



Risk Retention Re-Proposal

December 6, 2013

Importance of this meeting

- Issues discussed today affect the entire securitization market
- Attendees at this meeting include representatives of auto ABS issuers to emphasize the importance of ABS to:
 - Manufacturers
 - Dealers
 - Jobs
 - Our US and global economy

Agenda

- Representative Sample
- Eligible Horizontal Residual Interest (EHRI)
 - Key Issues of the Fair Value Approach
 - Limitations on EHRI Distributions
 - Revolving Transactions – Self Adjusting Approach
 - Simplified Approach for Simplified Structures
 - Relief for Truly Private Transactions
- Qualifying Auto Loan Exemption
- Floorplan
- Other Points

Representative Sample

- FDIC Safe Harbor has permitted representative sample method
- Banks and others have used representative sample approach for last few years
 - It's working, and these sponsors have found this alternative to be cost-effective
- Coordination with CRD 122a
- Necessary for many accounting sale transactions
- This method is extremely important to many of our members
 - Willing to go beyond Safe Harbor requirements if necessary to get regulators comfortable with approach
- Participation Interests also provide a simple and inexpensive method
 - We'd like an opportunity to discuss this in more detail later

EHRI – Key Issues of the Fair Value Approach

- Significant improvement over original proposal, but still has issues that require work
- Risks from disclosure of expected loss and other projections
 - Overreliance by investors on sponsor loss projections and fair value calculations
 - If you're doing a good job of predicting, you'll underestimate losses half the time
 - Reputational risk/investor perceptions if some of your deals are “underperforming”
 - Will result in systematic overstatement of losses, thereby reducing the fair value
 - Legislative intent of Risk Retention was to align issuer and investor interests, not create these issues
- Complexity and cost for sponsors with consolidated SPEs
 - Vast majority of auto ABS deals are on balance sheet
- Range of values under GAAP, not a single value
- “Chicken and egg” timing problem.
 - Structure of Securities to be sold and waterfall must be determined before the offering
 - Don't know fair value until pricing
 - Could have different pricing dates for senior and subordinated securities
- Does not work for revolving transactions
- Liability risks may require a Safe Harbor for these projections

EHRI - Limitations on EHRI Distributions

- Apples vs oranges
 - Comparison of all cash flows with just principal repayment
 - Fair value/discounted dollars (CDPCFR) vs nominal dollars (CDPPRR)
- Problematic for many established structures:
 - Simple, proven, plain vanilla auto ABS structures that maintain substantially more than 5% risk retention over their lives
 - Structures with significant excess spread
 - Issuers who only issue very senior (i.e., AAA and A) bonds with much more than 5% overcollateralization
- Timing: Calculations can't be made at the time bonds are structured (before marketing the transaction)
- Revolving transactions with reinvestment of principal
- Better to use a direct measure rather than limit distributions

EHRI - Revolving Transactions - Self Adjusting Approach

- Most revolving transactions are not in master trusts, including warehouse facilities
- Re-proposal does not offer a risk retention option that works for these common structures
 - These structures are used extensively by auto finance companies and are an important component of liquidity for them
- Can't project future cash flows without knowing the assets to be in the deal in the future.
- Commitments typically get renewed, so you don't know when amortization will begin
- Proposed Self Adjusting Approach to EHRI:
 - Testing at each time additional assets are added (or incremental amounts are invested)
 - At each testing date, the residual interest must be at least 5% of the total amount of all ABS interests (or securitized pool balance)
 - No distributions to residual holder if it would reduce the residual interest below 5%
 - Testing to be done as if no future assets are added and that the deal amortizes thereafter
 - Intended to mirror what really happens in revolving transactions

EHRI - Simplified Approach for Simple Structures

- Possible conditions were listed in our letter:
 - ABS principal amount sold to third parties $< 95\%$ of securitized pool balance
 - Asset WAC (or discount rate) $>$ ABS WAC
 - ABS are just traditional interest bearing securities (i.e., no I/Os)
 - Residual interest is a traditional equity interest
- Very important to our members
 - Many sponsors intend to structure their deals to be sufficiently “obvious” to avoid disadvantages of Fair Value
 - Many are willing to hold more than 5% for a simpler alternative

EHRI - Relief for Truly Private Transactions

- Some transactions involve investors negotiating their own note purchase agreement
 - No offering memo
 - Due diligence
- In these transactions, a substantial expansion of disclosure would be required at unnecessary cost
- Likely result is that these transactions would not be structured as securitizations
 - Issuer would not get the benefit of a lower cost of funds
 - Investors might not get benefit of bankruptcy-remote structure

Qualifying Auto Loan Exemption

- Some requirements are inconsistent with prime auto loan origination:
 - Down Payment
 - Debt-to-Income
 - Data Verification
- Blended Pools
- We'd be happy to have a separate meeting to discuss the details of the QAL exemption

Floorplan

- Critical to auto issuers to have a workable means of risk retention for floorplan transactions
 - Floorplan master trusts typically have a seller's interest that is not *pari passu*
 - Special Horizontal Interest requires a minor change or clarification to be an option for established floorplan master trusts
 - We don't intend to discuss in detail today, but wish to emphasize the importance of this issue to our members
- Floorplan transactions are important to auto finance companies, as well as to the manufacturers, dealers and the economy

Other General Issues

- Certification Requirements

- Dodd-Frank provides for certification only for ABS *“collateralized exclusively by”* QRMs
 - Certification should be required only for RMBS
 - For RMBS transactions, should be required only for QRM transactions exempt from standard risk retention
- Provide only to SEC and bank regulators
 - Rule 193 and Regulation AB Item 1111(a)(7) are already required
 - Rule 15Ga-1 requires reporting of repurchases
 - Repurchases are already required for inclusion of non-qualifying assets
- Retain certification for no longer than five years
 - Consistent with SEC retention requirements for signature pages

- Need for a No-Action Letter/Interpretive Process

- Innovation in the ABS market will necessarily result in new structures and related interpretive issues
- Very difficult to get six agencies to convene and focus on individual transactions