October 30, 2013

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[*12 CFR Part 43, Docket No. OCC-2013-0010, RIN 1557-AD40*]

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
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Washington, DC 20549-1090
[*17 CFR Part 246, Release Nos. 34–70277, RIN 3235–AK96*]

Robert deV. Frierson
Secretary
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[*12 CFR Part 244, Docket No. R-1411, RIN 7100-AD70*]

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Attn: Comments/RIN 2590-AA43
Federal Housing Finance Agency
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[*12 CFR Part 1234, RIN 2590–AA43*]

Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
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[*12 CFR Part 373, RIN 3064-AD74*]

Regulations Division
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451 7th Street SW, Room 10276
Washington, DC 20410-0500
[24 CFR Part 267, RIN 2501–AD53]

Re: CREDIT RISK RETENTION

To Whom It May Concern:

The American Financial Services Association ("AFSA")[1] submits this letter to comment on the Qualified Auto Loan ("QAL") portion of the re-proposed Credit Risk Retention rule ("Proposed Rule") released jointly by the Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System ("Board"), the Federal Deposit Insurance Corporation ("FDIC"), the Securities and Exchange Commission ("SEC"), the Federal Housing Finance Agency ("FHFA"), and the Department of Housing and Urban Development ("HUD") – collectively "the Agencies."

[1] AFSA is the national trade association for the consumer credit industry, protecting access to credit and consumer choice. Its more than 350 members include consumer and commercial finance companies, auto finance/leasing companies, mortgage lenders, mortgage servicers, credit card issuers, industrial banks and industry suppliers.

We appreciate the opportunity to comment on the Proposed Rule as part of the on-going process to finalize the requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). We also appreciate that the Proposed Rule reflects some of the comments and concerns that were submitted around the initial draft rule. However, our members continue to harbor deep concerns over the substance of the Proposed Rule for many of the same reasons that we expressed in our initial comment letter. Our focus in this letter is the impact of the Proposed Rule on the vehicle finance industry.

Many of AFSA's members issue asset-backed securities ("ABS") as a critical source of corporate funding and liquidity, which allows them to provide consumer credit products to the general public. The securitization markets are an important source of credit to U.S. households and businesses and state and local governments. The Dodd-Frank Act recognizes the importance of affordable, available credit – of the type historically provided by the securitization markets – to the general recovery and growth of the U.S. economy. In fact, Section 941 of the Dodd-Frank Act explicitly requires the Agencies to adopt implementing rules which, among other things:

- consider "the potential impact of the risk retention obligations on the access of consumers and businesses to credit on reasonable terms,"[2] and

- "improve the access of consumers and businesses to credit on reasonable terms[.]"[3]

AFSA's membership includes key participants in the automotive finance industry, covering retail, dealer floor plan and fleet financing and leasing. The automotive industry has historically operated on a fundamentally different model from other lenders and does not follow the "originate to distribute" model which is credited with creating much of the misalignment of interest between originators and sponsors of ABS and investors. In fact, the automotive finance industry has not been considered to be a material contributor to the recent economic crisis.

In our letter, we suggest some changes to the risk retention section of the Propose Rule as it relates to vehicle finance. We encourage the Agencies to substantially revise the Qualifying Automobile Loan (QAL) standard. It seems that the focus on the QAL underwriting standards and loan characteristics are more appropriate for mortgage loans than automobile loans. Additionally, the proposed QAL standard is extremely narrow and unduly harsh, so AFSA is suggesting an alternative approach. AFSA also strongly believes that the exclusion of motorcycles from the QAL should be removed. Lastly, AFSA asks for additional clarification for equipment and machinery finance.

I. Risk Retention - §____.4

AFSA certainly appreciates the fact that the Agencies reviewed and modified the earlier proposed regulations in ways that we believe will achieve the goals of mitigating risk when appropriate, but without adversely impact the availability and cost of credit to consumers, or causing undue disruption to the markets. That being said, we also believe significant flaws

[2] Exchange Act, § 15G(d)(2)(C)
[3] Exchange Act, § 15G(e)(2)(B)

remain in this Proposed Rule. We discuss the challenges associated with the QAL definition below, but there are also substantial issues in other areas. Here is a brief sample:

First, from both policy and operational perspectives, the calculation of fair value and the certifications and calculations required with respect to eligible horizontal retained interests (EHRIs) and internal controls raise a number of concerns for vehicle finance companies. Calculation of fair value under generally accepted accounting principles (GAAP) does not result in a definitive answer, but rather a range of values. The calculation of "fair value" to determine sponsors' required risk retention amounts is often a fluid and changing number, especially over time. And because the Proposed Rule sets forth two different points in time for fair value determinations, there may be significant confusion for purchasers. Moreover, many issuers would conduct these fair value analyses using proprietary models, making the requirement to describe the methodology used by the issuer problematic. Last, the fair value calculations will likely require issuers to disclose loss projections, something issues of vehicle securitizations have almost never done historically, and which could significantly increase exposure to the issuer, in the event that their estimates are "wrong." Many sponsors who consolidate their issuing entities do not do fair value calculations today, so requiring them just for risk retention would be a significant burden and expense.

Further, the Closing Date Projected Cash Flow Rate/Closing Date Projected Principal Payment Rate Calculation required by the Proposed Rule, is also problematic. For example, some deal structures set up to have increasing overcollateralization over time (generally viewed as something that should reduce the credit risk for investors) have difficulty meeting the requirements of this calculation.

Given the multitude of transaction types and structures that make up today's financing markets and the continual innovation in this area, we ask that the Agencies pursue a final rule that is more flexible while still fostering the important goals of risk retention. Potential changes include: making additional alternative options available for holding the required risk retention (including the reinstatement of representative sampling methods, and the addition of participating interests and third party credit support as alternative methods) and craft exemptions to the proposed risk retention scheme to address differences in deal structures and regulatory regimes across asset classes.

We also propose a lower minimum threshold risk retention amount (perhaps to 1%, as an example) for blended pools may better serve the goals of risk retention. Under the Proposed Rule, issuers have little incentive to include more than 50% of qualifying assets such as QALs into a particular transaction.

II. Housing-Centric Criteria

The core issue with the Proposed Rule continues to be that housing-centric criteria are used as part of the new QAL standard. As drafted, a great deal of the focus is on underwriting standards and loan characteristics that are more appropriately considered in the context of other asset classes. While there are some similarities in the way that auto loans are underwritten versus home loans, there are more differences than commonalities. For one, few (if indeed any) vehicle creditors operated under the "originate to distribute" model that was widespread in the mortgage

industry. Therefore, many of the potential root causes of issues or problems in mortgage securitizations were not, and are not, present in vehicle securitizations. Moreover, unlike homes, vehicles can be readily and quickly liquidated in the event (of a rare) repossession. Unlike other asset classes, automotive lenders often rely on proprietary methods to evaluate and price loans and leases that are not comparable to the underwriting standards and requirements set forth in the Proposed Rule. Indeed, what is contained in the new QAL rule runs counter to many standard industry underwriting practices.

III. QAL Standard - §____.18

The proposed definition of QAL is too narrow. To begin, the criteria are unduly harsh and restrictive overall. Some members believe that not a single vehicle loan originated under their current underwriting criteria will meet the proposed definition; other members believe that only the very smallest percentage (perhaps 1%) would qualify. In light of the strong performance of vehicle securitizations during the recent economic downturn, this seems particularly punitive, especially when compared to the proposed definition of "Qualifying Residential Mortgages" ("QRM," (§____.13) in which a much higher percentage of home loans would qualify as QRMs based on current underwriting criteria. There seems to be no rational basis to restrict QALs to a very small percentage of originations and/or force vehicle lenders to completely change their processes/systems (at great expense), especially when no one claims that vehicle securitization were any cause of the financial downturn and in fact, vehicle securitizations performed exceptionally well, even during the worst economic conditions since the Great Depression.

Additionally, the underwriting standards for qualifying automobile loans and underlying loan level definitions fail to take into account the legal requirements and business considerations for the automotive finance industry. For example the income and employment verification standards are extreme. Industry practice is that income and employment verification is primarily conducted on only the most marginal of credit applicants.

Below are AFSA's comments on specific sections of the QAL standards.

- *§____.18 (a)(1)(iii).* The use of the debt-to-income ratio ("DTI") as a measure of a customer's ability to repay an automobile loan is highly unusual. The fact that most vehicle lenders do not require income verification has NOT had an adverse effect on actual loan performance. The almost universal standard used in automobile loan underwriting is a payment-to-income ("PTI") measurement. Vehicle finance companies generally do not use DTI because: (1) PTI has shown to be a stronger predictor of vehicle loan performance than DTI, (2) automobile loans (with a strong PTI) will perform differently in bankruptcy (from those with a strong DTI), (3) borrowers will prioritize paying the automobile loans over other loans, and (4) DTI calculations take an inordinate amount of time which is highly inconvenient to consumers who expect their loan approval process to take only a few minutes. Unlike home loans with considerably higher loan balances, which can take weeks to underwrite, vehicle loan applications (particularly those for higher credit quality applicants) are often processed in minutes and income documentation is generally not obtained for higher credit tiers. To saddle lenders who choose to securitize with onerous verification requirements puts them at a significant

competitive disadvantage to lenders that do not need to rely on the securitization markets for funding. If a prime consumer can receive a decision in minutes from Lender A (and without having to cobble together debt and income verification data), there would seem little incentive for that prime consumer even to explore options with Lender B, which does require the consumer to prove his/her debt/income.

  - AFSA suggests that if the Agencies decide that DTI or PTI "validation" is needed, the Agencies allow a creditor to rely on data in a credit report.

  - We also note that the difficulties of validating remain whether the validation occurs at the time of origination or prior to securitization. There are several reasons why it would be difficult to validate after origination but prior to securitization. For example, prime customers would likely not want to offer up income validation weeks or months after the loan was originated.

- *§____.18 (a)(3).* The down-payment requirement is another housing-centric factor being mis-applied to the auto loan underwriting process. While we appreciate that regulators modified the 20% down-payment requirement to 10%, the fact remains that many vehicles are purchased without any down-payment at all yet still perform with low default rates. Again, something that is not currently a standard industry practice for auto loans is being applied to the auto loan process. Most vehicle lenders base down-payment requirements only on the vehicle purchase price. The Proposed Rule imposes additional requirements that any down-payment also cover: (i) the FULL amount of title, tax, registration; (ii) dealer imposed fee; and (iii) full price of any optional products purchased.[4] In addition to imposing a "de facto" down-payment requirement of higher than 10%, these data points are not typically tracked by vehicle lenders beyond the physical contact, and doing so would impose significant and expensive system enhancements. We therefore ask that the down-payment requirement be removed. However, if the Agencies continue to include a down-payment requirement, the down-payment requirement only should only be calculated from the vehicle's purchase price.

- The disallowance of proprietary credit scoring systems as a proxy requires arduous checks on borrower delinquencies, bankruptcy filings and other "derogatory factors" on a manual basis versus a proprietary credit scoring system which is automated and efficient. Proprietary credit scoring systems may also be more complete and less subjective. Since there is currently no automated way to get that type of information in an automated fashion, this would add unnecessary time and resources to the underwriting process. The Agencies should re-evaluate their decision and allow for the use of proprietary scoring systems in the QAL underwriting standards. Investors have said that they are comfortable

[4] The requirement that a QAL have a down-payment equal to the full cost of additional service products, insurance, etc. is unnecessary. These products are, as a general rule, cancelable or refundable. So, if the underlying collateral is repossessed, the creditor can cancel the unearned portion of the fee paid for an optional product which will be credited to the loan balance.

with the use of proprietary scoring systems in underwriting standards. The Board's own study even found that credit scores are predictive of credit risk.[5]

- *§____.18 (a)(5) and (6).* The Proposed Rule requires the terms of the loan agreement for QALs provide a maturity date for the loan that does not exceed the lesser of: (i) six years from the date of origination, or (ii) 10 years minus the difference between the current model year and the vehicle's model year. Regarding the former, AFSA believes that a standard of six years from the date of first payment would be preferable. Regarding the latter, this requirement has the effect of minimizing the number of used vehicles eligible.

We suggest that the Agencies permit payment deferrals in the QAL criteria. Many times customers, even prime customers, need an occasional break or extension to address extenuating circumstances. The customer can then stay current for the remaining term of the loan. While AFSA members are very careful when they grant such extensions, under the right circumstances, it can help members turn around a bad situation. Rarely does it seem to "postpone the inevitable." Used correctly, it can be a tool to help a customer catch up with other things, deal with emergencies, such as weather-related events like Superstorm Sandy or furloughs due to government shutdowns.

IV. Alternative QAL

An alternative approach to the definition set forth in the Proposed Rule is to focus on the securitization's entire asset pool based upon specified pool characteristics. Automotive finance assets are generally homogeneous within their respective subclasses. As compared to other asset classes covered by the Proposed Rule, automotive finance assets are short term, less sensitive to interest rate fluctuations, rarely refinanced and collateralized by an underlying asset that is easily and quickly liquidated following repossession. These characteristics suggest that a focus on loan-by-loan origination characteristics to forecast a securitization asset pool's future performance is inappropriate. Additionally, nothing in Section 15G of the Exchange Act requires that every loan in the collateralizing pool meet the definition of a qualified automobile loan definition for the ABS sponsor to be exempt from the risk retention requirement. This supports a conclusion that pool-level, rather than loan-level, definitions are appropriate. Accordingly, the final rule should establish criteria for qualifying automotive finance assets that establishes requisite standards at the pool level.

V. Exclusion of Motorcycles

In addition to what AFSA views to be inappropriate criteria as part of the auto loan underwriting process, the Proposed Rule still categorically omits certain vehicle classes regardless of how sound the underwriting, namely motorcycles. As proposed, the rule states that there are no underwriting standards for motorcycle loans, no matter how high those standards might be, that would qualify for a reduced risk retention requirement. This strikes us as an extreme stance, and one unsupported by the facts. In most cases, these loans are closed using the highest quality underwriting standards that we feel should not be subject to a 5% risk retention. In categorically

[5] "Report to Congress on Credit Scoring and Its Effects on the Availability and Affordability of Credit." Federal Reserve Board. August 2007. http://www.federalreserve.gov/boarddocs/rptcongress/creditscore/default.htm

excluding motorcycles from the Proposed Rule, even the most prudently underwritten motorcycle loans cannot be eligible for an exemption. Simply excluding a certain type of vehicle because it is different should not be the standard that is used.

Instead, the criteria should be based on the quality of the underwriting for that particular class of vehicles. There is no empirical data that a portfolio of motorcycle loans performs any worse than a similarly structured car-loan portfolio. There are two unsupported leaps/assumptions of logic one would need to make in order to agree with the proposed regulation: (1) motorcycles are used more often for "recreational" purposes; and (2) simply because motorcycles MIGHT be used more often for recreational purposes, a consumer is less likely to make timely payments on her motorcycle loan versus other obligations. The facts belie these assumptions in both cases. Indeed, as to the first point, many motorcycle riders rely on their motorcycle as the primary means of transportation. Further, and even more important, the mere fact that some riders use their motorcycles for recreation does not lead to adverse motorcycle loan performance.

The following table compares Net Loss[6] data from a wide swath of car loans to Net Loss data for motorcycle loans from one of our members. As you can see, through good times and bad (such as the recent recession), Net Losses on motorcycle loans are very similar to Net Losses on car loans. Therefore, motorcycle loans should not be categorically excluded from the QAL definition, and high-quality motorcycle loans should be just as eligible to be QALs as high-quality car loans.

Net Loss%, Car v. Motorcycle[7]

	Jul-08	**Jul-09**	**Jul-10**	**Jul-11**	**Jul-12**	**June-13**
Net Loss % on Car Loans	2.89%	3.01%	1.44%	1.34%	1.23%	1.55%
Car Loan data from S&P U.S. Auto Loan ABS Tracker: August 2103 (published Sep. 13, 2013).						
Net Loss % on Motorcycle Loans	2.14%	2.69%	2.04%	1.06%	0.58%	0.80%
Motorcycle Loan data from 10Q filings of Harley-Davidson, Inc.	**June-08**	**June-09**	**June-10**	**June-12**	**June-12**	**June-13**

VI. Equipment and Machinery Industry Considerations

Equipment and machinery financing provides a vital source of credit to many U.S. commercial enterprises, including small businesses and farming or agricultural operations. Nonetheless, the

[6] "Net Loss" is defined as the dollars lost as a percentage of the total loan portfolio, after any repossession and sale of underlying collateral or other account credits.

[7] The data from the S&P report include both prime and subprime loans, as do the figures from Harley-Davidson (which does not differentiate performance of prime versus subprime performance in its public documents). We certainly understand that the Proposed Rule seeks to have only prime originations eligible for QAL, however, the point of the data is merely that a portfolio of motorcycle loans (including prime/subprime) performs similarly to a wide portfolio of prime/subprime auto loans. Further, the S&P data are pulled from multiple securitization trusts with multiple vintages and ageing, whereas the Harley-Davidson data relate to its entire managed consumer portfolio. While not a perfect "apples to apples" comparison, the point is simply that motorcycle loans can perform very similarly to auto loans, and loan underwriting matters much more than the underlying collateral in these cases.

Proposed Rule is silent as it relates to this significant segment of the market. Historically, ABS issuances backed by such equipment and machinery finance assets have performed without material losses for ABS investors, similar to historical performance for ABS issuances collateralized by automotive finance assets.[8] This strong performance is based, at least in part, on factors such as "differences in market practices and conventions, which in many instances exist for sound reasons related to the inherent nature of the type of asset being securitized."[9]

Section 15G(c)(2)(B) directs the Agencies to issue regulations which "establish asset classes with separate rules for securitizers of different classes of assets, including residential mortgages, commercial mortgages, commercial loans, auto loans, and any other class of assets" deemed appropriate by the Agencies. Many classes of commercial loan assets fall squarely within the definition of commercial loan in the Proposed Rule (§____.14). However, it is essential for an additional subcategory of commercial loans to be separately defined to take into account equipment and machinery finance assets. The Proposed Rule should also include appropriately defined criteria for an exclusion from risk retention requirements for qualified equipment and machinery financing assets. The definition and exclusion should establish standards that recognize the strong, historical performance of ABS issuances collateralized by machinery and equipment finance assets and consider the industry-specific processes and standards that apply in their origination.

The definition of commercial loan and the requirements for a qualified commercial loan exemption from risk retention set forth in the Proposed Rule are focused solely on traditional commercial loan assets underlying typical collateralized loan obligations. Clarity for the equipment and machinery finance industry is necessary to ensure that this subcategory of commercial assets is not unduly burdened with respect to other commercial asset classes.

We expect that other commenters will provide detailed input to the Agencies regarding Equipment and Machinery ABS and equipment and machinery loans, and we encourage the Agencies to consider our comments, as well as comments provided by others, relating to the need for further revision of the re-proposal as it relates to Equipment and Machinery ABS.

VII. Conclusion

The consequences that would likely result if changes are not made to the latest iteration of the QAL portion of the QRM rule are that fewer vehicle finance companies would use securitizations. The main reason is that the unusual, housing-centric underwriting criteria would force vehicle finance companies either to retain the full 5% mandated by regulation (at significant expense) or to completely overhaul the way they underwrite an auto loan, again something that would result in significant costs. In turn, vehicle finance companies' ability to compete with banks would be compromised leaving consumers with fewer options and higher

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[8] See Board of Governors of the Federal Reserve System, Report to the Congress on Risk Retention p. 63 (Oct. 2010) (noting that ABS collateralized by equipment loans and leases "have displayed strong performance throughout the financial crisis" and that "the short maturity of the underlying equipment loans means that the level of credit enhancement increases over the life of the security.").

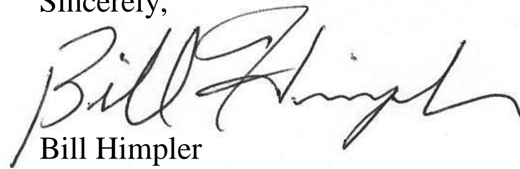
[9] *Id.* at p. 83.

costs. This would be felt by vehicle dealers as well. And, taken to the next logical step, fewer vehicles will be sold, harming economic growth and job-creation.

For those reasons, AFSA respectfully requests that the Agencies re-align the latest QAL proposal to move away from a housing-focused set of underwriting criteria to one that better fits the current, well-established conventions of auto loan underwriting.

We look forward to working with the Agencies on this Proposed Rule. Please contact me by phone, 202-466-8616, or e-mail, bhimpler@afsamail.org, with any questions.

Sincerely,



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