DATE:	October 21, 2014
MEMORANDUM TO:	The Board of Directors
FROM:	Richard J. Osterman, Jr. RJO Acting General Counsel
	Doreen R. Eberley Director, Division of Risk Management Supervision
	Bret D. Edwards Bret D. Edwards Director, Division of Resolutions & Receiverships
SUBJECT:	Final Rule: Credit Risk Retention

RECOMMENDATION

Staff recommends that the FDIC Board approve and authorize for publication in the *Federal Register* a final rule implementing the credit risk retention requirements of section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[1] If approved, the final rule would be jointly issued with the Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System ("FRB"), and the Securities and Exchange Commission ("Commission") and, with respect to the portions addressing residential mortgages, the Federal Housing Finance Agency ("FHFA") and the Department of Housing and Urban Development ("HUD") (collectively, the "Agencies"). The final rule uses the term "Agencies" to refer to the appropriate agencies that have rulemaking authority with respect to the asset class, securitization transaction, or other matter discussed, and this convention is also used below.

INTRODUCTION

Section 941 of the Dodd-Frank Act amended the Securities and Exchange Act of 1934 by adding a new section 15G ("section 15G"),[2] which generally requires a securitizer (or sponsor) of asset-backed securities ("ABS") to retain not less than 5 percent of the credit risk of the assets

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[1] Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[2] Codified at 15 U.S.C. § 78o-11.

collateralizing the ABS issuance. It also generally prohibits the securitizer from directly or indirectly hedging or otherwise transferring the credit risk that the securitizer is required to retain.[3]

Section 15G exempts certain types of assets from the risk retention requirements and authorizes the Agencies to exempt or establish a lower risk retention requirement for other types of assets. Of particular note, section 15G exempts securitizations consisting exclusively of qualified residential mortgages ("QRMs") from the risk retention requirements,[4] and directs the Agencies to develop a definition for QRM that takes into consideration underwriting and product features that historical loan performance data indicate result in a lower risk of default.[5] The Agencies' QRM definition may be no broader than the definition of qualified mortgage ("QM"), as implemented by the Consumer Financial Protection Bureau ("CFPB"). Additionally, section 15G requires the FDIC, FRB, and OCC (collectively, the "Federal Banking Agencies") to establish a risk retention requirement of less than 5 percent for residential mortgages, commercial mortgages, commercial loans, automobile loans, and any other asset class that the agencies and the Commission determine meet underwriting standards established by the Federal Banking Agencies indicating a low credit risk.[6]

The Agencies published the first notice of proposed rulemaking ("original proposal") on April 29, 2011 (76 *Federal Register* 24090) and published a revised notice of proposed rulemaking ("revised proposal") with major modifications to the original proposal on September 20, 2013 (78 *Federal Register* 57928). The revised proposal retained many core components of the original proposal, while eliminating certain provisions and modifying others to reflect comments received, ongoing developments in the markets, other rules that had been implemented, and practical and operational considerations. The revised proposal generally required that the sponsor[7] of any securitization transaction retain an economic interest equal to at least 5 percent

[3] See 15 U.S.C. § 78o-11(b), (c)(1)(A) and (c)(1)(B)(i).

[4] See 15 U.S.C. § 78o-11(c)(1)(C)(iii).

[5] 15 U.S.C. § 78o-11(c)(4)(A) and (B).

[6] See 15 U.S.C. § 78o-11(c)(1)(B)(ii) and § 78o-11(c)(2).

[7] Section 15G directs the Agencies to apply the risk retention requirements of the statute to a "securitizer" of ABS. Section 15G(a)(3) states that the term "securitizer" means "(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." (See 15 U.S.C. § 78o-11(a)(3). As was the case with the original proposal and the revised proposal, the final rule defines a "sponsor" of an ABS transaction as a "securitizer"

of the aggregate credit risk of the assets collateralizing any issuance of ABS.[8] The revised proposal allowed sponsors to retain risk in the form of an eligible vertical interest, an eligible horizontal interest (or cash reserve account), or any combination thereof, and also proposed several alternative risk retention options for certain types of ABS structures. The revised proposal aligned the definition of QRM with the definition of QM adopted by the CFPB,[9] but also sought comment regarding the merits of an alternative QRM definition that would have added to the core components of the QM definition criteria such as a maximum 70 percent loan-to-value ("LTV") requirement and credit history metrics. Additionally, the revised proposal set forth underwriting criteria for commercial real estate ("CRE") loans, commercial loans, and automobile loans that the Agencies decided would result in low credit risk, and provided that securitization of assets satisfying these standards would not be subject to risk retention. The proposal also included hedging, transfer, and financing prohibitions and other exemptions.

Comments were invited on all aspects of the revised proposal and were due by October 30, 2013. The Agencies received over 250 comments (nearly 150 of which were unique) on the revised proposal, conducted more than 20 meetings with interested parties, and carefully considered those comments in the final rulemaking process. The largest number of comments addressed the proposed alignment of the definition of QRM with QM, and the vast majority of those comments supported the proposal. There was also a significant number of comment letters critical of the proposed treatment of and special retention option for open market collateralized loan obligation issuances ("CLOs").[10] Commenters were also critical of the proposal to restrict the amount of

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for purposes of section 15G, and defines the term "sponsor" of an ABS transaction as a person described in clause (B) of the definition of securitizer, which is how sponsor is defined in Regulation AB of the Commission (17 CFR 229.1101).

[8] The rule defines an ABS by reference to section 3(a)(79) of the Securities and Exchange Act of 1934 (15 U.S.C. 78c(a)(79)), which defines ABS as "a fixed-income or other security collateralized by any type of self-liquidating financial asset (including a loan, lease, mortgage, or other secured or unsecured receivable) that allows the holder of the security to receive payments that depend primarily on cash flow from the asset...." The risk retention requirements apply to all ABS offerings, irrespective of whether the offering must be registered with the Commission under the Securities Act of 1933.

[9] See 78 FR 6408 (January 30, 2013), entitled "Ability-to-Repay and Qualified Mortgage Standards under the Truth in Lending Act (Regulation Z)." The CFPB subsequently proposed and finalized supplemental QM rules. See 78 FR 35430 (June 12, 2013). The CFPB's regulations implementing section 129C of the Truth in Lending Act are codified at 12 CFR part 1026.

[10] Commenters distinguished between two general types of CLOs: open market CLOs and balance sheet CLOs. As described by commenters, a balance sheet CLO securitizes loans already held by a single institution or its affiliates in portfolio (including assets originated by the institution or its affiliate), and an open market CLO securitizes assets purchased on the secondary market, in accordance with investment guidelines.

payments that could be made to a holder of an eligible horizontal residual interest ("EHRI").[11] Several comments were also received regarding the other asset classes, particularly CRE. Finally, commenters made a number of technical suggestions with respect to the proposed risk retention options for asset-backed commercial paper ("ABCP") conduits, municipal bond repackagings (also known as tender option bonds), and revolving pool securitizations (commonly known as master trusts and used for credit card securitizations) that they believed were critical to enabling these securitization structures to continue to be used as in the current market.

SUMMARY OF FINAL RULE

A. Scope and Applicability

The final rule applies to sponsors of ABS. Risk retention requirements apply regardless of whether a sponsor is an insured depository institution, a bank holding company or subsidiary thereof, a registered broker-dealer, or other type of entity. In circumstances where two or more entities each meet the definition of sponsor for a single securitization transaction, one of the sponsors must retain the entire amount of credit risk required; however, each sponsor is responsible for ensuring compliance with the risk retention requirements. Additionally, the final rule permits a sponsor to allocate its risk retention obligations to the originators[12] of the securitized assets in certain circumstances and subject to certain conditions.

B. General Risk Retention Requirement

Consistent with section 15G, the final rule generally requires a sponsor to retain an economic interest equal to at least 5 percent of the aggregate credit risk of the assets collateralizing an issuance of ABS and retains the ability for sponsors to hold risk retention in any combination of eligible vertical or horizontal interests. A sponsor can satisfy its risk retention obligation under the vertical option by holding a portion of each class (tranche) of ABS interests issued as part of the securitization transaction or a single eligible vertical security representing the same

[11] EHRI is a first-loss exposure that has the most subordinated claim to payments of principal and interest by the issuing entity and, for any payment date on which an issuing entity has insufficient funds to pay all of its contractual interest and principal due, receives payments reduced by any shortfall prior to any reduction in amounts paid to any other ABS interest.

[12] The rule defines "originator" generally to be a person that "creates" an asset that collateralizes an ABS and sells the asset directly or indirectly to a securitizer or issuing entity. Only the original creditor under a loan or receivable – and not a subsequent purchaser or transferee – is an "originator" of the loan or receivable.

percentage of each class.[13] Under the horizontal option, a sponsor must hold an EHRI or cash in a specified type of reserve account. The final rule requires EHRI to be measured on a fair value basis and includes disclosure requirements to provide investors, regulators, and others with information as to the fair value calculation, including a description of assumptions and methodologies used to determine the fair value of the retained interest.

C. Transaction-Specific Risk Retention Options

The final rule offers risk retention options that may be used for certain types of ABS structures as follows:

Commercial Mortgage Backed Securities ("CMBS")

Consistent with section 15G and the proposals, the final rule permits the CMBS first-loss position (or "B-piece") to be retained by a third-party purchaser that conducts due diligence on each asset in the asset pool before the issuance of the CMBS and meets the same standards for risk retention as the securitizer. The B-piece may be sold to and held by up to two third-party purchasers, if certain conditions are satisfied. The final rule permits, as an exception to the transfer and hedging restrictions, a sponsor or an initial third-party purchaser to transfer the B-piece to another third-party purchaser beginning 5 years after the date of closing of the securitization transaction. Subsequent third-party purchasers are then permitted to transfer the retained interest to other third-party purchasers.

The final rule allows third-party purchasers to combine interests with the sponsor to satisfy risk retention requirements in circumstances where the third-party purchasers hold the B-piece and the sponsor retains any additional required retention. For this risk retention option, the CMBS transaction documents must mandate the appointment of an independent operating advisor that is required to act in the best interest and for the benefit of investors as a collective whole. Additionally, the final rule requires the special servicer (the servicer that has the right to service assets upon the occurrence of one or more specified conditions) to consult with the operating advisor on all material decisions in connection with servicing the securitized assets when the B-piece has a principal balance of 25 percent or less of its initial principal balance. The operating advisor is required to review the actions of the special servicer and have the authority to

[13] ABS interest is defined to mean most types of interests or obligations issued by an issuing entity, other than equity that is issued primarily to evidence ownership of the issuing entity and the payment of which is not principally dependent on the cash flows of collateral held by the issuing entity.

recommend that the special servicer be replaced. Replacement of the special servicer requires an affirmative vote of a majority of the outstanding principal balance of all ABS interests voting on the matter, with a minimum quorum as specified in the transaction documents, but not more than 20 percent of the outstanding principal balance of all ABS interests in the issuing entity, with a minimum of three ABS interest holders that are not affiliated with each other.

Government Sponsored Entities ("GSEs")

In the final rule, the guarantee provided by Freddie Mac or Fannie Mae (each, a GSE), when acting as a sponsor, would satisfy the risk retention requirements, provided the GSE is operating under the conservatorship or receivership of FHFA with capital support from the U.S. Government. Similarly, an equivalent guarantee provided by a limited-life regulated entity that succeeds to the charter of a GSE also would satisfy the risk retention requirement if the entity operates under the authority and oversight of FHFA with capital support from the U.S. Government.

Open Market CLOs

The final rule provides a risk retention option for an open market CLO (i) whose assets consist only of senior, secured syndicated loans constituting CLO-eligible loan tranches[14] that are acquired directly from the sellers thereof in open market transactions and servicing assets, (ii) that is managed by a CLO manager, and (iii) that holds less than 50 percent of its assets, by aggregate outstanding principal amount, in loans syndicated by lead arrangers that are affiliates of the CLO or originated by originators that are affiliates of the CLO. Under this risk retention option, the 5 percent risk retention requirement could be satisfied by lead arrangers of loans purchased by the CLO rather than the CLO manager. A "lead arranger" is the institution that: is active in the origination, structuring, and syndication of commercial loan transactions and played a primary role in the structuring, underwriting, and distribution on the primary market of the CLO-eligible loan tranche; took an allocation of the syndicated credit facility under the terms of the transaction that includes the CLO-eligible loan tranche of at least 20 percent of the aggregate principal balance at origination, which allocation constitutes the largest allocation of any

[14] A "CLO-eligible loan tranche" is a term loan tranche of a syndicated credit facility to a commercial borrower where a minimum of 5 percent of the face amount of the CLO-eligible loan tranche is retained by the lead arranger until the earliest of the repayment, maturity, involuntary and unscheduled acceleration, payment default, or bankruptcy default of the CLO-eligible tranche and where loan tranche holders have certain voting rights and the applicable agreements satisfy certain other requirements.

syndication member at origination; and is identified at the time of origination in the agreement governing the CLO-eligible tranche.

Agencies considered comments regarding CLO managers' inability to retain risk, what they believed to be the unworkable nature of the alternative lead arranger option, and legal issues related to whether CLO managers meet the definition of sponsor. The Agencies also considered options put forth by the CLO industry for exemptions from risk retention. These included allowing CLO managers to hold about 40 to 50 basis points in risk retention while codifying certain industry best practices; creating a new category of "qualified" leveraged loan that would be exempt from risk retention; giving risk retention credit for managers' contingent fees; and allowing a third party to retain risk. The Agencies continue to believe CLO managers are sponsors and that requiring CLO managers or lead arrangers to retain risk largely as proposed will help ensure high quality underwriting of assets purchased by CLOs and ensure more meaningful risk retention than the options proposed by commenters.

Municipal Bond Repackagings

The final rule allows two risk retention options for certain municipal bond repackagings, known as tender option bonds.[15] The final rule permits the sponsor of a qualified tender option bond entity to satisfy its risk retention requirements by holding standard vertical or horizontal interests; by retaining a residual interest that, upon issuance, meets the requirements of an EHRI, but that, upon the occurrence of a "tender option termination event," as defined in Section 4.01(5) of IRS Revenue Procedure 2003-84, will meet the requirements of an eligible vertical interest; or by holding municipal securities from the same issuance of municipal securities deposited in the qualified tender option bond entity, the face value of which retained municipal securities is equal to at least 5 percent of the face value of the municipal securities deposited in the qualified tender option bond entity. The sponsor is also permitted to hold any combination of these options. Among other items, the final rule requires that a qualifying tender option bond entity have a legally binding commitment from a regulated liquidity provider to provide 100 percent guarantee or liquidity coverage for all of the issuing entity's outstanding tender option bonds.

[15] These structures allow the tax-exempt status of the securitized bonds to be passed through to the holders of ABS as long as they comply with certain requirements outlined in IRS Revenue Procedure 2003-84. The ABS, which are short term instruments, are frequently purchased by money market funds.

Revolving Pool Securitizations (formerly Revolving Master Trusts)

A revolving pool securitization is defined as an issuing entity that is established to issue on multiple issuance dates more than one series, class, subclass, or tranche of ABS that are collateralized by a common pool of securitized assets that will change in composition over time (such as credit card receivables or dealer floor plans) and does not monetize excess interest and fees from its securitized assets. Sponsors of revolving pool securitizations have a significant incentive to ensure continuation of the structure indefinitely by contributing well-performing assets in order to ensure continued financing for their operations. In addition, the seller's interest allowed by this option must be maintained during the life of the securitization.

For these reasons and in response to comments, the final rule expands the types of seller's interests and horizontal forms of risk retention available to revolving pool securitizations and, as a technical matter, allows this option to be used by any type of legal entity, regardless of whether it is organized as a trust. Under this option, the final rule allows the sponsor to satisfy the risk retention requirement by maintaining a transaction level seller's interest[16] measured on a face value basis, whether pari passu or subordinated to other ABS. In addition, the seller's interest may be combined with a series level seller's interest or horizontal forms of risk retention. The horizontal risk retention under this option, which must be measured on a fair value basis, may include an interest meeting the requirements of EHRI (with certain exceptions to accommodate revolving pool characteristics) or a residual interest in excess interest and fees that meets certain requirements, or a combination of the two. In addition, certain assets are required to be excluded when measuring the seller's interest, the sponsor may not monetize excess spread, retention may be held only by the sponsor or its wholly owned affiliates (not majority-owned as is generally permitted with other retention options), and there is no sunset applicable to the transfer and hedging restrictions for retention held in these structures.

ABCP Conduits

The final rule, like the proposals, provides a separate risk retention option for an ABCP conduit that is supported by receivables originated by one or more originators and that meets certain other conditions designed to ensure the option is not available to aggregators or securities

[16] Seller's interest is defined as an ABS interest collateralized by the portion of the pool of assets underlying the securitization transaction that is not allocated to make payments to other investors.

arbitrage ABCP programs.[17] Where an ABCP conduit is fully supported by a liquidity facility provided by a prudentially regulated domestic financial institution (or by a foreign financial institution satisfying certain criteria) and owns no assets other than ABS interests collateralized solely by assets or leases originated by a company (the "originator-seller") or a majority-owned affiliate of such company and servicing assets[18], and satisfies certain other requirements, the final rule, like the revised proposal, allows the sponsor of the conduit to satisfy the risk retention requirement if, for each ABS that the ABCP conduit acquires from an intermediate special purpose vehicle, the related originator-seller or one of its majority-owned affiliates retains risk in the same form, amount, and manner as would be required under the standard risk retention or revolving pool securitization options.[19]

D. Transfer of Risk Retention

Allocation to the Originator

Consistent with section 15G, the final rule permits a sponsor to reduce its risk retention requirement by the portion of any risk retention assumed by an originator of the securitized assets, provided that the originator contributes at least 20 percent of the underlying asset pool. In addition, the sponsor may not allocate to an originator a portion of its required risk retention amount that exceeds the percentage of the securitized assets contributed by the originator. By limiting this option to originators that have originated at least 20 percent of the asset pool, the rule seeks to ensure that the originator retains risk in an amount significant enough to function as a meaningful incentive for the originator to monitor the quality of all assets being securitized (and to which it would retain some credit risk exposure).

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[17] In general, securities arbitrage ABCP programs purchase securities (rather than receivables and loans) from originators and typically have more limited liquidity coverage than the ABCP conduits eligible to rely on the ABCP option.

[18] The term servicing assets is defined as rights and other assets designed to assure the servicing or timely distribution of proceeds to ABS interest holders and rights or other assets that are related or incidental to acquiring and holding the issuing entity's securitized assets.

[19] The final rule's requirements as to full liquidity coverage provide that, in the event that the ABCP conduit is unable for any reason to repay maturing ABCP issued by the issuing entity, the liquidity provider shall be obligated to pay an amount equal to any shortfall, and the total amount that may be due pursuant to the liquidity coverage shall be equal to 100 percent of the amount of the ABCP outstanding at any time plus accrued and unpaid interest (amounts due pursuant to the required liquidity coverage may not be subject to credit performance of the ABS held by the ABCP conduit or reduced by the amount of credit support provided to the ABCP conduit, and liquidity support that only funds performing receivables or performing ABS interests does not meet the requirements of this section).

Hedging, Transfer, and Financing Prohibitions

The final rule generally prohibits a sponsor from selling or transferring any interest or assets that it is required to retain under the rule to any person other than a majority-owned affiliate or, in the case of a revolving loan securitization, a wholly owned affiliate. However, hedge positions that are not materially related to the credit risk of the particular securitization transaction would be permitted. Permitted hedges would include positions related to overall market interest rate movements, currency exchange rates, or indexes that include ABS interests, subject to concentration limits applicable to the portion of ABS issued by the issuing entity or the sponsor and its affiliates represented in the index. The rule also permits hedges tied to securities that are backed by similar assets originated and securitized by other sponsors.

The final rule also prohibits a sponsor or any affiliate from pledging as collateral for any obligation, any interest or asset the sponsor is required to retain, unless the obligation is with full recourse to the sponsor or affiliate. Additionally, an originator, originator-seller, or a third-party purchaser that retains credit risk in accordance with the final rule would be required to comply with the hedging prohibition to the same extent as the sponsor.

Finally, the rule incorporates hedging and transfer expiration timeframes, or sunsets, as proposed. For residential mortgage-backed securities, these prohibitions expire on the later of 5 years after the securitization closes or the date on which the unpaid principal balance of the securitized assets is reduced to 25 percent of the original balance, but in any event no later than 7 years after the securitization closes. For all other transactions, these prohibitions expire on the later of 2 years after the securitization closes or the date on which the total unpaid principal of the securitized assets or ABS interests are reduced to 33 percent of the original balance.

E. Exceptions and Exemptions

QRMs

The final rule aligns the QRM definition with the definition of a QM. The CFPB issued a final QM rule on January 10, 2013, and finalized supplemental QM rules in May 2013 (together the "Final QM Rule").[20] The Final QM Rule was effective January 10, 2014. In general, a QM loan must have the following features:

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[20] See 78 FR 6408 (January 30, 2013), entitled "Ability-to-Repay and Qualified Mortgage Standards under the Truth in Lending Act (Regulation Z). The CFPB subsequently proposed and finalized supplemental QM rules. See 78 FR

(i) Regular periodic payments that are substantially equal;

(ii) No negative amortization, interest only, or balloon features;

(iii) A maximum loan term of 30 years;

(iv) Total points and fees that do not exceed 3 percent of the total loan amount;

(v) Payments underwritten using the maximum interest rate that may apply during the first 5 years after the date on which the first regular periodic payment is due;

(vi) Consideration and verification of the consumer's income and assets (including employment status, if relied upon), current debt obligations, alimony, and child support; and

(vii) Total debt-to-income ("DTI") ratio that does not exceed 43 percent, including mortgage-related obligations.

In recognition of the current mortgage market, the CFPB finalized a second temporary QM definition which requires that the mortgage satisfy the requirements of clauses (i), (ii), (iii), and (iv) above, and also be eligible for purchase, guarantee, or insurance by a GSE or certain U.S. Government agencies. The CFPB also developed additional QM provisions with greater underwriting flexibility (i.e., no quantitative DTI ratio applies) for certain small creditors if the loan is held in portfolio for at least 3 years.

The Agencies believe that aligning the definition of QRM with the definition of QM achieves an appropriate balance between limiting credit risk for the protection of investors, as required under section 15G, and preserving credit access. Moreover, the aligned definition facilitates clarity for all participants in the mortgage market, as well as compliance, and reduces associated costs by providing the mortgage market the benefit of a uniform regulatory framework for underwriting residential mortgages.

Qualifying Commercial, CRE, and Automobile Loans

Underwriting standards for qualifying commercial loans, CRE mortgages, and automobile loans, described below, are largely unchanged from the revised proposal. Consistent with section 15G, the final rule provides a zero percent risk retention requirement for ABS issuances collateralized solely by qualified assets of a single asset class and by servicing assets. As set forth in the revised proposal, for ABS issuances of the same asset class that are not solely collateralized by

35430 (June 12, 2013). The CFPB's regulations implementing section 129C of the Truth in Lending Act are codified at 12 CFR part 1026.

qualifying assets, the final rule reduces the 5 percent risk retention requirement by the pro-rata amount of qualifying assets in the underlying collateral, but not to less than a 2.5 percent risk retention requirement.

Qualifying Commercial Loans

The qualifying commercial loans underwriting standards include, but are not limited to:

- Verification and documentation of the borrower's financial condition;
- Analysis of the borrower's ability to service overall debt obligations during the next 2 years;
- Determination that based on 2 years' projections the borrower's total liabilities ratio will be 50 percent or less, leverage ratio will be 3.0 times or less, and debt service coverage ("DSC") ratio will be 1.5 times or greater;
- For secured commercial loans, a perfected security interest or recorded lien and covenants regarding the maintenance of, and ability to grant additional liens on, collateral;
- Loan payments must be determined based on level monthly payments of principal and interest (at the fully indexed rate) that fully amortize the debt over a term no longer than 5 years from origination; and
- The primary repayment source for the loan is the borrower's business operating revenue.

Qualifying CRE Loans

The qualifying CRE loans underwriting standards require a loan to, among other things:

- Be supported by an enforceable first lien on the CRE and improvements, with, in general, a perfected lien on the borrower's interest in associated tangible and intangible property;
- Not exceed a 25-year amortization term, or 30 years for a qualifying multi-family property;
- Satisfy a minimum DSC ratio of 1.5 times if the loan is a qualifying leased CRE loan, 1.25 times if the loan is a qualifying multi-family property loan, or 1.7 times for all other CRE loan types; and
- At origination, have a LTV ratio and combined LTV ratio of no greater than 65 percent and 70 percent, respectively, or if the appraisal used a capitalization rate that is less than or equal to the 10-year swap rate plus 300 basis points, a LTV and combined LTV of 60 percent and 65 percent, respectively.

Qualifying Automobile Loans

The qualifying automobile loans underwriting standards include, but are not limited to:

- Prior to origination, the originator must determine and document that based on a credit report within 30 days of origination, that the borrower was not currently 30 days or more past due on any debt obligation; not 60 days or more past due within the past 24 months; and not the subject of any bankruptcy, foreclosure, or similar proceeding within the previous 36 months;

- Prior to origination, the originator must verify and document that the borrower has at least 24 months of credit history;

- Upon origination of the loan, the borrower's monthly DTI ratio is required to be less than or equal to 36 percent, based on verified income and outstanding debt;

- At closing, the borrower is required to make a down payment from personal funds and trade-in allowance, if any, that is at least equal to 10 percent of the vehicle purchase price and other fees and products purchased in connection with the vehicle purchase;

- The loan terms must specify a fixed interest rate and provide for level monthly payments that fully amortize the loan over the loan term; and

- The maturity date must not exceed the lesser of 6 years from the origination date or 10 years minus the difference between the current model year and the vehicle's model year.

General Exemptions

Section 15G requires the Agencies to provide a total or partial exemption from the risk retention requirements for certain types of securitization transactions: (i) residential, multi-family, or healthcare facility mortgage loan securitizations that are themselves, or that are collateralized by assets that are, insured or guaranteed by the U.S. or an agency of the U.S; (ii) securitization transactions that are collateralized solely by loans or other assets made, insured, guaranteed, or purchased by an institution that is subject to the supervision of the Farm Credit Administration, including the Federal Agricultural Mortgage Corporation, and servicing assets; (iii) ABS issued or guaranteed by any state or U.S. possession, or by any political subdivision of a state or U.S. possession, or by any public instrumentality of a state or U.S. possession that is exempt from the registration requirements of the Securities Act of 1933 under Section 3(a)(2) of that Act; (iv) ABS that meet the definition of qualified scholarship funding bonds under the Internal Revenue Code; (v) ABS collateralized by obligations of the U.S. Government (or an agency thereof) or assets that are fully guaranteed or insured by the U.S. Government (or an agency thereof); and (vi) ABS fully guaranteed or insured by the U.S. Government (or an agency thereof).

Section 15G permits the Agencies to adopt or issue additional exemptions, exceptions, or adjustments if the exemptions, exceptions, or adjustments would help ensure high-quality underwriting standards and encourage appropriate risk management practices, improve access to credit on reasonable terms, or be in the public interest and for the protection of investors. Consistent with these provisions, the final rule exempts: (i) any re-securitization transaction collateralized solely by servicing assets and tranches of ABS transactions that comply with, or are exempt from, the risk retention requirements, and is structured as a single class of ABS interests entitled to the pass-through of principal and interest payments received on the underlying ABS; (ii) any re-securitization transaction collateralized solely by servicing assets and first-pay classes[21] of ABS (for which required credit risk was already retained or which were exempt from risk retention) collateralized by first-lien residential mortgages on properties located in the U.S., as long as they are structured to reallocate prepayment risk and not credit risk, do not include inverse floaters or similarly structured ABS interests, and do not provide for any ABS interests issued in the securitization to share in principal losses other than on a pro-rata basis; (iii) ABS collateralized solely by seasoned loans meeting certain requirements;[22] (iv) ABS secured by the intangible property right to collect charges for the recovery of specified costs and such other assets, if any, of an issuing entity that is wholly-owned, directly or indirectly, by an investor-owned utility company that is subject to the regulatory authority of a state public utility commission or other appropriate state agency; (v) FDIC-sponsored securitizations when acting as conservator or receiver; (vi) community-focused lending[23] securitizations; (vii) qualifying 3-

[21] First-pay class means a class of ABS interests for which all interests in the class are entitled to the same priority of payment and that, at the time of closing of the transaction, is entitled to repayments of principal and payments of interest prior to or pro-rata with all other classes of securities collateralized by the same pool of first-lien residential mortgages until such class has no principal or notional balance remaining.

[22] The requirements are that the loan has not been modified since its origination and has not been delinquent for 30 days or more. With respect to ABS collateralized by residential mortgage loans, a seasoned loan is a loan that has been outstanding and performing for the longer of 5 years or until the outstanding principal balance of the loan has been reduced to 25 percent of the original principal balance. Notwithstanding the aforementioned criteria, a residential mortgage loan is considered seasoned if it has been outstanding and performing for at least 7 years. Additionally, with respect to all other loan types, a seasoned loan is a loan that has been outstanding and performing for the longer of 2 years or until the outstanding principal balance of the loan has been reduced to 33 percent of the original principal balance.

[23] Community-focused lending refers to (i) loans made pursuant to a program administered by a state Housing Finance Agency; (ii) loans made by a Treasury-designated Community Development Financial Institution; (iii) loans made by certain HUD-designated Downpayment Assistance through Secondary Financing Providers; (iv) loans by certain HUD-designated Community Housing Development Organizations; and (v) loans by certain non-profit organizations that extend credit no more than 200 times annually, provide credit only to low-to-moderate income consumers, and follow their own written procedures to determine reasonable ability to repay.

to 4-unit mortgage loans; and (viii) ABS collateralized solely by servicing assets and student loans made under the Federal Family Education Loan Program ("FFELP") that are guaranteed as to 100 percent of defaulted principal and accrued interest. The risk retention requirement is reduced to 2 percent for a securitization transaction collateralized solely by servicing assets and FFELP loans guaranteed to at least 98 percent, and reduced to 3 percent for any other securitization transaction collateralized solely by servicing assets and FFELP loans.

OTHER NOTABLE CHANGES FROM THE PROPOSED RULE

Periodic Review of QRM

The final rule requires the Agencies to periodically review the definition of QRM to take into account developments in the residential mortgage market. The rule requires the Agencies to review the QRM definition 4 years after the effective date and every 5 years thereafter. Also, any agency can request a review at any time if it specifies a reason. The purpose of the scheduled reviews is to determine whether the QRM definition should be modified or continue to fully align with QM. The rule establishes a 6-month timeframe for completion of any review and a 12-month timeframe for completion of any rulemaking (if it is determined necessary), in each case unless extended by the Agencies.

Restrictions on Payments to Holders of EHRI

The final rule does not include the restrictions contained in the revised proposal on projected cash flow to the EHRI. The Agencies determined that the restrictions would not operate without significant risk of unintended consequences. The Agencies did not identify a restriction mechanism that would function effectively across asset classes without undue impact on a particular asset class. However, the final rule requires rigorous disclosure and restricts transferring or hedging risk retention. If the Agencies observe that the assumptions and methodologies used to calculate risk retention undermine the alignment of sponsor and investor interests, the Agencies will consider whether modifications to the rule are needed.

Community-Focused Lending Securitizations

The final rule exempts certain community-focused residential mortgages that are exempt from the ability-to-repay rules under the Truth in Lending Act ("TILA"). As such, they do not qualify to be QMs under TILA, and, in turn, do not qualify for QRM status. Without this (or some other) exemption, if these lenders chose to securitize, they would be required to hold risk retention. Commenters expressed concerns that the result could be reduced credit availability for low- to moderate-income ("LMI") households.

These lenders are government-certified, originate loans under government-administered programs, or are small non-profit programs that have a specific community mission. The Agencies determined that these lenders' primary mission of providing safe, affordable, sustainable loans to LMI borrowers will continue to ensure high-quality underwriting, which will also help protect investors. These lenders' primary mission helps to improve access to credit on reasonable terms for borrowers and is in the public interest. The final rule requires the Agencies to periodically review this exemption under the same timeframes as the QRM review to consider whether it should be modified.

Qualifying 3- to 4-Unit Mortgage Loans

The final rule also exempts certain owner-occupied 3- to 4-unit mortgage loans that are exempt from the ability-to-repay rules under TILA because they are not covered transactions.[24] As such, they do not qualify to be QMs under TILA, and, in turn, do not qualify for QRM status. In the proposal, the Agencies understood that covered transactions could include owner-occupied, one to four unit residential properties.[25] The Agencies also understand that market practice is to generally categorize residential mortgage securitizations as those with one-to-four unit properties and that 3- to 4-unit properties are frequently securitized along with one and two unit properties. The Agencies are concerned that excluding 3- to 4-unit mortgage loans that otherwise meet all of the other criteria for QM could have a negative effect on funding and access to credit for loans secured by these properties. Therefore, the Agencies determined that certain owner-occupied, 3- to 4-unit mortgages that meet the same requirements under the QM rule as 1- and 2-unit properties (but are not subject to the ability-to-pay rule under TILA because the credits are considered business purpose loans) should be exempt from risk retention. The exemption applies to ABS collateralized solely by qualifying 3- to 4-unit mortgage loans or to ABS blended with

[24] Regulation Z Official Interpretations (12 CFR part 1026 Supplement I, paragraph 3(a)(5)(i)) specify that a credit extended to acquire a rental property that is or will be owner-occupied within the coming year and that has more than two housing units is deemed to be for business purposes and therefore, the loan is not a consumer credit transaction or covered transaction under Regulation Z.

[25] See 78 FR 57928, 57991, 58037), September 20, 2013

qualified residential mortgages. The exemption the Agencies are providing for permitting the blending of QRMS with non-QRMs is limited in scope in that the qualifying 3- and 4-unit mortgage loans constitute a small part of the overall market and must be subject to the exact same underwriting and product standards set forth in QM that result in lower losses. The final rule requires the Agencies to periodically review this exemption under the same timeframes as the QRM and community-focused residential mortgage exemption reviews to consider whether it should be modified.

Revised Valuation for Vertical Interest

The final rule does not require vertical risk retention to be measured using fair value as proposed in the revised proposal. Commenters noted, and the Agencies agreed, that a fair value calculation is not necessary because a 5 percent interest in the cash flow of each class would always be equivalent to 5 percent of the value of each class.

Modified Fair Value and Other Disclosures

The rule contains modified disclosure requirements to address commenter concerns (including concerns regarding disclosure of proprietary information) and industry practices, while balancing benefits to investors. Among other things, a sponsor is permitted to use data as of a cut-off date not more than 60 days prior to the date of first use of the fair value calculation with investors (or 135 days if the issuer makes distributions on a quarterly or less frequent basis).

Other Changes

- **Quorum to Remove CMBS Special Servicer** – The final rule increases the quorum required to remove the special servicer from 5 percent to not more than 20 percent of the outstanding principal balance of all ABS interests in the issuing entity, with a minimum of three ABS interest holders that are not affiliated with each other. The 5 percent quorum was determined to be too low, potentially allowing a single investor to remove a special servicer.

- **Tenor of Commercial Paper and Tender Option Bonds Tender Notice Period** – The final rule increases the permitted tenor of commercial paper that could be issued by an eligible ABCP conduit from 9 months to 397 days and increased the permitted notice period for tenders of bonds under the tender option bond option from 30 days to 397 days. These changes are consistent with what is generally the maximum maturity of instruments in which money market funds invest and provisions of the Volcker rule.

- **Certifications Related to Open Market CLO Option -** The final rule contains modified certification requirements for the lead arranger and CLO manager in response to concerns expressed by commenters as to the scope of the certifications included in the revised proposal.

- **Modification of Certain Restrictions Related to Eligible ABCP Option –** Instead of requiring the ABCP conduit sponsor to make disclosures related to the fair value of the ABS interests held by the ABCP conduit, the ABCP conduit sponsor must now disclose the percentage amount of risk retention held by each originator-seller and the form of such retained interest. The final rule also permits the transfer of ABS interests between eligible ABCP conduits with the same regulated liquidity provider; the inclusion of assets acquired by originator-sellers and their majority-owned affiliates in business combination transactions; and "orphan trusts" (entities with nominal equity owned by trust or corporate service provider specializing in providing independent ownership of special purpose vehicles) to be the issuers of the ABS interests acquired by an eligible ABCP conduit.

- **Modification of Certain Requirements as to Special Asset Classes -** The final rule changes the payment requirements relating to commercial and CRE loans from a straight line amortization to a level monthly payment requirement. Additionally, the final rule allows improved ground-leased CRE and CRE owned for less than 2 years by the borrower to be eligible for the qualifying CRE asset class exemption.

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