfolio but rather the financial institution performs certain administrative/servicer duties with respect to the loans. In this instance, the financial institution is basically acting as the depositor or sponsor of the transaction, similar to a more traditional ABS transaction.

Traditional CLO

A Traditional CLO is also a securitization of corporate credit, predominantly loans to companies. However, the main purpose of a Traditional CLO is typically asset gathering by a portfolio manager (i.e., to grow a portfolio manager's assets under management), and in some cases to replace existing forms of financing, such as a total return swap ("TRS"), that a portfolio manager may have on assets it currently manages. Traditional CLOs should be thought of as investment vehicles, as one would think about closed-end funds. Investment advisors utilize the CLO as a means to grow assets under management and increase management fee income, not as a means of disposing of self-originated assets.

Henceforth, every reference to "CLO" shall mean a "Traditional CLO" and not a "Balance Sheet CLO" or any other collateralized debt obligation transaction.

Background

As stated above, CLOs should be thought of as investment vehicles and not a source of originator risk distribution, as is the case with the "originate to distribute" ("OTD") model of securitizations where the originator creates assets with the intention of selling or transferring those assets into a securitization vehicle[15]. Much like a closed-end fund, CLOs offer investors the opportunity to take levered exposure to corporate credit at various risk and reward levels (i.e., tranches). While the securitization technology behind the CLO is similar to other forms of securitization that support the OTD model, the fundamental building blocks of CLOs are very different. This distinction is clearly evidenced in both the underlying collateral and the management framework of a CLO.

Underlying Collateral

The assets comprising a CLO are loans made to commercial entities by a syndicate of banks and other institutional lenders. The arranger of the syndication and the initial lenders in the syndicate engage in a rigorous and extensive diligence process prior to closing the credit facility. Financial and other information regarding the borrower and its business are provided by

[15] Footnote 121 of the Senate Report describes the "originate to distribute" model as follows:

> In an 'originate-to-distribute' model, for the most part, the originator of mortgages sells the mortgages to a person who packages the loans into securities and sells the securities to investors. By selling the mortgages, the originator thus gets more funds to make more loans. However, the ability to sell the mortgages without retaining any risk, also frees up the originator to make risky loans, even those without regard to the borrower's ability to repay. In the years leading up to the crisis, the originator was not penalized for failing to ensure that the borrower was actually qualified for the loan, and the buyer of the securitized debt had little detailed information about the underlying quality of the loans.

the borrower to potential lenders, and lender meetings are held by the borrower for purposes of answering questions from the potential lender group. When a CLO enters into a loan agreement as a lender by acquiring a syndicated loan by assignment into its portfolio, it becomes a direct lender to the borrower and, pursuant to the typical marketing materials and constituent documents of CLO's, as part of that process the CLO's investment adviser (on behalf of the CLO investors) are to perform a review of the financial condition of the borrower prior to the CLO's purchase of the loan. Indeed, lenders in a syndicated credit agreement expressly acknowledge that they have made their own credit analysis of the borrower. Additionally, any loan acquired by the CLO will be purchased by the CLO at arms-length terms in fair, open market transactions.

Typically, loans in a CLO's portfolio are loans to companies that provide a variety of goods and services, generally supporting corporate America and the overall health of the economy. Of the 27 largest companies that borrow term loans from institutional lenders, the total principal amount of term loans borrowed is approximately $135.8 billion and 19.5% of the principal amount of these loans are held by CLOs.[16] These 27 companies include healthcare providers, energy producers, automotive companies, food producers and service providers, as well as many others, and employ approximately 1.2 million people.[17] And this is just a small sample of the 100+ companies to which a typical CLO lends.

Note that while the CLO is an important provider of capital to these companies, CLOs are only one of many types of lenders in syndicated credit facilities to these companies. In addition to CLOs, other lenders include banks, mutual funds, insurance companies, prime rate funds and other types of funds.

Unlike the assets that are in OTD securitizations, syndicated loans are far larger (typically in the multi-hundreds of millions of dollars, with some loans reaching into the billions of dollars) than any one CLO could own in its loan portfolio. The typical CLO size is $300 million to $500 million and the typical maximum single obligor limit does not exceed 2 percent of the portfolio notional, meaning the maximum exposure to any given loan in a typical $500 million CLO is $10 million, with average exposure more likely in the $5 million range. In addition, there is an active secondary market for loans where one can easily assign a value to such loans and in many cases from at least two pricing services, further contributing to an additional degree of asset level transparency.

Management Framework

CLOs employ an investment adviser who is responsible for each and every credit related decision relating to the CLO's loan portfolio. Much like the manger of a closed-end fund, a CLO's investment adviser is responsible for all purchases into, dispositions out of and monitoring of the CLO's portfolio. Subject to the purchase and sale restrictions dictated by the CLO's governing documentation (which are negotiated among the CLO's investors, the

[16] CLOs most often will come into a syndicated loan facility in a term loan tranche usually entitled the "Term Loan B" tranche.
[17] J.P. Morgan Research as of May 22nd, 2011.

investment adviser and rating agencies), the investment adviser has sole discretion and control over the CLO's portfolio. None of the arrangers or initial lenders of the syndicated loans, or the dealer that arranges the CLO, have any say in the assets to be included in or removed from the CLO's portfolio.

The investment adviser is effectively hired by the CLO's investors to manage the CLO's investment portfolio on their behalf, and is compensated for such services. The investment adviser is hired under a management agreement which contains a standard of care with regards to the performance of its obligations and owes a duty of care to the CLO and its investors.

As compensation for its management services, the investment adviser typically receives various levels of fee compensation. The fees payable are senior fees, which are payable prior to any of the CLO's rated noteholders receiving any payments; subordinated fees, which are payable after all of the CLOs rated noteholders have received payments, but prior to making payments to the equity holders; and incentive fees, which are typically a pre-determined percentage of excess cashflows payable to the equity tranche after the equity tranche has achieved a pre-determined rate of return. Senior and subordinated fees are paid on a running basis, with typically 60% or greater of an investment adviser's running fees being subordinated fees. Incentive fees are typically paid near the end of the life cycle of the transaction and can account for a significant portion of the investment adviser's total compensation. To the extent the CLO's portfolio is not performing and interest is not being paid to any of the rated notes, subordinated and incentive management fees will not be paid to the investment adviser until the portfolio's performance improves.

This accountability to investors, as well as the form of compensation payable to the investment adviser, are two important characteristics of a CLO. A significant portion of the investment adviser's compensation is tied directly to the performance of the loans within the CLO's portfolio, effectively aligning the economic interests of the investment adviser with that of the CLO's investors. This accountability and the arms-length and independent basis by which the investment adviser decides whether to acquire loans under a syndicated credit facility and become a lender thereunder also support the conclusion that the risk retention rules are unnecessary for CLOs. Congress' goal of aligning the interests of CLO investors with the party choosing the assets for the CLO is already built into the structure.

Statutory Interpretation

The first rule of statutory construction is that analysis of the purpose and meaning of a statute begins with the statute's plain language.[18] "[I]n interpreting a statute a court should always turn to one cardinal canon before all others . . . courts must presume that a legislature says in a

[18] *See Conn. Nat'l Bank v. Germain*, 503 US 249, 253-54 (1992) *Id.* ("[W]hen the words of a statute are unambiguous, then, this first canon is also the last: 'judicial inquiry is complete.'") (quoting *Rubin v. United States*, 449 U.S. 424, 430 (1981)).

statute what it means and means in a statute what it says there."[19] Where the language of the statute is clear, courts are required only to refer to the statute and enforce it according to its terms.[20] Proper statutory construction avoids delving into legislative intent unless the plain meaning of the language is ambiguous or unclear.[21] In such event, as is the case with the risk retention requirements of Section 941, the Agencies do not have the authority to rewrite a law to implement the legislature's perceived intent because "Judges interpret laws rather than reconstruct legislators' intentions."[22]

Pursuant to Section 941 of Dodd-Frank, the Agencies were directed by Congress to issue regulations that require a securitizer to retain an economic interest in a portion of the credit risk of the assets underlying asset-backed securities.[23] Specifically, Section 941(b) of Dodd-Frank instructs the Agencies to:

> "jointly prescribe regulations 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"[24].
>
> Dodd-Frank clearly defined a "securitizer" as:
>
> (A) an issuer of an asset-backed security; or
>
> (B) a person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuer[.][25]

The Agencies ultimately concluded that the "issuer" of an asset-backed security is the same as a depositor.[26] In addition, the Agencies also concluded that the "sponsor" of a

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[19] *Id*.

[20] *See Caminetti v. United States*, 242 US 470, 485 (1917).

[21] *See Ratzlaf v. United States*, 510 U.S. 135, 147-48 (1994).

[22] *I.N.S. v. Cardoza-Fonseca*, 480 U.S. 421, 452-53 (Scalia, J., concurring).

[23] Securities Exchange Act § 15G(1)(b), 15 U.S.C. § 78o-11(b)(1), as added by Dodd-Frank Act § 941(b).

[24] Dodd-Frank Act § 941(b) (as codified at § 15G(b)(1) of the Securities Exchange Act of 1934, 15 U.S.C. §78o-11, §78o-11(b), (c)(1)(A), and (c)(1)(B)(ii)).

[25] Dodd-Frank Act §941(b) (as codified at §15G(a)(3) of the Securities Exchange Act).

[26] Proposal at 30-31, providing:

> The term "issuer" when used in the federal securities laws may have different meanings depending on the context in which it is used. For example, for several purposes under the federal securities laws, including the Securities Act and the Exchange Act and the rules promulgated under these Acts, the term "issuer" when used with respect to an ABS transaction is defined to mean the entity—the depositor—that deposits the assets that collateralize the ABS with the issuing entity. The Agencies interpret the reference in section 15G(a)(3)(A) to an

transaction is "a person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuer[.]"[27] Thus, it is clear that if a transaction participant is either (a) the depositor of the assets into the securitization vehicle or (b) the entity that (1) organizes and initiates an asset-backed securities transaction and (2) does so by directly or indirectly selling or transferring the underlying assets to the issuer, then such transaction participant must retain risk. In the case of a CLO, there is no entity that satisfies either leg of the definition and therefore risk retention is not required.

The investment adviser initiates and organizes a CLO by engaging an investment bank to seek investor appetite for a new CLO. However, the investment adviser does not initiate the transaction by selling or transferring the assets to the SPV. In a typical CLO, the investment adviser only selects, monitors and disposes of the loan portfolio. While the investment bank that is hired by the investment adviser to assist it in arranging the transaction may, by happenstance, also be the lead arranger/bookrunner for the syndicated credit facility pursuant to which some of the syndicated loans that the investment adviser picks for the CLO, the transaction is initiated and organized by the investment adviser and the loans purchased are from a wide variety of credit facilities, and from a wide variety of initial lenders and other lenders who have themselves acquired the loans in the secondary loan market. Thus, a typical CLO has neither a depositor nor sponsor for purposes of Dodd-Frank or the Proposal.

Since the authority granted to the Agencies to prescribe rules for imposing risk retention requirements on "securitizers" under Section 941 of Dodd-Frank is strictly limited by the unambiguous terms of Section 941's definition of "securitizer" and administrative agencies may not prescribe rules that are inconsistent with the intent of Congress as expressed in the plain language of the controlling statute[28], the Agencies must work within the meaning of Dodd-Frank's text. Thus, since there is no "securitizer" of a CLO within the plain meaning of the language there can be no risk retention requirements applicable thereto. A review of the legislative history also supports this conclusion.

Legislative History

From a plain language perspective, there is no need to examine the legislative history of Dodd-Frank, given that the term securitizer is explicit and clear on its face. However, we believe it is worth noting that a review of the legislative history indicates that neither investment advisers

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"issuer of an asset-backed security" as referring to the "depositor" of the ABS, consistent with how that term has been defined and used under the federal securities laws in connection with ABS.

[27] *Id*. at 29 (emphasis added).

[28] *See Sullivan v. Everhart*, 494 U.S. 83, 89 (1990) ("If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.") (citing *Chevron U. S. A. Inc. v. NRDC, Inc.*, 467 U.S. 837, 842-43 (1984)); *New Jersey v. EPA*, 517 F.3d 574, 581 (D.C. Cir. 2008) (same).

nor investment funds known as CLOs[29] were the intended targets of Section 941's risk retention regime.

The legislative history of Section 941 is not extensive. The primary piece is the Senate Committee on Banking, Housing, and Urban Development's Report on the Dodd-Frank Restoring American Financial Stability Act of 2010, S. REP. NO. 111-176 (the "Senate Report"), which includes a section-by-section analysis of Dodd-Frank and cites nine authorities in Section 941's legislative history.[30] Six of the authorities were testimony before the committee and three were written reports.[31]

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[29] We do not believe CLOs are "CDOs" in the manner used within the legislative history. On the surface, the structures look similar; however, the fundamental building blocks are very different. A CLO is a primary securitization of financial assets that are not originated in the OTD model. A CDO is a resecuritization (and a CDO-squared is two resecuritizations) where the underlying assets may have been created in the OTD model. The legislative history demonstrates both key distinctions between the two. *See* S. HRG. NO. 111-397 at 35 ("Typically, a CDO consisted of junior tranches of RMBS from different offerings, sometimes paired with other types of asset-backed securities involving receivables from things like credit cards or auto loans."); *id* at 33 ("Lenders were able to hedge their equity tranches or shed them by *resecuritizing* them as CDOs." (emphasis added)); Senate Report at 128 ("[I]t proved impossible for investors in asset-backed securities to assess the risks of the underlying assets, particularly when those assets were *resecuritized* into complex instruments like collateralized debt obligations (CDOs) and CDO-squared." (emphasis added)).

[30] Senate Report at 128-31. Five of the nine authorities were directly quoted in the report. The Group of Thirty's "Financial Reform: A Framework for Financial Stability" was quoted to the effect that a credit risk retention requirement would help restore market confidence in underwriting standards. Dr. William Irving, Portfolio Manager of Fidelity Investments, stated in his testimony that the originate-to-distribute model of credit provision had contributed to the financial crisis, and mentioned loan originators, warehouse facilitators, security designers, credit raters, and marketing and product-placement professionals as responsible parties. Prof. Patricia A. McCoy, law professor at the University of Connecticut, testified that complexity and opacity in the securitized products markets intensified the investor panic and halt to credit flow accompanying the crisis. George Miller, executive director of the American Securitization Forum, was quoted for his group's support of risk retention requirements to create better alignment of incentives. Finally, J. Christopher Hoeffel of the CREFC (formerly, the Commercial Mortgage Securities Association) was quoted cautioning the committee that risk retention regulation must be tailored carefully to recognize the differences in securitization practices for various asset classes.

The other citations to written reports were to the Treasury Department's 2009 legislative proposal and to a report by the Investor's Working Group, which is a joint venture of the Council of Institutional Investors and the C.F.A. Institute financial analysts' trade group, called "U.S. Financial Regulatory Reform: An Investor's Perspective." The other witnesses whose testimony was cited were Barbara Roper of the Consumer Federation of America and Joseph Dear of the CalPERS pension fund. Those four authorities were cited basically for the proposition that the various groups they represent supported credit risk retention regulation overall.

The minority viewpoint included in the Senate report cites only one authority: a February 2010 speech by John C. Dugan, Comptroller of the Currency, which warned that while lax underwriting standards helped cause the financial crisis of 2008, risk retention for securitizers is not the best way to repair that problem.

[31] We are drawing a distinction between commercial loans and syndicated corporate bank loans, which were not discussed in the legislative history, suggesting that Congress did not consider corporate bank loans to be assets requiring regulation in the aftermath of the financial crisis. There is reference, however, to "commercial loans" in the Senate Report, which follows a reference to the testimony before the committee of J. Christopher Hoeffel, Executive Committee Member, CREFC (formerly the Commercial Mortgage Association). Senate Report at 130. The

The Senate Report's discussion of Section 941 identifies the problems leading to the financial crisis that the section is meant to address. It states the section's general purpose and describes how the Senate majority expects the section to operate and the Agencies to write regulations under it. The overall purpose of the risk retention requirement as summarized by the Senate Report is to provide securitizers with "a strong incentive to monitor the quality of the assets they purchase from originators, package into securities, and sell."[32]

As explained in the Senate Report, Congress designed the risk retention regime to address two specific problems that contributed to the financial crisis of 2008. First was the OTD model[33] of extending credit where "loans were made expressly to be sold into securitization pools, which meant that the lenders did not expect to bear the credit risk of borrower default."[34] Section 941 places a risk retention requirement on securitizers with the goal of aligning their economic interests with those of investors in asset-backed securities. Section 941 is also intended to raise credit and underwriting standards by placing originators "under increasing market discipline because securitizers who retain risk will be unwilling to purchase poor-quality assets."[35]

The second problem Congress sought to address with the risk retention requirement was the difficulty that many investors face in assessing the risks of the underlying assets of certain securitization transactions. The Senate Report states that "[c]omplexity and opacity in securitization markets created the conditions that allowed the financial shock from the subprime mortgage sector to spread into a global financial crisis . . . ."[36] The Senate Report identified resecuritizations of asset-backed securities as an example of transactions that inhibit an investor's ability to enforce market discipline upon originators of financial assets.

While Congress explicitly addressed CLOs and the parties to a CLO throughout Dodd-Frank, they are not mentioned in Section 941, nor are they discussed in the legislative history accompanying Section 941. This lack of legislative history implies that CLO Participants are not the intended targets of the risk retention regime, and consistent with that premise, the legislative history that is available demonstrates that CLOs do not own the type of assets, lack the transparency or include the incentives that Congress sought to regulate in other securitizations.

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prepared statement of Mr. Hoeffel uses the phrase "commercial loans" to refer to real estate related loans included in a commercial mortgage backed security. S. HRG. NO. 111-397 at 64.

32 Senate Report at 129.

33 *Id.* at 41.

34 *Id.* at 128.

35 *Id.* at 129.

36 *Id.* at 128.

Comparing the CLO Model to the Originate-to-Distribute Model

The legislative history is clear that Congress sought to regulate the OTD model of financial asset creation through capitalization in the securitization markets. Two key aspects of CLOs are: (1) CLOs are not created for the purpose of fostering financial asset creation and (2) CLOs acquire loans subject to robust underwriting standards.

Purpose of Securitization Transaction

The OTD model involves the use of the securitization markets as a means of capitalizing the creation of financial assets. In the OTD Model, the primary incentive of the originator is to raise capital to promote the business of creating additional loans. The Senate Report acknowledged as much: "By selling the mortgages, the originator thus gets more funds to make more loans. However, the ability to sell the mortgages without retaining any risk, also frees up the originator to make risky loans, even those without regard to the borrower's ability to repay."[37] In other words, the OTD model involves a securitization whose primary purpose is the funding of loan creation by the party establishing the securitization by issuing securitized debt to raise the needed capital.

In contrast, the primary purpose of a CLO is to provide its investors with the ability to gain exposure to corporate loans on a diversified and leveraged basis. The CLO investment adviser initially selects and continually manages and monitors the loans in the CLO and is highly concerned with the quality and performance of those loans throughout the life of the transaction in part because the fees it receives are directly tied to the success of the fund and its ability to attract new business is closely tied to its performance track record and overall reputation. Consistent with the plain language of Dodd-Frank, a CLO has no "securitizer" because there is no single originating lender organizing and benefiting from the capital raised by the CLO; rather, the capital is raised with the primary purpose of acquiring assets within the investment parameters from whatever sources and prices benefit the investors in the CLO.

Underwriting Standards

CLOs typically hold commercial loans made under syndicated credit facilities. Syndicated commercial loans involve extensive documentation, which are typically highly customized for the specific transaction and are subject to a robust credit approval process prior to the credit facility closing. As previously noted, the arranger(s) of the syndicated facility and their counsel will diligence the borrower. The opportunity for further due diligence of the borrower is made available to other potential lenders, including CLOs, in the syndicate who also engage in their own credit analysis of the borrower and review the documentation for the facility. Each lender, including CLOs, represents in the credit facility that it has done its own credit analysis and review of documentation.

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[37] Senate Report at 41 n. 121.

The diligence and review process for syndicated loans is extensive, with multiple lenders, their credit review process and often external law firms examining the borrowers and the related documentation. In addition the credit worthiness of these borrowers is generally easier to verify before loan origination and to monitor thereafter through their audited financial statements. A CLO essentially becomes a direct lender to a borrower once the investment adviser selects a loan after performing its own credit and investment diligence. The investment adviser carefully selects loans within its investment expertise (i.e. company and industry). It then seeks to acquire each loan.

Investors' Inability to Assess Risks

Congress also focused on the inability of investors to properly evaluate complex securities due to convoluted market practices: "investors in asset-backed securities could not assess the risks of the underlying assets, particularly when those assets were resecuritized into complex instruments like collateralized debt obligations."[38] If the structure is easily understood, and the investors can accurately assess the risks, then investors will presumably act in their own self-interest and purchase securities in transactions with the better risk-adjusted returns. As discussed in greater detail above, a CLO is a highly transparent structure.

From the detailed description of the transaction and related documents set forth in the offering memorandum, to the investment criteria that the investment adviser must use when selecting loans as collateral, investors have a significant amount of credit-relevant information available to them prior to buying into a CLO. Independent ratings on the CLO's underlying assets provide additional transparency. Not only is an independent third party looking at the credit of the asset, but the rating shows that sufficient information relating to that asset is available for market participants to perform a meaningful review. The periodic reports provided to investors in a CLO typically identify the syndicated commercial loans collateralizing the securities and are compiled by a third party to the transaction, such as a trustee. Most of the syndicated loans trade regularly in the secondary loan market, and pricing for the loans is generally available. The borrowers of the underlying loans typically provide audited financial statements, which are publicly available to investors in the CLOs when the obligor is a public filer with the Securities and Exchange Commission. Investors often also have access to ongoing information on the loans, such as third-party credit ratings.

Incentive Alignment

Congressional silence with respect to applying risk retention to CLOs makes sense when considering the two primary objectives noted above. It is clear that Congress intended to eliminate the originator's indifference to credit quality by aligning the originator's financial incentives with those of the investors. While a CLO's investment adviser does not own or originate loans, it is nevertheless highly concerned with the credit quality and strong performance of such assets. The investment adviser owes a duty of care to the CLO and its investors. In

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38 *Id.* at 36.

addition, the better the loans perform, the higher the fees the CLO's investment adviser can collect. This demonstrates that the CLO's investment adviser's interests are substantially aligned with those of the CLO investors.

Conclusion

For the foregoing reasons, we hereby respectfully request that the Agencies make clear in the final rulemaking, consistent with the plain terms of Section 941 and the terms of the Proposal, that neither the investment adviser nor any other Participant in a CLO transaction is subject to the risk retention requirements of Dodd-Frank.

9. MUNICIPAL TENDER OPTION BOND TRANSACTIONS

JPMorgan Chase supports the analysis, commentary and recommendations expected to be contained in the Industry Comment Letters, particularly, those letters, or portions thereof, submitted by ASF and SIFMA as they relate to municipal bond repackagings.

Specifically, we support the recommendation expected to be contained in those comment letters that the Agencies should grant an exemption in their final rules implementing Section 15G of the Exchange Act for securities issued pursuant to municipal tender option bond ("municipal TOB") programs, as further described below, under the discretion granted the Agencies in Section 15G(c)(1)(G)(i) of the Exchange Act, which provides that "a total or partial exemption of any securitization [may be granted], as may be appropriate in the public interest and for the protection of investors."

We wanted to add our separate voice to the industry recommendations as a measure of the importance of this issue.[39]

The Municipal TOB Program Structure

Typically, municipal TOB programs[40] are organized as common law or statutory trusts ("municipal TOB trusts") under New York or Delaware law. High quality, tax-exempt municipal bonds are deposited into a municipal TOB trust and that municipal TOB trust issues (i) a class of variable-rate demand securities ("Floaters") which bear interest at floating rates that are adjusted at specified intervals, typically on a daily or weekly basis, and own a right to tender ("tender option") the Floaters to the municipal TOB trust, generally on a daily or weekly basis, and (ii) a class of inverse floating rate securities ("Inverse Floaters"), which receive residual returns based on the interest paid on the deposited tax-exempt municipal bonds and not otherwise paid to the Floater investors, net of expenses of the municipal TOB trust. The deposited tax-exempt municipal bonds[41] are static and held until the termination of the municipal TOB trust.[42]

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[39] As we will note further herein, we agree that the proposed municipal ABS exemption provided for in the Proposal (See Section ___.21(a)(3)) does implement the requirements in Section 15G(c)(1)(G)(iii) of the Exchange Act as required in Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. No. 111-203, 124 Stat. 1376 (2010))("Dodd-Frank"). However, as further discussed herein, we feel strongly that municipal TOB programs should also be exempted under the authority granted to the Agencies in Section 15G(c)(1)(G)(i) of the Exchange Act.

[40] Some municipal TOB programs are structured in a different manner than the municipal TOB structure described herein. Notwithstanding the specific municipal TOB structure, each such structure's primary goal is to retain the tax-exempt character of the deposited tax-exempt municipal bonds on payments to the investors participating in the related municipal TOB transactions. We believe the discussions and recommendations described herein would apply generally to most municipal TOB transaction structures.

[41] The underlying tax-exempt municipal bonds are generally purchased in the secondary market. As such, it is important to note that the municipal TOB structure does not rely on the "originate to distribute" model that was a major impetus for Dodd-Frank which sought to curb abuses in that model.

[42] In most instances, only a single asset comprises the tax-exempt municipal bonds in a municipal TOB trust. In certain instances, multiple assets that share distinct, predetermined criteria may comprise the tax-exempt municipal

Municipal TOB programs are usually managed by broker-dealers. In this role, the broker-dealer typically initiates the transaction documentation, facilitates settlement of the underlying tax-exempt municipal bonds into the municipal TOB trust, settles the issuance of Floaters and Inverse Floaters, serves as placement agent for the transaction and as remarketing agent for the Floaters. In many instances, the liquidity provider (described below) is an affiliate of the broker-dealer.[43]

To support the tender option owned by the holders of Floaters, each municipal TOB trust enters into a liquidity facility with a highly-rated financial institution that is obligated, subject to certain conditions, to purchase tendered Floaters if they cannot be sold to other investors. The liquidity provider will frequently have recourse to the Inverse Floater investor for any losses incurred as liquidity provider to the municipal TOB trust.

The underlying tax-exempt municipal bonds are usually selected by the Inverse Floater investor,[44] subject to the agreement of the relevant liquidity provider. The Inverse Floater investor is generally a long-term investor in tax-exempt municipal bonds and, as further described below, generally bears all losses, if any, arising in connection with a termination of the municipal TOB trust not occurring as a result of a credit default (as defined below).

Once deposited into the municipal TOB trust, the holders of the Floaters and Inverse Floaters own, often on a *pari passu* basis,[45] the deposited tax-exempt municipal bonds and are entitled to their agreed upon share of any payments of principal received in respect of the deposited tax-exempt municipal bonds by the municipal TOB trust. Consistent with shared ownership of the deposited tax-exempt municipal bonds, upon the occurrence of an obligor default, an obligor bankruptcy, a downgrade of the deposited tax-exempt municipal bonds below investment grade or a final determination that the deposited tax-exempt municipal bonds are taxable (each such event, a "credit default" and together, one or more of such events, "credit defaults"), the holders of Floaters and Inverse Floaters will share the loss upon the sale of the tax-exempt municipal bonds held by the municipal TOB trust in connection with the early termination thereof upon the occurrence of a credit default.

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bonds in a municipal TOB trust. Where there are multiple tax-exempt municipal bonds in the same municipal TOB trust, it is generally for the ease of administering the particular municipal TOB transaction.

[43] On occasion, the broker-dealer or an affiliate may also be the purchaser of the Inverse Floaters on a municipal TOB transaction.

[44] In some instances, an issue of tax-exempt municipal bonds that meet both an Inverse Floater investor's investment guidelines and the municipal TOB program criteria may be identified for investment by the Inverse Floater investor by the broker-dealer managing the municipal TOB program. However, the ultimate investment decision is always made by the Inverse Floater investor.

[45] The specific loss-sharing arrangement for losses in case of a credit default between the Floater and Inverse Floater investors may vary in certain municipal TOB transactions and is disclosed prior to the sale of any municipal TOB securities. Unless investors agree on how to share credit default-related losses prior to sale, that municipal TOB transaction will not be issued.

The Floaters are generally marketed to tax-exempt money market mutual funds and other sophisticated short-term institutional investors. Inverse Floater investors are generally comprised of banks, funds and other long-term institutional investors in tax-exempt municipal bonds.

The disclosure document for each municipal TOB transaction is robust and includes a description of the municipal TOB structure and a description of the underlying tax-exempt municipal bonds. Municipal TOB investors are also provided with a link to the relevant official statement for the underlying tax-exempt municipal bonds as posted on EMMA,[46] the liquidity facility, legal opinions and rating letters. In addition, in connection with the closing of the underlying bond transaction, the issuers of underlying tax-exempt municipal bonds have typically agreed to provide continuing secondary market disclosure in accordance with Rule 15c2-12 of the Exchange Act.

Municipal TOB Programs are Important to the Municipal Market

Municipal TOB programs serve at least three important public constituencies in the tax-exempt municipal market.

First, they increase the demand for long-term municipal securities enhancing market access and providing lower finance costs for issuers of long-term tax-exempt municipal bonds and the related taxpayers. Second, as noted immediately below, they provide the short-term tax-exempt money market funds with a reliable supply of Floaters that meet the strictures of Rule 2a-7.[47] Finally, they allow investors in long-term tax-exempt municipal bonds to invest their capital more efficiently in the municipal bond market.

It is worth noting that the municipal TOB structure is tailored such that Floaters may be purchased by tax-exempt money market funds that need to comply with the regulatory requirements of Rule 2a-7.[48] As such, the underlying long-term rating of the deposited tax-exempt municipal bonds is at least AA-/Aa3,[49] the liquidity facilities are structured as Rule 2a-7 compliant liquidity facilities with conditional demand features, and the liquidity providers maintain short-term ratings in the highest rating category.

[46] EMMA (Electronic Municipal Market Access) is the official source for municipal disclosures and market data and is a service of the Municipal Securities Rulemaking Board. EMMA is available at http://emma.msrb.org/.
[47] Rule 2a-7 under the Investment Company Act of 1940, as amended.
[48] We understand that the Securities and Exchange Commission has released proposed rules that would remove references to credit ratings from Rule 2a-7. We expect that the municipal TOB structure would be changed as necessary to conform to Rule 2a-7 as may be amended pursuant to the final rules issued thereby. The proposed rule changes are available at http://sec.gov/rules/proposed/2011/33-9193.pdf.
[49] In certain circumstances, lower rated underlying tax-exempt municipal bonds may be deposited into a municipal TOB trust, but only if they are supported by a letter of credit issued by a highly rated financial institution.

Interests are Appropriately Aligned in the Current Municipal TOB Structure

Though not specifically in one of the forms ascribed in Section 15G or by the Agencies in the Proposal, the risks inherent in the municipal TOB structure are retained and shared by the party that most appropriately bears them. These transaction-related risks are disclosed appropriately and are transparent to all parties in each municipal TOB transaction. As shown by its strong performance during the recent financial crisis, the municipal TOB structure already effectively aligns the interests of these parties.

The holders of the Floaters and Inverse Floaters, as beneficial owners of a municipal TOB trust and its assets, share the benefits and burdens of ownership of the underlying tax-exempt municipal bonds. They are entitled to their share of payments of principal and interest that are received by the municipal TOB trust. They similarly share losses, if any, occurring as a result of a credit default and the resultant sale of the deposited tax-exempt municipal bonds in connection with the termination of the municipal TOB trust. This is appropriate as the underlying tax-exempt municipal bonds, though selected by the Inverse Floater investor, are disclosed to the Floater investors prior to their investment in the municipal TOB transaction. If the Floater investors do not approve of the selected tax-exempt municipal bonds or any other terms of a proposed transaction as they are disclosed to them, no municipal TOB transaction will be issued.

The holder of the Inverse Floater is typically responsible for any market value losses incurred in connection with an early termination of the municipal TOB transaction unless the loss is the result of a credit default of the underlying tax-exempt municipal bonds.[50] As described elsewhere herein, in certain instances, based on the agreement between the Inverse Floater investor and the liquidity provider, a portion or all of these losses may be assumed by the liquidity provider. In no case shall any of these losses be apportioned to the Floater investors. Both the Inverse Floater investor and the liquidity provider understand the nature of their risks and have fully negotiated the division of these losses. This is appropriate because (1) the Inverse Floater investor has generally initiated the municipal TOB transaction, (2) the liquidity provider has agreed to provide liquidity to the municipal TOB transaction and (3) where such agreement exists between the liquidity provider and the Inverse Floater investor, the liquidity provider has agreed to bear losses.

[50] In the absence of a credit default, upon termination of a municipal TOB trust, all Floaters are tendered to the liquidity provider at a price of par plus accrued interest to the termination date.

It is important to note that, during the recent financial crisis, we are not aware of any short-term tax-exempt money market funds incurring losses in connection with the early termination of municipal TOB transactions, i.e., these losses were experienced by those parties that most appropriately bore those risks – either the Inverse Floater investor and/or the liquidity provider. The municipal TOB structure protects Floater investors because of its compliance with Rule 2a-7, the high quality of the underlying tax-exempt municipal bonds deposited into the municipal TOB trust, the retained tender option and the highly rated liquidity providers supporting that tender option. It is not clear that the stated goals supporting Section 15G of the Exchange Act and the Proposal are furthered in any material way as applied to the municipal TOB structure.

The Proposal Risks Harm to Municipal TOB Programs and the Municipal Market

The various options for risk retention contained in the Proposal would be very difficult to incorporate into the municipal TOB structure without jeopardizing the structure itself.[51] Even if the Proposal could be applied in a manner that does not completely damage the municipal TOB structure, it is very likely that the Proposal would render the municipal TOB structure uneconomic and result in a severe reduction in the number of municipal TOB transactions, with the coincident damage done to tax-exempt municipal issuers and investors described herein.

Further, as applied to municipal TOBs programs, the Proposal would significantly reduce the size of the municipal TOBs market due to increased costs of complying therewith and would provide no measurable benefit to municipal TOBs investors, municipal issuers or the public interest in general. Municipal TOBs provide an important source of demand for tax-exempt municipal bonds, enhancing municipalities market access and lowering their (and the related taxpayers') funding costs. For the short-term money market funds, Floaters have historically been and remain an important investment choice, especially given recent changes to the liquidity requirements for money market funds in Rule 2a-7. Inverse Floaters allow long term investors in tax-exempt municipal bonds to use their capital efficiently. The municipal TOB structure serves an important role for these public constituencies and, importantly, did not suffer from the abuses associated with the recent market disruptions that Section 15G of the Exchange Act and the Proposal seek to address.

[51] As noted above, the key consideration in the structure of municipal TOB trusts is preserving the tax-exempt character of the payments on the underlying tax-exempt municipal bonds. The application of the Proposal to the municipal TOB structure may cause payments on the Floaters and Inverse Floaters to lose their tax-exempt character, vitiating the main purpose of the municipal TOB structure.

Municipal TOB Programs Should Be Exempted From the Final Risk Retention Rules

The proposed municipal ABS exemption provided for in the Proposal (See Section ___.21(a)(3)) is appropriate and implements the requirements contained in Section 15G(c)(1)(G)(iii) of the Exchange Act. However, we believe that the exemption was under-inclusive. The Agencies, under the discretion granted them in Section 15G(c)(1)(G)(i) of the Exchange Act, which provides that "a total or partial exemption of any securitization [may be granted], as may be appropriate in the public interest and for the protection of investors" should exempt, in the final rules implementing Section 15G of the Exchange Act, all securities issued by municipal TOB programs that are collateralized by obligations issued or guaranteed by any State of the United States, or by any political subdivision of a State or territory, or by any public instrumentality of a State or territory that is exempt from the registration requirements of the Securities Act of 1933 by reason of Section 3(a)(2) of that Act (15 U.S.C. 77c(a)(2)).

We do not believe that the Proposal or the final risk retention rules should apply to municipal TOB programs. The inclusion of municipal TOB programs as part of the final risk retention rules will cause the municipal TOB structure to be uneconomic and will harm both issuers of tax-exempt municipal bonds and investors in municipal TOB programs. Applying the Proposal or the final rules to municipal TOB programs will not further the goals underlying Section 15G of the Exchange Act and the Proposal. Finally, we believe the attempt to realign incentives in the municipal TOB structure, where those incentives have demonstrated, through strong performance during the recent financial crisis, to be properly aligned, only serves to risk harm to important constituencies and the municipal markets in general.

We are pleased to have had this opportunity to provide you with our comments on the Proposal. If you have any questions concerning this comment letter, or would like to discuss further any of the matters that we have raised, please feel free to contact me.

Sincerely,

Barry L. Zubrow
Executive Vice President