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Legislative and Regulatory Activities Division
400 7th Street SW
Suite 3E–218, Mail Stop 9W–11
Washington, DC 20219
Docket Number OCC–2013–0010

Securities and Exchange Commission
100 F Street NE
Washington, DC 20549–1090
Attn.: Elizabeth M. Murphy, Secretary
File Number S7–14–11

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551
Attn.: Robert deV. Frierson, Secretary
Docket No. R–1411

Federal Housing Finance Agency
Constitution Center, (OGC) Eighth Floor
400 7th Street SW
Washington, DC 20024
Attn.: Alfred M. Pollard, General Counsel
Comments/RIN 2590–AA43

Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429
Attn.: Comments, Robert E. Feldman, Executive Secretary
RIN 3064–AD74

Department of Housing and Urban Development
Office of General Counsel
Regulations Division
451 7th Street SW
Room 10276
Washington, DC 20410–0500
RIN 2501–AD53

Re: Credit Risk Retention Re-proposed Rule

Dear Mesdames and Sirs:

Bank of America Corporation ("Bank of America") appreciates the opportunity to submit this letter in response to the request of the Department of the Treasury, Office of the Comptroller of the Currency (the "OCC"), the Board of Governors of the Federal Reserve System (the "FRB"), the Federal Deposit Insurance Corporation (the "FDIC"), the Securities and Exchange Commission (the "SEC"), the Federal Housing Finance Agency, and the Department of Housing

and Urban Development (each an "Agency," and collectively the "Agencies") for comments regarding their second proposed rule regulating credit risk retention (the "Re-proposed Rule").[1]

Bank of America is one of the world's largest financial institutions and is actively engaged in facilitating the provision of credit to individual consumers, small and middle market businesses, and corporations. Since acting as the issuer of the first publicly registered offering of non-agency residential mortgage pass-through certificates in 1977, Bank of America has continued to act as a leader in the securitization market as an issuer itself and by providing underwriting, distribution, and advisory capabilities to clients. We believe that securitization helps individual consumers, small and middle market businesses, and corporations by supporting lending and allowing for an efficient redeployment of capital and new credit creation. Accordingly, we understand the significant impact that the regulatory framework described in the Re-proposed Rule will have on the securitization market and, as a result, on the provision of credit generally in both the primary consumer market and the commercial market.

On April 29, 2011, the Agencies proposed a rule (the "Original Proposed Rule")[2] regulating credit risk retention under Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act").[3] Bank of America suggested certain changes to the Original Proposed Rule in a comment letter submitted to the Agencies on July 13, 2011 (the "Bank of America Original Risk Retention Letter")[4] and a supplemental comment letter submitted on August 1, 2011 (the "Bank of America Original Risk Retention Supplemental

[1] Credit Risk Retention, 78 Fed. Reg. 57928 (proposed September 20, 2013) (hereafter "Re-proposed Rule").
[2] Credit Risk Retention, 76 Fed. Reg. 24090 (proposed April 29, 2011) (hereafter "Original Proposed Rule").
[3] Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, § 941, 124 Stat. 1376, 1891 (2010) (codified as amended at 15 U.S.C. § 78o-11).
[4] Bank of America Corporation, Comment Letter on the Credit Risk Retention Proposed Rule (July 13, 2011), *available at* http://fdic.gov/regulations/laws/federal/2011/11c84ad74.PDF (hereafter "Bank of America Original Risk Retention Letter").

Letter").[5] We thank the Agencies and their staff for their attention to the comments provided by Bank of America, as well as for their significant efforts in addressing those comments in the Re-proposed Rule.

While the Re-proposed Rule represents a significant positive step in addressing concerns articulated by Bank of America and other securitization industry participants in respect of the Original Proposed Rule, nevertheless we believe that certain additional changes are necessary. Our goal with this comment letter is to provide additional constructive recommendations that will ensure a risk retention requirement that will align incentives among the various parties in the securitization process without unduly and adversely affecting market functionality and, thus, the cost and availability of credit to consumers and businesses.

We remain concerned that aspects of the Re-proposed Rule could result in unintended consequences concerning credit availability and increased transaction costs. Unless the Re-proposed Rule is adjusted, it will be difficult for institutions that play a central role in restarting and reinvigorating the credit markets to continue to offer some of the necessary products and services they have traditionally provided. We believe that measured changes will result in solutions that are responsive to the realities of the marketplace and still encourage prudent origination practices. Similarly, if the Re-proposed Rule is adopted without adjustment and in a manner that is not sufficiently mindful of the realities of the marketplace, it may discourage appropriate risk mitigation transactions, needlessly increase the costs and inefficiencies borne by direct and indirect participants in the securitization market, and reduce credit availability to homeowners, consumers, small and middle market businesses, and corporations. As we stated in the Bank of America Original Risk Retention Letter, the alternative to securitization is a banking

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[5] Bank of America Corporation, Supplemental Comment Letter on the Credit Risk Retention Proposed Rule (August 1, 2011), *available at* http://www.fdic.gov/regulations/laws/federal/2011/11c84suppad74.PDF (hereafter "Bank of America Original Risk Retention Supplemental Letter").

market funded, to a larger degree, by deposits and wholesale funding—an outcome that would not best facilitate the restoration of credit or the efficient management of bank assets and liabilities. Reversion to such a model, in which banking organizations would increasingly finance long-term assets (such as the traditional thirty-year mortgage loans that are a staple of the residential home market) with shorter term liabilities (such as deposits), creates duration mismatching that has been viewed as a contributing factor to the savings and loan crisis of the 1980s. We believe the Re-proposed Rule reflects the Agencies' agreement with this concept in principle, and our comments are aimed at ensuring that the appropriate objective of risk retention, as set out in Section 941 of the Dodd-Frank Act, is not impeded through inadvertent measures intended to reduce perceived risk.

In the residential mortgage space, unless banks and other business organizations return to more normalized volumes of non-agency securitization activity, we suspect that high concentrations of credit risk will continue to reside with the Federal Housing Administration and the Government National Mortgage Association, institutions regulated by the Federal Housing Finance Agency (Fannie Mae and Freddie Mac) and, in some cases, supported by the United States Treasury and on the balance sheet of the Federal Reserve. Responsible, efficient, and transparent non-agency securitization markets could help gradually reduce concentrations of these risks in governmental agencies. While we believe that the qualified residential mortgages definition in the Re-proposed Rule and the elimination of the premium capture cash reserve account contained in the Original Proposed Rule will permit such a non-agency securitization market to develop, we believe that the Re-proposed Rule, like the Original Proposed Rule, contains certain unnecessary requirements that will inhibit the development of that market.

Similarly, other consumer asset classes, such as credit card or automobile loans, have weathered the recent financial crisis and are currently performing well. We are concerned that the Re-proposed Rule, while representing a substantial improvement over the Original Proposed Rule, continues to present issues which, if unresolved, could unnecessarily disrupt these markets and the consumer financing they facilitate.

## I. Executive Summary

As noted above, there are numerous provisions in the Re-proposed Rule that should be modified in order to prevent unintended negative consequences for homeowners, consumers, small and middle market businesses, and corporations. This comment letter discusses those provisions and offers what we believe are constructive recommendations for improvement. Many of our comments relate to specific asset classes and securitization structures. Some of our comments relate to critical substantive matters, while other comments are technical in nature. From our comments, several recurring themes emerge. Those themes are intended to ensure that the risk retention rule ultimately adopted by the Agencies (the "Final Rule"):

- Serves the intended policy purposes of the risk retention requirement;
- Permits greater flexibility in the manner by which risk may be retained;
- Provides risk retention rules that are more closely tailored to the characteristics of different types of asset classes and securitization structures; and
- Specifies a formal process for providing implementation guidance and resolving the interpretive questions under the Final Rule.

This letter is divided into two main parts. The first part consists of our comments of general applicability to all asset classes and securitization structures. The second part of the letter is subdivided into sections relating to particular topics as follows:


- Residential Mortgage Backed Securities Page 31
- Commercial Mortgage Backed Securities Page 43
- Revolving Asset Master Trusts Page 50
- Auto Loans Page 68
- Resecuritization Page 77
- Municipal Bond Repackaging/Tender Option Bonds Page 79
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- International Transactions Page 103


For further ease of reference, a complete table of contents is included at the end of this letter in Appendix A and an index of defined terms is included in Appendix D.

## II. General Comments

Bank of America has certain comments on the Re-proposed Rule that are applicable to multiple asset classes. This section will address the Re-proposed Rule's use of a fair value concept, the cash flow restrictions applicable to eligible horizontal residual interests, the 2.5% minimum risk retention requirement for blended asset pools, new certifications that would be required under the Re-proposed Rule, the concept of permitting *pari passu* interests in assets as a form of risk retention, the proposed classification of non-economic residual interests as ABS interests (as defined in Section __.2 of the Re-proposed Rule), and the need for a mechanism for providing interpretive guidance under the Final Rule.

### A. Fair value

Bank of America acknowledges and appreciates that the Agencies removed from the Re-proposed Rule the "premium capture cash reserve account" concept, which created significant problems for many asset classes. In connection with such removal, the Re-proposed Rule proposes that the required risk retention amount be measured by fair value: "The fair value of the amount retained by the sponsor . . . must equal at least 5 percent of the fair value of all ABS interests in the issuing entity issued as part of the securitization transaction, determined in accordance with [generally accepted accounting principles]."[6] The Re-proposed Rule also requires disclosure of fair value and related calculations. We consider the replacement of the "premium capture cash reserve account" concept with the fair value concept as a significant improvement. However, the fair value concept in the Re-proposed Rule raises troubling issues that need to be addressed.

Because of the complexities and variations involved in fair value determinations under generally accepted accounting principles ("GAAP"), and the lack of sufficient benefit to

[6] Re-proposed Rule § __.4(b)(1), 78 Fed. Reg. at 58027. *See also* Re-proposed Rule, 78 Fed. Reg. at 57934.

investors, Bank of America believes that the Agencies should revise the Re-proposed Rule as described below with respect to the fair value calculations and the fair value disclosures.

Fair value under GAAP is, by any measure, a complex and sophisticated determination. The standards for measurement of fair value under GAAP are lengthy and have seen substantial revision over time. As the Agencies have recognized,[7] GAAP fair value is not intended or designed to be a single number, but rather to be a reflection of the market-based value or values of an asset. As a result, there may be several legitimate fair values for a particular asset, some or all of which may vary over time, especially if under the GAAP fair value measurement hierarchy the fair value of an asset is being determined by projections and assumptions rather than a market price.

With respect to the fair value calculations, the Re-proposed Rule provides that the "fair value of the ABS interests in the issuing entity (including any interests required to be retained in accordance with this part) must be determined as of the day on which the price of the ABS interests to be sold to third parties is determined."[8] In many types of securitizations, the structure, price and class sizes will depend, in part, on the size of the risk retention piece. For example, a sponsor desiring to utilize the third-party purchaser option must determine and include in the related offering documents the stated par value amount of the eligible horizontal residual interest.[9] Because that size will depend on the fair value of all ABS interests issued, it is necessary to determine that fair value in connection with setting the structure and preparing the related offering documents. For this reason, the Final Rule should allow the determination of fair

[7] *See* Re-proposed Rule, 78 Fed. Reg. at 57938.
[8] Re-proposed Rule § __.4(b)(1), 78 Fed. Reg. at 58027.
[9] Also, as described below, the Re-proposed Rule requires the fair value of the eligible horizontal residual interest to be disclosed to potential investors "a reasonable period of time prior to the sale." Re-proposed Rule § __.4(d)(1), 78 Fed. Reg. at 58027.

value to be “within a reasonable time period prior to the day on which the price of the ABS interests to be sold to third parties is determined.”

Another concern with respect to fair value calculation is the complexity and variations of possible values. Because, as described above, the fair value determination may have to be made prior to the day of pricing of the ABS interests, an independent observable market price may not yet be available and, under the GAAP fair value hierarchy, fair value would be determined from pre-pricing information. In the absence of a recent and closely comparable market price, fair value is likely to be determined on the basis of discounted cash flow projections or similar methods, which could vary from the ultimate sale price and would require the sponsor to make several required assumptions, including material assumptions regarding interest, default, recovery and prepayment rates, as well as correlation across assets within the pool and, for revolving pools, timing of reinvestments. Bank of America is concerned about the possible consequences a sponsor may face if it makes such a determination of fair value and the size of the required risk retention piece prior to pricing and the subsequent pricing information reflects a different fair value. In such a circumstance, the sponsor should not have liability for its GAAP based fair value determination and should not be required to recalculate the size of the required risk retention. For those reasons, the Final Rule should include a clear and unequivocal safe-harbor for the sponsor’s calculation of the required risk retention amount if made in good faith based on GAAP.

Additionally with respect to fair value calculations, even if the fair value determinations are deemed to be necessary to measure the size of required horizontal retention, they are not necessary to measure the amount of vertical risk retained. Under the Re-proposed Rule, an eligible vertical interest is “a single vertical security or an interest in each class of ABS interests

in the issuing entity issued as part of the securitization transaction that constitutes the same portion of the fair value of each such class."[10] A 5% *pari passu* piece of each ABS interest issued in a securitization transaction should be acceptable as an eligible vertical interest representing 5% of the fair value of all ABS interests without calculating the fair value of all ABS interests. With respect to each ABS interest, a 5% *pari passu* piece of that ABS interest is by definition 5% of the fair value of that ABS interest because, as a *pari passu* interest, it has equal rights to payments with the remainder of that ABS interest. One does not have to know the fair value of that ABS interest to know that the 5% *pari passu* piece of it is 5% of its fair value. It follows that a vertical piece (either as one piece or a piece of every issued ABS interest) that represents a 5% *pari passu* interest in each ABS interest issued is *de facto* equal to 5% of the aggregate fair value of all ABS interests.

With respect to the fair value disclosures, the Re-proposed Rule requires a sponsor utilizing the horizontal risk retention option to disclose to investors the fair value of the eligible horizontal residual interest and the methodology, key inputs and assumptions, including discount rates, recovery rates, prepayment rates and other reference data or historical information, used to calculate the total fair value of all ABS interests and the fair value of the eligible horizontal residual interest.[11] Similar disclosure is required with respect to retained vertical interests.[12] Because the Re-proposed Rule requires such disclosure to be provided prior to the time of sale of the ABS interests, and because in some cases, the calculation of fair value must be made prior to the time of sale, fair value is likely to be determined on the basis of discounted cash flow projections or similar methods involving assumptions and projections as described above. Disclosing these required assumptions and projections to investors will subject sponsors to a risk

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[10] Re-proposed Rule § __.2, 78 Fed. Reg. at 58026.
[11] Re-proposed Rule § __.4(d)(1), 78 Fed. Reg. at 58027.
[12] Re-proposed Rule § __.4(d)(2), 78 Fed. Reg. at 58028.

of claims from investors if the actual sales price of the securities or performance of the assets varies from those assumptions and projections. Additionally, the assumptions, projections and related models used in a discounted cash flow determination are often considered proprietary or commercially-sensitive information by many sponsors.

If retained in the Final Rule, this disclosure requirement would substantially "chill" the interest of sponsors in using securitization transactions as a financing alternative and drive sponsors to potentially less efficient forms of alternative financing thereby impairing the sponsor's ability to provide available and affordable financing to customers. Further, sharing such information with investors is contrary to the proper functioning of a market. A market price should be the result of a willing buyer and a willing seller negotiating a price based on each party's independent research and analysis of the value of the assets to be sold. Requiring the selling party to share its internal and proprietary analysis and determination of fair value with the purchaser upsets the balance required to reach a fair market price. A purchaser would certainly never consent to disclosure of its internal valuation of assets it is about to purchase just prior to negotiating a price. Similarly, neither should the seller.

The required disclosures provide little to no benefit to justify the negative aspects described above. Disclosure that a securitization transaction is subject to required risk retention, that such retention is determined in accordance with GAAP, and that the sponsor intends to comply with such requirements should be sufficient information for prospective investors; any additional information on the fair value of the retention piece or how it was calculated is not material and of questionable benefit. For these reasons, Bank of America strongly urges the Agencies to remove these disclosure requirements in the Final Rule. Instead of such disclosure to

investors, a sponsor should be required to make such information available upon request to the SEC and any "appropriate Federal banking agency."[13]

Without prejudice to Bank of America's view described above that disclosure of fair value and the methodology, key inputs and assumptions used to determine fair value should not be required, if the Final Rule retains such or similar disclosure requirements, the Final Rule should include a clear and unequivocal safe-harbor for such disclosure and any related assumptions and projections if made in good faith based on GAAP.

**B. Cash flow restrictions applicable to eligible horizontal residual interest**

The Re-proposed Rule requires a sponsor utilizing the horizontal risk retention option to calculate the Closing Date Projected Cash Flow Rate and the Closing Date Projected Principal Repayment Rate for each payment date and to certify to investors that the Closing Date Projected Cash Flow Rate for each payment date does not exceed the Closing Date Projected Principal Repayment Rate for such payment date.[14] For the reasons described below, Bank of America believes that the cash flow restriction imposed by such calculation should be eliminated along with the certification requirement.

The Re-proposed Rule's change to fair value to measure the size of required risk retention as opposed to par value as used in the Original Proposed Rule increases the size and value of the 5% horizontal retained risk for many asset classes. Additionally, the Agencies recognized that the use of fair value provides "greater clarity for the measurement of risk retention and [helps] prevent sponsors from structuring around their risk retention requirement

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[13] *See* Re-proposed Rule § __.2, 78 Fed. Reg. at 58025 (defining "appropriate Federal banking agency").

[14] Re-proposed Rule § __.4(b)(2), 78 Fed. Reg. at 58026–27. See Re-proposed Rule § __.4(a), 78 Fed. Reg. at 58026–27 for definitions of Closing Date Projected Cash Flow Rate and the Closing Date Projected Principal Repayment Rate.

by negating or reducing the economic exposure they are required to maintain."[15] The Agencies also recognized that "horizontal risk retention, as first-loss residual position, generally would impose the most economic risk on a sponsor" as compared with vertical risk retention.[16] Given the increased amount of retention and the anti-abuse effect of using fair value and given that eligible horizontal residual interests impose more risk on the sponsor than vertical interests, it is questionable why a further cash flow restriction on the eligible horizontal residual interest is necessary. Further, the test is structurally flawed in that it compares the rate of payment of principal and interest to the principal pay-down rate resulting in a distorted test that many structures used in current transactions would not meet. For example, in most commercial mortgage-backed securities ("CMBS") deals, the assets have bullet maturities and periods of little or no principal amortization. In such a deal, the Closing Date Projected Principal Repayment Rate for many payment dates would be zero, or very low, the result of which would be that the eligible horizontal residual interest would not be permitted to receive current interest. A similar result would occur in securitization transactions with revolving or reinvestment periods, such as CLOs, where it is expected that principal receipts from the underlying assets during such period will be applied to the acquisition of additional underlying assets.

This restriction on cash flow to the eligible horizontal residual interest effectively eliminates or substantially restricts otherwise permissible interest or yield to be paid to the eligible horizontal residual interest. These restrictions change the nature of the retained eligible horizontal residual interest from an alignment of sponsor and investor interests through shared risks and rewards to the eligible horizontal residual interest acting as credit support for the transaction. Under the cash flow test, collections that would otherwise be used to pay current

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[15] Re-proposed Rule, 78 Fed. Reg. at 57937.
[16] *Id.* at 57940.

interest to an eligible horizontal residual interest would instead presumably be used to pay, or remain available to pay on future payment dates, more senior investors. This changes the nature of the eligible horizontal residual interest to be more similar to credit support than risk retention. Therefore, Bank of America believes the cash flow restrictions proposed in the Re-proposed Rule are inappropriate given the intended purpose of the risk retention requirement under the Dodd-Frank Act.

As noted above, the amount of eligible horizontal residual interests required to be held has been increased by the use of a fair value calculation, horizontal retention imposes greater risk on sponsors than other forms of risk retention, and cash flow restrictions change the nature of risk retention to credit support. If, however, the Agencies still concluded that some restrictions on cash flows are necessary then we ask that the Final Rule be adjusted to fit existing market practices and provide flexibility. We propose that two options should be provided and that an eligible horizontal interest would be required to satisfy one. One test should be the alternative proposal test described in the Re-proposed Rule with the simple addition of a materiality standard and a change to clarify that the test is not applicable when the eligible horizontal interest is the only remaining ABS interest. The test would provide that "on any payment date on which any ABS interest other than the eligible horizontal interest remains outstanding, in accordance with the transaction's governing documents, the cumulative amount paid to an eligible horizontal residual interest may not materially exceed a proportionate share of the cumulative amount paid to all holders of ABS interests in the transaction. The proportionate share would equal the percentage, as measured on the date of issuance, of the fair value of all of the ABS interests issued in the transaction that is represented by the fair value of the eligible horizontal residual interest."

The materiality standard would provide for important flexibility that is needed to allow for immaterial variances between the timing of cash flows of the retained interest and that of the transaction as a whole. Given the wide array of asset classes and structures the rule is intended to cover, this flexibility would prevent serious structural changes or cash flow restrictions being applied to transactions that have minor cash flow variances from the test.

The other test we would propose is that on any payment date on which any ABS interest other than the eligible horizontal interest remains outstanding, in accordance with the transaction's governing documents, the cumulative amount of principal paid to an eligible horizontal residual interest may not materially exceed a proportionate share of the cumulative amount of principal or notional amount paid to all holders of ABS interests in the transaction. The proportionate share of principal in this test would equal the percentage, as measured on the date of issuance, of the stated principal or notional amount of all of the ABS interests issued in the transaction that is represented by the stated principal or notional amount of the eligible horizontal residual interest.

Because of the great variety of different structures in securitizations, one test does not fit all transactions. We believe that the majority of current securitization structures could satisfy one of these tests. We note that the Agencies' goal was to "prevent sponsors from structuring a transaction in which the eligible horizontal residual interest is projected to receive such a disproportionate amount of money that the sponsor's interests are no longer aligned with investors' interests."[17] We think this proposal more than meets that standard.

We also note that the Re-proposed Rule requires a sponsor to certify to investors that it has performed the calculations required by the cash flow test and that the cash flow test is met. We believe that the certification requirement should be eliminated in the Final Rule and replaced

[17] *Id.* at 57939.

with a requirement that the sponsor disclose to investors in the offering documents that it performed the cash flow test and that the cash flow test is met. As described in Section I.D.2 below with respect to other certification requirements, disclosing such information provides investors the protections of Federal securities laws with respect to truthfulness and sufficiency of the disclosures made. That protection should be sufficient with respect to the cash flow test.

### C. 2.5% floor on risk retention for blended asset pools

We welcome the change in the Re-proposed Rule that allows reduced risk retention for a securitization transaction involving a collateral pool that consists of both qualifying and non-qualifying commercial real estate ("CRE"), commercial, or automobile loans. We agree with the Agencies that a reduction to the risk retention requirement that is proportional to the ratio of the combined unpaid principal balance of qualified loans to the total unpaid principal balance of the loans in a pool should promote the origination of loans meeting the underwriting standards for qualified loans set forth in the regulation. Such proportional reduction also should mitigate the potential liquidity problem that could result from isolating qualified loans from the rest of the market by granting an exemption only for pools consisting of 100 percent qualified loans. However, the Agencies' proposal to limit this proportional reduction by creating a 2.5 percent risk retention minimum for blended pools would unnecessarily limit the effectiveness of the proposed proportional reduction.

If the Final Rule includes a minimum retention requirement of 2.5 percent for blended pools, any pool consisting of more than 50 percent but less than 100 percent qualified loans will be subject to a 2.5 percent risk retention requirement, with no incremental reduction in the retention requirement as the percentage of qualified loans approaches 100 percent of the pool. Such a limitation would reduce the incentive for sponsors to create the fully blended pools that the Agencies have recognized increase market liquidity and ultimately lower costs to borrowers.

Sponsors are not likely to include additional qualified loans in blended pools once the 50 percent threshold has been reached. Similarly, the 2.5% floor is a disincentive to originators to originate high quality loans as their percentage of qualified loans originated reaches 50%. The 2.5% floor actually punishes originators that have as their business model the origination of mostly qualified loans. All of these results severely limit the effectiveness of the proposed proportional reduction in promoting the origination and securitization of qualified loans.

Additionally, if, despite that disincentive, a sponsor does include qualifying assets in excess of that 50 percent threshold, the 2.5 percent floor has the effect of imposing a 5% risk retention requirement on those additional qualifying loans, which seems inconsistent with Section __.15(a), which states that loans that meet the underwriting standards and other requirements referenced in Section __.15(a) "shall be subject to a 0 percent risk retention requirement."[18]

**D. New certifications**

The Re-proposed Rule includes new requirements that obligate sponsors seeking an exemption from the risk retention rules across a broad range of asset classes to provide investors with the related depositor's certification of its internal supervisory controls for ensuring that the underlying assets are qualified assets. Bank of America believes that such requirements (1) are not required by Section 941 of the Dodd-Frank Act, except as they apply to qualified residential mortgages, and (2) place unnecessary burdens and potential liabilities on sponsors without providing sufficient corresponding benefits to investors. For these reasons, Bank of America believes that revisions should be made to the Final Rule so that: (i) such certifications are required to be made by depositors only with respect to transactions involving qualified residential mortgages ("QRMs", each, a "QRM"); and (ii) sponsors are required to provide such

[18] *Id.* at 58038.

certifications only to the SEC and the sponsor's appropriate Federal banking agencies (as currently defined in the Re-proposed Rule),[19] if any.

### 1. Certification requirement should apply only to QRM-related transactions

Under the Re-proposed Rule, the depositors of securities backed by certain types of qualified assets—residential mortgage loans,[20] commercial loans,[21] CRE loans,[22] and automobile loans[23]—are required to certify that they have "evaluated the effectiveness of [their] internal supervisory controls with respect to the process for ensuring that all assets that collateralize the asset-backed securit[ies] are qualified . . . assets and [have] concluded that [their] internal supervisory controls are effective."[24] Sponsors are further required under the Re-proposed Rule to provide these certifications, or cause them to be provided, to potential investors within "a reasonable period of time prior to the sale of asset-backed securities in the issuing entity, and upon request, to the SEC and its appropriate Federal banking agency, if any."[25]

The only legislative support for such new certification requirements can be found in Section 941(e)(6) of the Dodd-Frank Act, which provides that "the [SEC] shall require an issuer to certify, for each issuance of *an asset-backed security collateralized exclusively by qualified residential mortgages*, that the issuer has evaluated the effectiveness of the internal supervisory controls of the issuer with respect to the process for ensuring that all assets that collateralize the asset-backed security are qualified residential mortgages."[26] This language applies to QRMs

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[19] *See* Re-proposed Rule § __.2, 78 Fed. Reg. at 58025 (defining "appropriate Federal banking agency").
[20] Re-proposed Rule § __.13(b)(4)(i), 78 Fed. Reg. at 58037.
[21] Re-proposed Rule § __.16(a)(8)(i), 78 Fed. Reg. at 58039.
[22] Re-proposed Rule § __.17(a)(10)(i), 78 Fed. Reg. at 58041.
[23] Re-proposed Rule § __.18(a)(8)(i), 78 Fed. Reg. at 58042.
[24] Re-proposed Rule § __.13(b)(4)(i), § __.16(a)(8)(i), § __.17(a)(10)(i) and § __.18(a)(8)(i) , 78 Fed. Reg. at 58037–42.
[25] Re-proposed Rule § __.13(b)(4)(iii), § __.16(a)(8)(iii), § __.17(a)(10)(iii) and § __.18(a)(8)(iii), 78 Fed. Reg. at 58037–43.
[26] 15 U.S.C. § 78o-11(e)(6) (emphasis added).

only, and has no apparent applicability to exempt transactions securitizing commercial loans, CRE Loans and automobile loans. Section 941(e)(6) reflects Congress' concern about audit quality control of residential mortgage loans in the "originate to distribute" market, which is an issue not relevant to other markets. In light of the limited statutory authority for certification requirements, we ask that such certification requirements be removed from the exemption requirements for commercial loans (Section __.16(a)), CRE Loans (Section __.17(a)) and automobile loans (Section __.18(a)), and the related safe harbor conditions from such sections of the Re-proposed Rule.

### 2. Certifications should be made only to identified federal regulators upon request

Secondly, Bank of America believes that investors do not need these certifications in light of the substantial disclosures already made to investors by sponsors, originators, and sellers pursuant to existing Federal securities laws. The underwriting and due diligence processes employed for asset-backed securities are well documented in current offering disclosures, giving investors sufficient opportunity to weigh and determine for themselves the adequacy of a depositor's controls. Indeed, it is this information that is truly the most useful to an investor in deciding whether or not to purchase such securities. Rule 193[27] and the related amendments to Item 1111 of Regulation AB[28] promulgated by the SEC for publicly registered asset-backed securities offerings presently require the issuer or sponsor of an asset-backed security to review the pool of assets underlying the security, and to disclose the nature of that review along with the findings and conclusions of the review. Furthermore, Rule 15Ga-1[29] obligates sponsors and issuers of asset-backed securities to report statistics regarding repurchases of underlying assets as

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[27] 17 CFR § 230.193.
[28] 17 CFR § 229.111(a)(7) and (a)(8). *See* Issuer Review of Assets in Offerings of Asset-Backed Securities, 76 Fed. Reg. 4231 (amending 17 CFR § 229.1111 and adding 17 CFR § 230.193).
[29] 17 CFR § 240.15Ga-1.

a result of breaches of the applicable seller's or originator's representations and warranties, thus ensuring that investors will have access to quantitative data to help them determine if there have been material issues with supervision of the underlying assets in a sponsor's prior securitizations. In short, investors in both public and private asset-backed securities transactions already enjoy substantial protections under existing Federal securities laws with respect to the truthfulness and sufficiency of the disclosures made regarding depositors' internal supervisory controls and issuers' and sponsors' reviews of the underlying assets. This obviates the need for a further certification related to the same topic.

In addition to the foregoing, the Re-proposed Rule provides that if one or more of the assets included in the underlying pool fail to meet all of the Re-proposed Rule's criteria for qualifying assets, then a sponsor may avail itself of a safe-harbor by repurchasing the non-qualifying assets.[30] This safe-harbor also provides further protections to investors by encouraging sponsors to remove non-qualifying assets from the pool in the event that errors are made by sponsors or depositors in determining whether underlying assets are qualifying assets.

Finally, Bank of America believes that the delivery of the foregoing certifications directly to investors is problematic because it creates unknown liabilities to investors that fall outside the scope of the Federal securities laws. Relying on the Federal securities laws to protect investors benefits investors and all other parties to a transaction because the standards for liability have been well developed through a large body of Federal case law and legal scholarship. For these reasons, Bank of America strongly encourages the Agencies to eliminate the requirement that depositor certifications must be provided to investors.

While Bank of America believes for the reasons stated above that it is inappropriate to require that depositor certifications be provided directly to investors, it sees value (and benefits

[30] Re-proposed Rule § __.13(c), § __.16(b), § __.17(b) and § __.18(b) , 78 Fed. Reg. at 58037–43.

for investors) in requiring such certifications to be delivered to the SEC or the appropriate Federal banking agencies identified in the Re-proposed Rule. Bank of America also believes that the SEC and the appropriate Federal banking agencies identified in the Re-proposed Rule should continue to have an ongoing right to request copies of such certifications as currently permitted under the Re-proposed Rule.[31]

This arrangement would ultimately protect and benefit investors who elect to purchase securities in transactions exempt from the risk-retention rules by ensuring that depositors conduct the necessary corporate due diligence to certify that the assets underlying an asset-backed security are qualified assets. At the same time, the revised approach suggested above also would provide sponsors with additional evidence supporting their decisions to enter into transactions on a non-risk retained basis. Bank of America believes that such a proposal is a balanced compromise between promoting the purposes of the Dodd-Frank Act and avoiding unnecessary burdens and liabilities on sponsors and depositors.

**E. *Pari passu* interests in assets as a form of risk retention**

Under the Re-proposed Rule, a sponsor is required, subject to certain exceptions, to retain an "eligible vertical interest or eligible horizontal residual interest . . . equal [to] at least 5 percent of the fair value of all ABS interest in the issuing entity . . . ."[32] For the reasons described below, the Re-proposed Rule should also allow an eligible vertical interest to be held in "loan" form as a *pari passu* interest in each loan in the transaction. Depending on the size of each such *pari passu* interest the sponsor elects to retain, the *pari passu* interests could be the sole form of retention in a transaction, or could be used in combination with other forms of risk retention in a transaction as necessary to satisfy the 5% requirement. For example, if each such *pari passu* interest is 5%

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[31] *See* Re-proposed Rule § __.13(b)(4)(iii), § __.16(a)(8)(iii), § __.17(a)(10)(iii) and § __.18(a)(8)(iii) , 78 Fed. Reg. at 58037–43.

[32] *See* Re-proposed Rule § __.4(b), 78 Fed. Reg. at 58027.

of the related loan in the transaction, all such *pari passu* interests collectively would constitute a vertical retention piece of 5% and would satisfy the entire risk retention requirement. Likewise, if each such *pari passu* interest is 3% of the related loan in the transaction, all such *pari passu* interests collectively would constitute a vertical retention piece of 3%, and could be used in combination with other forms of risk retention to satisfy the 5% requirement. Also, it should not be a requirement that all *pari passu* interests are the same percentage of the respective ABS interests, but, in such a case, the *pari passu* interests collectively would constitute a vertical retention piece equal to the lowest percentage that any such *pari passu* interest represents in the related loan. For example, in a securitization with three assets, if the sponsor retains a 4% *pari passu* interest in one loan, and a 2% *pari passu* interest in each of the other loans, those retained *pari passu* interests would constitute a 2% vertical retention piece.

Further, the Re-proposed Rule should allow flexibility for a *pari passu* interest in a loan to be in different forms. A *pari passu* interest could be in the form of a *pari passu* participation interest in the loan, or in the form of a *pari passu* mortgage note secured (on a *pari passu* basis) by the same mortgage as the mortgage note owned by the securitization issuing entity. If in the form of a *pari passu* participation interest, it would be required to satisfy the requirements of the definition of "participating interest" in Section 860-10-40-6A of the FASB Accounting Standards Codification.

The Re-proposed Rule should also permit a "loan level" participation interest or a "pool level" participation interest. A "loan level" participation interest would be a participation interest in an individual loan, whereas a "pool level" participation interest would be one participation interest representing a *pari passu* interest in each of several loans. A pool level participation interest may be particularly beneficial as an option in securitization transactions involving

smaller assets where the cost of issuing a loan level participation interest in each loan may be prohibitive. Transactions involving fewer, but larger, assets, such as CMBS transactions, may be more conducive to loan level participation interests. CMBS transactions also would likely use the option of having a *pari passu* interest in the form of a *pari passu* mortgage note, as this is a structure currently used in CMBS transactions, as well as a *pari passu* participation interests, to divide very large commercial mortgage loans into different CMBS transactions to avoid concentration risk associated with a large loan in one transaction.

In the Re-proposed Rule, the Agencies stated that they had rejected participations as a permissible form of retention because they thought "there would be little to no economic benefit for allowing this option because the option is currently not used by the market and would unlikely be used."[33] We do not agree with this reasoning. First, there has not been a general risk retention requirement in effect, so sponsors have not had that risk retention requirement as a reason to structure these participation interests. Despite that, some types of securitizations, such as CMBS, do currently use the *pari passu* participation interest and *pari passu* mortgage note structures. In additional, retention in "loan" form represents the same credit risk to the holder as does retention in the form of a security, so allowing a sponsor to hold vertical retention in "loan" form (as an alternative to holding it in the form of a security) neither diminishes the amount of retained risk nor disadvantages investors. This "loan" form retention also provides several benefits. With a *pari passu* interest in each loan in a transaction, the interests of the sponsor and the interests of the investors are perfectly aligned, as the sponsor and the issuing entity will proportionally share in all collections and losses on each loan.

Another important reason to allow the flexibility offered by pari passu interests is that it is an extremely helpful alternative for sponsors who seek off-balance sheet treatment for their

[33] Re-proposed Rule, 78 Fed. Reg. at 58013.

securitizations. In some instances, "loan" form retention may allow off-balance sheet treatment where retention in the form of a security would make off-balance sheet treatment difficult. Further, holding assets in loan form rather than in the form of securities affords the sponsor better capital treatment with respect to the retention piece. An asset held in loan form often requires less capital retention under BASEL than the same asset held in a certificated form. This "loan" form retention provides definite benefits without negatively affecting investors and should be allowed in the Final Rule.[34]

**F. Classification of certain REMIC interests**

Bank of America believes that the Re-proposed Rule should be revised to exclude certain "REMIC" interests from the definition of ABS interest. For certain tax reasons, residential mortgage-backed securities ("RMBS") and CMBS securitizations often take the form of "real estate mortgage investment conduits" or "REMICs," as defined in the Internal Revenue Code.[35] As a general rule, a special purpose vehicle that holds and securitizes a pool of mortgage loans is subject to entity-level corporate taxation, even if the vehicle is formed as a pass-through entity for state law purposes.[36] Congress recognized that entity-level taxation was a major barrier to a vibrant mortgage-backed securitization market and in 1986 introduced the REMIC tax regime to remove that barrier and eliminate the entity-level taxation of mortgage loan securitization vehicles.

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[34] Note that this "loan" form of vertical risk retention is permitted under the risk retention requirements applicable to European sponsors, the guidance for which provides that retention of at least 5% of the nominal value of each of the tranches transferred to investors "may . . . be achieved by retaining at least 5% of the credit risk of each of the securitised exposures, if the credit risk thus retained with respect to such securitised exposures always ranks pari passu with, or is subordinated to, the credit risk that has been securitised with respect to those same exposures." *See* Committee of European Banking Supervisors, Guidelines to Article 122a of the Capital Requirements Directive 24 (December 31, 2010), *available at* http://www.eba.europa.eu/documents/10180/106202/Guidelines.pdf.

[35] I.R.C. § 860D.

[36] I.R.C. § 7701(i).

For an entity to qualify as a REMIC, and thus, not be subject to corporate level taxation, it must satisfy certain tests concerning its issued interests. In this respect, three REMIC requirements in particular are relevant to the risk-retention requirements under the Re-proposed Rule; namely, the nature of and the requirement to issue a single class of REMIC residual interests, the limitations associated with permitted holders of REMIC residual interests, and the REMIC tax requirements governing the permitted division of securitized mortgage loan cash flows.

A REMIC is authorized to issue only two types of interests. It may, and typically will, issue one or more classes of "regular interests" and it must issue one, and only one, class of "residual interests."[37] In most REMIC structures, the issued REMIC regular interests are entitled to substantially all of the economic cash flows attributable to the underlying securitized mortgage loan pool. Thus, each REMIC regular interest is structured as one of an assortment of permitted fixed income instruments, is treated under the Internal Revenue Code as indebtedness for federal tax purposes and is typically sold, or held for sale, to investors (e.g., a REMIC regular interest sold to investors that has a stated principal balance with interest payable thereon at a fixed or permissible variable interest rate).

By statute, under the Internal Revenue Code, the issued REMIC residual interest serves to capture the income tax consequences associated with the REMIC's securitization of its pool of mortgage loan assets.[38] That is, the REMIC residual interest captures the difference between the gross income recognized by the REMIC on its mortgage loan assets and the interest deductions allowed to the REMIC on its issued and outstanding REMIC regular interests which, as noted above, are treated as debt instrument for tax purposes.

[37] I.R.C. § 860D(a)(2), (3).
[38] I.R.C. § 860C.

The difference in each period between a REMIC's gross income and its deductions is taken into account by the holder of the REMIC residual interest on its own income tax return, similar to a holder of a partnership interest. Importantly, however, a REMIC residual interest is not required to be entitled to <u>any</u> cash flows from the REMIC. In fact, in most REMIC securitizations, the issued REMIC residual interest is not entitled to any (or is entitled to only an initial *de minimis*) cash flow from the REMIC, thus serving in most every way simply to take into account the income tax consequences from the REMIC's securitized mortgage loan pool. Because such REMIC residual interest securities are entitled to *de minimis* or no cash flow from the REMIC, but are required under the Internal Revenue Code to take into account the income tax consequences from the related securitized mortgage loan pool, they represent, in effect, the ownership of a net economic tax liability requiring the depositor to pay the acquiring party an "inducement fee" to accept ownership of the security. Under the Internal Revenue Code, these securities are characterized, and commonly known, as noneconomic residual interests ("NERs").[39]

In response to comments suggesting a technical correction to the definition of ABS interests to exclude NERs from the risk retention requirement, the Agencies state in the release accompanying the Re-proposed Rule that they "preliminarily believe that non-economic residual interests would constitute ABS interests."[40] Bank of America requests that the Agencies reconsider this position. Including these non-economic residual interests in the definition of ABS interests would have tax consequences for REMIC sponsors that are unrelated to the credit risk of the underlying collateral, may make it difficult or impossible for certain REMIC sponsors to comply with the requirements of the REMIC regulations, and would likely reduce the intended

[39] I.R.C. § 860E; 31 C.F.R. § 1.860E-1(c).
[40] Re-proposed Rule, 78 Fed. Reg. at 57935 n.32.

impact of the risk retention rules by reducing the aggregate fair value of ABS interests, thereby reducing the retention requirement in REMIC securitizations with NERs.

The problems created by applying the risk retention requirements to NERs will likely result regardless of whether the sponsor elects to hold a vertical or a horizontal interest to satisfy the risk retention requirements of the Re-proposed Rule. In the case of vertical retention, the sponsor would be required to hold five percent of the NER, although it is not clear how the sponsor could retain 5 percent of the fair value of a class that has a negative value. And in the case of horizontal retention, the NER would likely be considered the most subordinate ABS interest in the structure because it is technically entitled to any remaining cash flow after all classes of "regular interest" securities have been paid, even if no such cash flow is expected. Therefore, a sponsor electing horizontal retention would be required to retain this NER interest in its entirety.

In either case, the requirement for the sponsor to hold all or a portion of the NER would force the sponsor to assume the tax liabilities and burdens that are associated with such interests. Exposing the sponsor to these tax implications fails to serve the purpose of the risk retention rules, which is to expose the sponsor to the credit risk of the collateral underlying the ABS interests.

Furthermore, a requirement to retain NERs may place the sponsor in an untenable situation with respect to complying with the requirements of the REMIC rules related to permitted ownership of REMIC residual interests and the risk retention rules. A REMIC is required to make reasonable arrangements to ensure that a REMIC residual interest is not held by a "disqualified organization" within the meaning of the REMIC rules.[41] If a REMIC sponsor were considered such a disqualified organization (e.g., certain tax-exempt organizations;

[41] I.R.C. § 860E(e).

agencies of the United States government), it would be forced to choose between compliance with the REMIC regulations, which require the REMIC to take measures to keep the REMIC residual interest out of the hands of disqualified organizations, and the risk retention requirements, which would require the REMIC sponsor to retain at least some of the REMIC residual interest regardless of whether the sponsor is a disqualified organization under the REMIC regulations.

Finally, including non-economic interests in the definition of ABS interests would undermine the purpose of the risk retention rules. Including the negative value of these non-economic interests in the fair value calculation would reduce the amount of credit risk that the sponsor is required to retain. This consideration, together with the negative consequences such a definition of ABS interests would impose on REMIC sponsors, are compelling reasons why NERs should not be considered ABS interests

The Re-proposed Rule should also be revised to exclude certain other REMIC interests from the definition of ABS interest. The REMIC rules define the manner in which the cash flows from a securitized mortgage pool may be divided within a securitization.[42] In order to comply with these rules and also obtain the desired characteristics for each class of issued securities, it is often necessary in a REMIC securitization to create a tiered REMIC structure with the issued (non-certificated) lower tier REMIC regular interests being owned by a subsequent higher tier REMIC and the highest tier REMIC comprising the REMIC which issues the issued REMIC interests to the ultimate investors. None of the tiered lower tier REMIC interests should be treated as ABS Interests subject to independent risk-retention. Critically, they represent the same *economic* interest as the certificates that are ultimately sold to investors and subject to the risk-retention rules. To require separate retention on these lower tier interests would result in double

[42] I.R.C. § 860G(a)(1), (c), (d); I.R.C. § 860(F).

counting (or more) of the risk-retention requirements. Further, it would be impossible for a sponsor to own a portion of the lower tier regular interests because, for REMIC structuring purposes, they must be held by the subsequent higher tier REMIC. These lower tier REMICs are creatures of tax law, do not otherwise affect the economics of the deal and should not be considered ABS interests.

### G. Mechanism for providing interpretive guidance

In the Bank of America Original Risk Retention Letter, we raised concerns that there was no mechanism for raising and resolving interpretive questions concerning the risk retention rules once the Final Rule is adopted. While we appreciate the efforts the Agencies took in the Re-proposed Rule to clarify and address uncertainties raised by the Original Proposed Rule in the hopes of avoiding the need for significant interpretive guidance and the further clarifications about issuances of interpretive guidance,[43] we remain concerned that the Re-proposed Rule does not go far enough to provide a meaningful and efficient process for determination of appeals, promulgation of rule clarifications, or resolution of interpretative questions.

The Agencies have asked for further feedback about whether staff interpretations and guidance to be issued publicly should be issued jointly. Our concern is that preparing jointly issued materials, particularly in this case when so many Agencies are involved, is quite time consuming. To the extent that the need for interpretation arises in the context of a particular transaction, market participants may be left waiting for guidance. While the Agencies have done an admirable job in the Re-proposed Rule of addressing uncertainties raised by the Original Proposed Rule, the dynamic and evolving nature of securitization, when coupled with the anticipated scope and complexity of the Final Rule, will inevitably create a host of interpretive

[43] Re-proposed Rule, 78 Fed. Reg. at 57933.

questions that will need to be addressed and lengthy delays in receiving feedback on these questions could be harmful to the markets.

On the other hand, allowing each Agency to issue its own guidance will inevitably lead to conflicting guidance on issues as they arise. We are cognizant of the issues that this could create for market participants as well as the Agencies. For this reason, we respectfully ask again that the Agencies establish a formal process for determination of appeals, promulgation of rule clarifications, and resolution of interpretative questions. Ideally, such a process would set clear criteria for requesting clarifications, provide for joint and uniform Agency guidance, and establish a timeline for Agency responses. The precise contours of the process are less important than the existence of some clearly defined process that ensures that regulatory clarification will be available via a definitive, efficient, uniform, and expeditious process. Without a clear process for providing regulatory clarification, it is likely that situations will arise in which industry participants may be left without guidance or timely final determination of their responsibilities.

## III. Residential Mortgage Backed Securities Comments

Bank of America appreciated the opportunity to comment on the Agencies' Original Proposed Rule and is pleased to see the substantial improvements made with respect to RMBS in the Re-proposed Rule. We believe, however, that adoption of the QRM as QM definition and two other additional changes are necessary if the Final Rule is to achieve the goals of risk retention while at the same time supporting a vibrant RMBS securitization market without constricting consumers' access to responsibly underwritten home mortgages.

This section of the comment letter will address the following topics:

- The Re-proposed Rule's revised definition of qualified residential mortgage and alternate "QM+" proposal.
- The need to permit blended pools of both qualified and unqualified home loans and of seasoned and unseasoned home loans that are subject to reduced risk retention requirements, and the Agencies' statutory authority to allow such blended pools.
- Suggested changes to the definition of "seasoned loan" designed to make the seasoned loan exemption more workable without compromising the credit quality of loans exempt thereunder.

### A. QRM/QM Definitions

The Re-proposed Rule offers two possible definitions of QRM. The first option is to use the same criteria for QRM as are used for qualified mortgages ("QM") under the Truth In Lending Act[44] ("TILA"). The second is the so-called "QM+" standard, which would adopt all of

[44] Truth in Lending Act, 15 U.S.C. 1639c(b)(2). As further defined in regulations promulgated by the Consumer Financial Protection Board, a QM loan must have: (1) regular periodic payments that are substantially equal; (2) no negative amortization, interest only, or balloon features; (3) a maximum loan term of 30 years; (4) total points and fees that do not exceed 3 percent of the total loan amount, or the applicable amounts specified in the Final QM Rule

the core criteria of the QM definition and further require that a QRM (1) have a minimum down payment, suggested to be 30%; (2) be a first lien mortgage on the borrower's primary residence; (3) if the mortgage is a purchase money loan, not have any junior liens; and (4) satisfy certain credit history requirements with respect to the borrower.[45]

Bank of America believes that the QRM as QM definition should be adopted and that the Agencies should not adopt the QM+ standard. As an initial matter, the legislative intent of the QM and QRM rules are satisfied by the Agencies adoption of the same definition. Section 941 of the Dodd-Frank Act was adopted to encourage originators to originate and securitizers to securitize loans with high credit quality. The QM standard is designed as a safe harbor for the TILA requirements that loans satisfy ability-to-repay requirements. The implementing characteristics of a rule intended to ensure that a borrower can repay its loan and a separate rule that seeks to ensure that the loan have low credit risk are virtually indistinguishable, thus it is appropriate to use the same standard to satisfy both regulatory requirements.

Performance data demonstrates that loans that meet the QM requirements have substantially lower risk of delinquency and default than those that do not. An analysis of existing loans prepared by the Mortgage Bankers Association[46] indicates that existing residential mortgage loans that meet the QM requirements experienced a 90+ day delinquency 58% less frequently than those that do not meet the QM requirements. Accordingly, loans originated in accordance with the QM criteria appear to be of sufficiently high quality to meet the statutory

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for small loans up to $100,000; (5) payments underwritten using the maximum interest rate that may apply during the first five years after the date on which the first regular periodic payment is due; (6) consideration and verification of the consumer's income and assets (including employment status if relied upon), current debt obligations, mortgage-related obligations, alimony and child support; and (7) total debt-to-income ratio that does not exceed 43 percent.

[45] Re-proposed Rule, 78 Fed. Reg. at 57993.

[46] *See* Mortgage Bankers Association, Comment Letter on the Credit Risk Retention Proposed Rule 11 (October 24, 2013), *available at* http://www.fdic.gov/regulations/laws/federal/2013/2013-credit_risk_retention-c_06.pdf.

requirements for exemption from the risk retention requirements under Section 941 of the Dodd-Frank Act.

Adopting the definition of QM as the definition of QRM also would specifically address the purpose of the risk retention requirement under Section 941 of the Dodd-Frank Act. The rationale for the risk retention requirement under Section 941 is that the quality of the underwriting process for financial assets, which investors and rating agencies have little visibility into, should improve if originators or securitizers have an interest in the performance of those assets. The risk retention requirement is intended to promote greater alignment of the interests among originator, securitizers and investors as a means of overcoming market failures that could result from informational asymmetries relating to the underwriting and securitization processes. The QM rule addresses the quality of the underwriting process and related informational asymmetries by providing detailed requirements for the documentation and verification of income, assets and employment. By contrast, the QM+ standard mandates additional objective, verifiable and fully-disclosed loan characteristics. Those characteristics, or substantially similar characteristics that have greater utility to market participants, are fully-disclosed to and well understood by investors and rating agencies. Such characteristics also are reflected in the prices paid by investors and the credit enhancement levels required by rating agencies. Because the additional requirements of the QM+ standard are not aimed at mitigating the risk that information asymmetries may pose to the secondary mortgage market, the QM+ standard incorrectly promotes risk retention as a desired outcome in its own right. That approach to the risk retention rules would result in additional and unnecessary expenses to financial institutions and the consumers and businesses they serve.

Aligning QM and QRM rules, and the single regulatory standard that would result, will achieve the goals of both rules in the most efficient way possible. Residential mortgage originators are committing substantial resources to develop, license and implement new systems to comply with the QM rules. Implementation of the QM+ standard would require similar but distinct systems that may not be offered by third-party vendors given the limited number of new issuances in the non-agency RMBS market. The cost and complexity of implementing compliance systems to satisfy the risk retention under the QM+ standard could significantly deter new issuances in the non-agency RMBS market and the cost of such a duplicative compliance system will need to be reflected in the cost of credit made available to consumers.

The costs associated with risk retention will increase the cost of borrowing for all consumers who require non-QRM loans. The QM+ standard, particularly the 30% down payment requirement, would mean that the segment of consumers who must rely on this more expensive credit would constitute the substantial majority of the market. According to data provided by the Mortgage Bankers Association, only 46% of borrowers in the refinance market and 18% of the purchase market would qualify for QRM loans if the QRM included the 30% down payment or 70% loan-to-value ("LTV") requirement as required by the QM+ standard.[47] This compares to the 79% of refinance borrowers and the 67% of borrowers that would qualify if the QRM were the same as QM.[48] Loans made to first-time and low-to-moderate income homeowners would be subject to risk retention and the associated increase in the cost of credit under the QM+ standard in disproportionately greater numbers than indicated by this aggregate data. We do not believe that it is appropriate, nor do we believe that Congress intended, to impose the additional costs associated with risk retention under the QM+ standard on such a broad segment of homeowners

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[47] *Id.* at 16.
[48] *Id.* at 16.

absent any clear rationale for how such risk retention would substantially improve the efficiency or soundness of the RMBS market.

## B. Blended Pools

### 1. Blended pools of home mortgage loans are in the public interest

If the Final Rule is identical to the Re-proposed Rule, it is possible that there may not be sufficient origination of QRM and/or non-QRM loans (either on an individual or combined basis) to generate the critical mass needed within the relatively short time periods required to create an active securitization product and to effectively manage hedging costs. Since the volume of mortgage loan originations of any loan type varies dramatically depending on market conditions, these problems might make one type of loan inefficient at one point in time, while during other times, under different economic circumstances, another type of loan could suffer the same problem. Regardless of when or in what type of loan this problem occurs, the resulting lack of liquidity in the mortgage loan markets generally will ultimately increase costs to borrowers. Similarly, portfolio holders may need to manage their holdings of seasoned loans, including seasoned loans that do not meet the QRM criteria but do satisfy the criteria for exemption from the risk retention obligation for seasoned residential mortgage loans (such loans, "ESMLs"), but lack a critical mass of such mortgage loans to securitize them without including them in pools of unseasoned QRM and/or non-QRM loans.

Fortunately, this potential liquidity problem can be mitigated without reducing investor protection or sponsors' incentives to originate and securitize quality mortgage loans. Specifically, issuers should be allowed to create securities backed by a mix of QRM loans, non-QRM loans and ESMLs, so long as they retain the appropriate amount of risk for each underlying loan. Such commingling would not change the risk retention requirements for individual loans or the incentives of originators to originate high quality mortgage loans in any

way, since the method by which loans are aggregated does not change underwriting standards or individual borrower characteristics. Thus, "meaningful" risk retention would still be determined at the only point where it matters—loan-level lending decisions.

As discussed in Section II.B.2 below, Bank of America believes that the Dodd-Frank Act provides the Agencies with sufficiently broad powers to allow blended pools of QRM loans, non-QRM loans and ESMLs under certain circumstances and that exempting such pools from the risk retention requirement would provide meaningful relief to the RMBS market.

Issuers can easily create structures within a securitization using established cash-flow payment rules to reflect an exact participation in each loan based on its QRM, non-QRM or ESML status. A rule requiring commingled transactions to use such a structure could readily be drafted, thus avoiding any concerns of gaming the system by creating blended pools. Disclosure via the related prospectus specifying which assets required risk retention would alert and inform investors of the potential risks associated with these assets. Accordingly, we urge the Agencies to revise the Re-proposed rule to allow pools that include QRM loans, non-QRM loans and ESMLs, and thus avoid unnecessary market inefficiencies that cannot benefit any participant.

#### 2. Blended pools of home mortgage loans are not prohibited by the Dodd-Frank Act

As an initial matter, support for the concept of blended pools can be found in the Agencies' discretion with respect to the definition of QRM. The only restriction that the Dodd-Frank Act places on the definition of QRM is that it can be no broader than the definition of QM, *i.e.* it must be at least as restrictive as the definition of QM. Thus, the Agencies have the implicit authority to require zero risk retention on pools composed exclusively of QM loans. It would not then be rational for Congress to grant the Agencies full discretion to except QMs from the risk

retention requirements on the one hand, but prohibit them from granting exceptions for these same loans if the Agencies were to exercise their discretion to adopt a tighter definition of QRM.

Moreover, the Agencies plainly have the authority under Section 941 of the Dodd-Frank Act to permit pools of QRM loans, non-QRM loans and ESMLs as proposed here. While Congress provided generally for the adoption of rules requiring 5% risk retention on securitized assets, including on QRM loans when pooled with non-QRM loans,[49] Congress likewise gave the Agencies broad authority to exempt both securitizations and entire asset classes from these requirements. Specifically, the Agencies are authorized to provide "a total or partial exemption of any securitization, as may be appropriate in the public interest and for the protection of investors."[50] Likewise, Congress empowered the Agencies to "jointly adopt or issue exemptions, exceptions, or adjustments to the rules issued under this section, including exemptions, exceptions, or adjustments for classes of . . . assets relating to the risk retention requirement."[51] The only restrictions that Congress placed on the Agencies' discretion to exercise their power to exempt asset classes from the risk retention requirements are that "[a]ny exemption, exception, or adjustment" must "help ensure high quality underwriting standards," "encourage appropriate risk management practices," and "improve the access of consumers and businesses to credit on reasonable terms."[52] Consistent with this direction, Congress authorized the Agencies to allow less than 5% of the credit risk to be retained on non-QRM loans that collateralize an asset-backed security when those loans satisfy underwriting standards that indicate a low credit risk.[53] In other words, the Agencies can allow securitization of assets subject to risk retention of less than 5% so long as any reduction is based on the low credit risk of the underlying assets or if it is in the

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[49] *See* 15 U.S.C. § 78o-11(c)(1)(B)(i).
[50] § 78o-11(c)(1)(G)(i).
[51] § 78o-11(e)(1).
[52] § 78o-11(e)(2).
[53] § 78o-11(c)(1)(B)(ii), (c)(2)(B).

public interest to do so. We believe that these broad powers include the ability to craft exemptions to Section 15G(c)(1)(B)(II)'s mandate that the Final Rule requires securitizers to retain risk on QRMs when they are securitized together with non-QRMs.[54]

Indeed, we do not believe that securities backed by blended pools of QRM loans, non-QRM loans and ESMLs would negatively impact investors in any way. The characteristics of underlying loans have always been disclosed and will continue to be disclosed under the Re-proposed Rule. Percentages of QRM loans, non-QRM loans and ESMLs comprising a pool would merely be another asset characteristic like debt-to-income, LTV, or geography that residential mortgage investors consider. Further, if investors decide that they want a security backed solely by a particular loan subtype, it should be possible to accommodate their wishes, so long as they are willing to pay any potential premiums caused by the scarcity of the related loans. Permitting commingling simply makes loan subtypes, like QRM, more liquid (and thus less expensive) than they otherwise would be.

### C. Seasoned loans

Bank of America appreciates the Re-proposed Rule's addition of an exception from risk retention for seasoned loans. As proposed, however, the exemption is too narrow to provide significant benefits to securitizers of seasoned mortgage loans. Specifically, the requirement that seasoned loans cannot ever have been delinquent or modified eliminates most outstanding residential mortgage loans. Bank of America believes that, with the modest changes below, the seasoned loan exemption could be expanded to enable securitizers of seasoned residential mortgage loans to more efficiently securitize their holdings without exposing investors to meaningful amounts of additional risk.

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[54] We note that § 941 of the Dodd-Frank Act requires 5% of *credit risk* to be retained. There is nothing in the statute that suggests that Congress intended to mandate that this risk be retained in the form of an ABS interest. This provides the Agencies with additional latitude to interpret provisions such as § 15G(c)(1)(B)(II).

First, while it is appropriate to exclude loans that have been modified for loss mitigation purposes (*e.g.*, HAMP modifications), many loans are modified for other reasons that are actually indicative of high credit quality. For example, if a borrower with good credit is solicited by a competing lender with a more attractive loan offer, its existing lender may modify the existing loan to match the better offer. Loans modified in this way are among the highest quality in any lender's portfolio. The seasoned loan exemption should be expanded to include loans modified for purposes other than loss mitigation.

Second, Bank of America believes the proposed requirement that a loan must either be seasoned for five years with an outstanding principal balance no greater than 25% of the original outstanding principal balance or be seasoned for 7 years is unduly restrictive. Only a small minority of five-year-old residential mortgage loans will have had 75% of their original principal balance paid. Accordingly, this requirement essentially means that to benefit from the exception, a residential mortgage loan must be seasoned for 7 years.

We believe that residential mortgage loans that have been seasoned for 5 years and satisfy certain performance tests described below should be exempt from the risk retention requirements, regardless of their outstanding principal balance. By the time a residential mortgage loan has become seasoned 5 years, its performance history is generally considered to be the strongest indicator of its credit quality and imposing a risk retention requirement for that loan would only negligibly promote sound underwriting. We also believe that, as residential mortgage loans become more seasoned, defaults occur more frequently due to life events such as loss of employment, divorce or death of an immediate family member than due to underwriting deficiencies. This belief is supported by the data shown in Figures 1 and 2 below. The first row of each chart shows what percentage of loans went into default by June 2012 with 1-5 years of

clean payment history following origination. As you can see only 2.14% of 2003 first pay loans that demonstrated five years of clean payment history following origination experienced a subsequent default event (180 days late) as of June 2012 and only 2.68% of 2004 first pay loans that demonstrated five years of clean payment history following origination experienced a subsequent default event (180 days late) as of June 2012. We believe once you reach default percentages this low they are, in the vast majority of instances, on account of life of loan events and not unsound underwriting practices for which risk retention is designed to address.

Third, over the life of a home loan, it is not uncommon for creditworthy borrowers to become 30 days delinquent at one time or another for reasons unrelated to their willingness and ability to repay. For example, a home owner may forget to mail a check, be travelling, or otherwise be unable to make a payment on time. Or, if a loan servicer changes, a borrower may send his or her check to the wrong address. In this later case, even though the borrower paid on time, the loan likely became delinquent as the payment made its way to the correct servicer. As long as the loan is brought current in the next pay period, none of these irregularities indicate increased credit risk. As shown in Figures 1 and 2 below, the default rates of loans that have not had delinquencies and those that have had delinquency of less than 60 days converge as the amount of time since their last delinquency event increases. More specifically the charts show that (i) for all loans that had one delinquency of 30+ but never a delinquency of 60+ and that had never again been 30 days delinquent for 5 years from its last 30 days delinquent event, only 1.88% of such loans experienced a subsequent default event (180 days late) as of June 2012, (ii) for all 2005 first pay loans that had two delinquencies of 30+ but never a delinquency of 60+ and that had never again been 30 days delinquent for 5 years from its last 30 days delinquent event, only 2.08% of such loans experienced a subsequent default event (180 days late) as of June 2012,

(iii) for all 2004 first pay loans sample that had one delinquency of 30+ but never a delinquency of 60+ and that had never again been 30 days delinquent for 5 years from its last 30 days delinquent event, only 1.95% of such loans experienced a subsequent default event (180 days late) as of June 2012 and (iv) for all 2004 first pay loans that had two delinquencies of 30+ but never a delinquency of 60+ and that had never again been 30 days delinquent for 5 years from its last 30 days delinquent event, only 1.56% of such loans experienced a subsequent default event (180 days late) as of June 2012.[55] We believe that these default rates show that risk retention as a regulatory tool to promote sound underwriting is of the same low relevance to these loans as to those that have been performing without a 30+ delinquency event. Thus, the seasoned loan exemption should include loans that have been either (i) seasoned for 5 years and have never been 30 days delinquent or (ii) been 30 days delinquent not more than twice, never sixty days delinquent and have not been 30 days delinquent for 5 years from its last 30 day delinquency event.

**First pay year = 2003**

| | **% Defaulted as of 6/2012** | | | | |
|---|---|---|---|---|---|
| **Category** | **1 year** | **2 years** | **3 years** | **4 years** | **5 years** |
| **No DLQ since Origination for** | 2.71 | 2.58 | 2.58 | 2.41 | 2.14 |
| **1x30, then clean for** | 5.08 | 4.03 | 3.32 | 2.59 | 1.88 |
| **2x30, then clean for** | 6.74 | 5.06 | 3.93 | 2.77 | 2.08 |
| **1x60, then clean for** | 9.35 | 6.53 | 5.01 | 3.69 | 2.53 |
| | **Sample Size** | | | | |
| **No DLQ since Origination for** | 4,331,339 | 3,476,744 | 2,894,444 | 2,559,318 | 2,308,368 |
| **1x30, then clean for** | 315,136 | 223,949 | 169,550 | 131,936 | 99,890 |
| **2x30, then clean for** | 87,878 | 54,845 | 37,917 | 27,253 | 18,950 |
| **1x60, then clean for** | 15,128 | 9,588 | 6,921 | 5,260 | 4,027 |

*Fig. 1*

[55] Our analysis of delinquency data extends for only 5 years from the last delinquency date. Because of the large numbers of refinancing and other early terminations of loans, the sample sizes of loans with 7 years of history post delinquency were too small to be statistically valid.

**First pay year = 2004**

| | % Defaulted as of 6/2012 | | | | |
|---|---|---|---|---|---|
| **Category** | **1 year** | **2 years** | **3 years** | **4 years** | **5 years** |
| **No DLQ since Origination for** | 4.45 | 4.22 | 4.02 | 3.56 | 2.68 |
| **1x30, then clean for** | 7.43 | 5.75 | 4.47 | 3.24 | 1.95 |
| **2x30, then clean for** | 9.03 | 6.46 | 4.78 | 3.18 | 1.56 |
| **1x60, then clean for** | 12.4 | 8.84 | 6.76 | 4.19 | 1.97 |
| | **Sample Size** | | | | |
| **No DLQ since Origination for** | 1,982,415 | 1,605,689 | 1,391,701 | 1,233,333 | 1,050,729 |
| **1x30, then clean for** | 148,287 | 103,120 | 75,609 | 56,104 | 39,167 |
| **2x30, then clean for** | 43,577 | 26,261 | 17,330 | 11,694 | 7,429 |
| **1x60, then clean for** | 8,099 | 4,911 | 3,373 | 2,410 | 1,726 |

*Fig. 2*[56]

In addition to broadening the definition of seasoned loan to include certain modified loans and loans that have been delinquent for 30 days, as discussed in Section II.B above, Bank of America believes that the Agencies should permit blended pools of seasoned and unseasoned loans.[57] This would add additional flexibility to the securitization markets without jeopardizing the goals of the risk retention rules. Allowing securitizers to benefit proportionally from the inclusion of low risk assets permits those assets to be securitized, even if they cannot be collected in the critical mass necessary to support a securitization. Thus, investors benefit from better access to strong assets without becoming subject to additional risks.

[56] The assumptions for Figures 5 and 6 were as follows:

- Review was done based on loans delivered to Fannie Mae and Freddie Mac from the 2003 and 2004 vintages the data for which was released by Fannie Mae and Freddie Mac in April 2013 to help the market better understand and analyze the credit performance of Fannie Mae and Freddie Mac mortgage loans over time.
- “Default” equals 180 days delinquent.
- The sample excluded all modified or inactive loans.
- The “No DLQ” selection indicates 1, 2, 3, 4 and 5 years without delinquency from first pay.
- The 1X30 selection indicates 1, 2, 3, 4 and 5 years after the 1x30 delinquency event before default.
- The 2X30 selection indicates 1, 2, 3, 4 and 5 years after the 2x30 delinquency event before default.
- The 1X60 selection indicates 1, 2, 3, 4 and 5 years after the 1x60 delinquency event before default.

[57] The statutory authorities permitting blended pools of QRM and non-QRM loans discussed above are equally applicable to pools comprised of seasoned and unseasoned loans.

## IV. Commercial Mortgage Backed Securities Comments

The CMBS market has performed well following the credit crisis and has experienced steady growth. This performance is largely due to investor confidence in the underlying structure of CMBS transactions and the existing protections for investors that meet market expectations. Such protections include thorough due diligence on each of the underlying assets, careful pool selection that includes the involvement (including kick-out rights) of the most junior investors and a number of control mechanisms. The control mechanisms encompass protections such as the involvement of trustees, operating advisors and special servicers who, throughout the life of the transaction, monitor the underlying assets and provide accountability among the deal participants. Additionally, these protections and control mechanisms encourage CMBS sponsors and originators to conform to sound CRE loan underwriting standards.

In addition to the issues addressed in Section II of this letter ("General Issues"), we believe the Re-proposed Rule raises four primary issues specific to the CMBS market that must be addressed in order to preserve a strong CMBS market while providing accountability and incentives for quality underwriting of CRE loans for securitization.

- First, the retention option for CMBS transactions that allows investment by up to two third-party purchasers (each, a "B-piece buyer") in an eligible horizontal residual interest (referred to in this context as a "B-piece") to satisfy the risk retention requirement should be modified to permit the B-piece buyers to hold their interests as a senior piece and a subordinate piece.
- Second, the proposed definition of qualifying CRE ("QCRE") loan should be adjusted so that a larger percentage of the commercial mortgage loans that are typically securitized will qualify for the CMBS risk retention exemption.

- Third, a sponsor should be permitted to use the B-piece buyer option in combination with any other form of risk retention held by the sponsor or originators.
- We also note that the ability to allow an eligible vertical interest to be held in a "loan" form as a *pari passu* interest in each loan in a transaction is particularly important to CMBS. As discussed under General Issues above, allowing for *pari passu* risk retention provides for more flexibility, better capital treatment and easier off-balance sheet treatment.

Unless modified, the proposed risk retention requirements will significantly reduce credit availability and increase the cost of borrowing for many commercial mortgage borrowers.

**A. B-piece risk retention criteria**

The Re-proposed Rule expanded the Original Proposed Rule's B-piece retention option to allow up to two B-piece buyers to satisfy the risk retention requirement in a CMBS transaction.[58] This expansion of the B-piece retention option is a welcome adjustment to the Original Proposed Rule, and we believe that with the proper modifications, this form of risk retention will be very useful to CMBS market participants. While up to two B-piece buyers are permitted to hold the B-piece, the Re-proposed Rule requires that their interests be held *pari passu* with each other.[59] This option should be expanded to also allow the B-piece buyers to hold the interests as a senior piece and subordinate piece.

An agreement between two B-piece buyers to hold a B-piece as a senior piece and subordinate piece would not negatively impact the benefits to investors of the B-piece option; each B-piece buyer would still be required to diligence and review each asset in the pool, and

[58] *See* Re-proposed Rule § __.7(b)(1), 78 Fed. Reg. at 58031.
[59] *See id.*

each B-piece buyer would still be subject to the limits on financing, transferring and hedging its B-piece and to the other applicable requirements under Section __.7 of the Re-proposed Rule. Similar to the *pari passu* option, a senior-subordinate option would still provide two close examinations of the underlying assets (as opposed to the single review that a lone B-piece buyer would provide). The risk of absorbing some of the losses allocable to an eligible horizontal residual interest would continue to be sufficient incentive to the B-piece buyers to ensure that loans in the pool were properly underwritten.

Furthermore, both of the B-piece buyers would benefit from the ability to match the yield on their portion of the B-piece to their risk and to their particular investment needs. The portion of a CMBS deal that will constitute a B-piece in an amount necessary to satisfy the 5% fair value retention requirement will be much greater than (roughly double in some cases) what is presently considered a B-piece in the CMBS market. A 5% fair value horizontal amount has historically priced at two different levels, because the market assesses the risk associated with the subordinate portion (the traditional B-piece) of the 5% fair value amount quite differently from the risk associated with the more senior portion. Requiring two B-piece buyers to each hold a *pari passu* interest imposes the same pricing inefficiencies as the single B-piece buyer option. The investment risk and return goals of typical investors in the subordinate portion are not satisfied by the risks and returns provided by the more senior portion. Allowing two B-piece buyers to hold the eligible horizontal residual interest in a senior/subordinate structure allows more efficient matching of investor needs to the offered investments. Under the Re-proposed Rule as written, the B-piece buyer(s)'s purchase of the entire B-piece will demand more

discounted pricing of the senior portion, which will in turn result in unnecessary market inefficiencies and higher costs to borrowers.[60]

**B. CRE loan and QCRE loan definitions**

Under the Re-proposed Rule, a securitization made up entirely of QCREs will be subject to a 0% risk retention requirement.[61] The Re-proposed Rule also provides for a pro rata reduction to the 5% retention requirement for securitized pools that are only partially comprised of QCREs, subject to a 2.5% floor.[62] This total or partial exemption will be very important to the continued efficiency of the CMBS market, making the definition of QCRE critical. We believe that the requirements imposed by the Re-proposed Rule's definition of QCRE are too restrictive and can be loosened while still reflecting high quality underwriting. According to one report, cumulative default rates on all CMBS loans securitized after 2008 is 0%.[63] Only a *de minimus* number of those loans, however, would qualify as QCRE loans under the Re-Proposal. Bank of America believes that this shows that less restrictive metrics for a QCRE loan can be consistent with sound underwriting and lower risk loans.

We believe that the QCRE exemption could be structured to meet the goals of the Agencies of promoting sound underwriting and providing ample disclosure to potential investors, while still creating workable and valuable relief to the risk retention requirements for CMBS issuers and sponsors. Representatives of Bank of America have been active participants in the preparation by the Commercial Real Estate Finance Council ("CREFC") of a response to the Re-proposed Rule expected to be filed on or about October 30, 2013 (the "CREFC Comment Letter") regarding CMBS and Bank of America supports the positions to be taken by CREFC

[60] We note that allowing the senior/subordinate B-piece structure is in line with the goal of maintaining the historical structure of CMBS transactions. *See* Re-proposed Rule, 78 Fed. Reg. at 57936.
[61] *See* Re-proposed Rule § __.15(c), 78 Fed. Reg. at 58039.
[62] *See* Re-proposed Rule § __.15(b), 78 Fed. Reg. at 58039.
[63] *See North American CMBS Default And Loss Study: Credit Metrics Continued To Improve Through June 2013*, RATINGSDIRECT (Standard & Poor's Ratings Services), Aug. 30, 2013.

with respect to the CRE loan and QCRE definitions and the comments that CREFC is making in the CREFC Comment Letter as to the Re-proposed Rule's definition of CRE loan and its treatment of the QCRE exemption.

**C. B-piece buyer/sponsor retention**

The Re-proposed Rule would allow a sponsor to satisfy the 5% retention requirement by combining its retained interest with an eligible horizontal residual interest held by up to two qualifying B-piece buyers.[64] However, the Re-proposed Rule indicates that this combination option is available only if the sponsor retains its retained interest as an eligible vertical interest.[65] The Re-proposed Rule should be revised to allow the sponsor's retained interest to not only be an eligible vertical interest but an eligible horizontal residual interest. There is no reason why the Final Rule should not allow the sponsor to satisfy its risk retention requirement with the 5% eligible horizontal residual interest partially held by the sponsor and partially held by a B-piece buyer. This option would be particularly important in (but should not be limited to) a circumstance in which a sponsor arranged for two B-piece buyers to purchase the eligible horizontal residual interests at the closing of a securitization and the sale to one of the B-piece buyers falls through. The Final Rule should allow the sponsor to hold a horizontal retained interest in combination with a B-piece buyer.

The Final Rule should also allow a CMBS sponsor that retains an eligible horizontal residual interest at closing to transfer that interest to a qualified B-piece buyer anytime within 90 days after the securitization closing date. The Re-proposed Rule allows the sponsor to transfer the B-piece on the closing date; why should it not be able to make the same transfer one day later, or 30 or 90 days later? If the same requirements applicable to a transfer on the closing date

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[64] *See* Re-proposed Rule § __.7(b), 78 Fed. Reg. at 58031.
[65] *See* Re-proposed Rule, 78 Fed. Reg. at 57953.

are satisfied on such a subsequent transfer, we do not see the difference in achieving the goal of an alignment of interest to encourage better underwriting. This ability would be particularly important in a circumstance in which a sponsor arranged for a B-piece buyer to purchase the B-piece at the closing of a securitization and the sale falls through.[66] Under the Re-proposed Rule, the sponsor would have to hold that B-piece for five or more years because of the failed execution with respect to the intended B-piece buyer. This scenario not only means the sponsor must retain an unanticipated B-piece, but would likely mean that off balance sheet treatment could not be obtained for the securitization, thus requiring full consolidation of the securitization by the sponsor. Allowing sale of the B-piece at a later date would alleviate such serious, unanticipated consequences.

### D. Fair value and cash flow restrictions applicable to eligible horizontal residual interest

We want to emphasize the importance to CMBS transactions of the issues addressed in Sections II.A and II.B of this letter. The entire discussion on fair value in Section II.A is particularly important to CMBS transactions, including the discussion of timing of the calculation of fair value given that the sponsor of a CMBS transaction desiring to utilize the third-party purchaser option must determine and include in the related offering documents the stated par value amount of the eligible horizontal residual interest. With respect to the cash flow restrictions discussed in Section II.B, it should be emphasized that a prohibition on cash flow that prevents a B-piece buyer from receiving a current return on its investment, as does the current proposed restriction, will severely reduce the effectiveness of the third-party purchaser option.

[66] We also note that a B-piece buyer could use this threat to force last minute price concessions since the financial costs to the sponsor of having to unexpectedly retain the eligible horizontal residual interest and consolidate the transaction are very high.

### E. *Pari passu* interests in assets as a form of risk retention

We also want to emphasize the importance to CMBS transactions of the issues addressed in Section II.E of this letter. The entire discussion on p*ari passu* interests in Section II.E is important to CMBS transactions, especially since the *pari passu* loan interest is already a structure utilized in the CMBS market for other purposes. Because it is an accepted structure in CMBS transactions, its use as a form of risk retention is less likely disrupt the current functioning of the market.

### F. Conclusion

If the foregoing suggested changes to the Re-proposed Rule are adopted, as well as the changes suggested above in Section II of this letter to address General Issues, we believe that the CMBS market will continue to thrive. The risk retention structure, combined with the current market standards highlighted above, will work to satisfy the purpose of the Dodd-Frank Act to properly align interests and ensure improved underwriting and origination practices for CRE loans. A vibrant CMBS market will lower the cost of borrowing to commercial property owners, improve credit availability and promote the long-term stability of commercial real estate values.

## V. Revolving Asset Master Trust Comments

FIA Card Services, National Association ("FIA"), an indirect subsidiary of Bank of America Corporation, engages in national consumer lending activities, primarily focused on issuing and maintaining credit card accounts. FIA formed BA Credit Card Master Trust II ("Master Trust II") on August 4, 1994. Master Trust II has issued a collateral certificate representing an undivided interest in Master Trust II to BA Credit Card Trust ("BACCT"), which is the primary ABS-issuing entity sponsored by FIA in connection with the securitization of credit card receivables.

As a securitization sponsor, as well as an underwriter of credit card asset-backed securities ("ABS"), Bank of America appreciates the efforts of the Agencies to address comments submitted in connection with the Original Proposed Rule. A number of the revisions evident in the Re-proposed Rule will aid our existing securitization structure to comply with the rule, including the accommodations made for legacy trusts and de-linked structures.

However, we believe additional modifications to the Re-proposed Rule are needed in the following areas in order to make the revolving master trust option workable for existing master trusts:

- As discussed in Section V.B.1.b of the Bank of America Original Risk Retention Comment Letter,[67] in virtually all master trust structures, the seller's interest is *pari passu* to each series of investors' ABS interests with respect to allocations of principal collections only during the revolving period. During all other periods the seller's interest is generally a subordinate interest. Therefore any requirement in the Final Rule that the seller's interest be *pari passu* to investors' ABS interests

[67] Bank of America Original Risk Retention Comment Letter, *supra* note 4, at 77.

should not apply for any period during which principal is required to be paid, or accumulated for the benefit of, investors' ABS interests.

- The definition of revolving master trust should be flexible enough to include issuing entities that satisfy clause (2) of the definition of "revolving master trust" but are formed as limited liability companies, partnerships and other corporate forms of organization, rather than as trusts.
- Neither the standard horizontal interest option nor the special horizontal interest option for master trusts, as currently presented, provides a viable horizontal risk retention option for master trusts. As a result, it is imperative that the proposed option for combined risk retention at the trust and series level reflect common modes of risk retention held by sponsors of master trusts.
- The need for the Final Rule to be reflective of current market practice is especially acute given the Agencies' proposal to offer no grandfathering for ABS interests issued by master trusts prior to the effective date of the Final Rule. Unless the Final Rule resolves certain issues fundamental to sponsors of master trust securitizations with respect to the risk retention options proposed in the Re-proposed Rule, ABS interests issued by master trusts prior to the effective date of the Final Rule should be exempt from the Final Rule.
- As noted in the Bank of America Original Risk Retention Comment Letter,[68] the monthly measurement periods for the seller's interest option should provide for adequate cure periods in a manner consistent with the securitization transactions documents.

[68] *Id.* at 84.

- Horizontal interest options available to master trusts should be subject to valuation only as of the date of issuance, rather than on each date on which the seller's interest is measured, and a sponsor should have the option of excluding from the valuation of the horizontal interest any ABS interests that are not relied upon by the sponsor as an offset against the 5% risk retention requirement.

## A. The seller's interest option for revolving master trusts

### 1. Definition of seller's interest

We appreciate the Agencies' expressed intent to define the seller's interest in a manner that is consistent with market practice.[69] As proposed, however, the definition of "seller's interest" and related risk retention provisions are still not aligned with market practice in a number of respects. We believe that if adopted as proposed, the seller's interest form of risk retention will be unavailable to us and virtually every other credit and charge card master trust. Because restructuring our master trust structure to satisfy the seller's interest option in the Re-proposed Rule would require, to the extent feasible, extensive amendments to existing program documents involving the consent of investors and confirmation from the applicable rating agencies that the amendments would not adversely affect the ratings of any rated securities, we are particularly focused on the changes necessary to align the seller's interest option under the Re-proposed Rule with existing transaction structures and market practice. Therefore, we request that the definition of "seller's interest" and related risk retention provisions be revised in the following ways:

- Revise clause (2) of the seller's interest definition to acknowledge subordination of the seller's interest during scheduled amortization and scheduled accumulation periods; and

[69] *See* Re-proposed Rule, 78 Fed. Reg. at 58013.

- Permit a seller's interest that covers shortfalls in payments on investors' ABS interests to count toward the 5% risk retention requirement.

### a. Revisions of clause (2) of the seller's interest definition are necessary to reflect allocations of collections during scheduled amortization and accumulation periods

Clause (2) of the proposed definition of "seller's interest" contemplates an ABS interest "that is *pari passu* to each series of investors' ABS interests issued by the issuing entity with respect to the allocation of all distributions and losses with respect to the securitized assets prior to an early amortization event (as defined in the securitization transaction documents)."[70] Thus, the Re-proposed Rule recognizes that the collections allocated to the seller's interest become subordinated upon the occurrence of an early amortization event. However, as we indicated in Section V.B.1.b of the Bank of America Original Risk Retention Letter,[71] virtually all credit card securitizations provide for a similar subordination of the seller's interest during times of scheduled amortization or accumulation even in the absence of an early amortization event.

During a scheduled amortization period, principal payments are made to investors on regular payment dates in accordance with a predetermined schedule whereas during a scheduled accumulation period principal collections are set aside in trust accounts to make a "soft bullet" payment of principal on a targeted or expected payment date.[72] In any type of amortization period, the numerator used to determine the allocation percentage for interest and/or principal collections is based on the outstanding principal amount of the ABS interests at the beginning of the amortization period, rather than the current outstanding principal amount of the ABS interests at the time of allocation. This feature is typically referred to as "fixing" the allocation of

[70] Re-proposed Rule, § __.5(a), 78 Fed. Reg. at 58028.
[71] Bank of America Original Risk Retention Comment Letter, *supra* note 4, at 77.
[72] We will refer to all types of scheduled amortization and accumulation periods as "amortization periods" in this section for ease of reference.

collections. The difference between (i) the outstanding principal amount of the ABS interests as of the beginning of the amortization period (which is used to determine the allocation percentage of collections throughout the amortization period) and (ii) the current invested amount[73] of the ABS interests on any payment date, represents the portion of the seller's interest that becomes subordinated to investor ABS interests with respect to the allocation of collections during the amortization period.

Upon such fixing of allocation percentages during an amortization period described above, the seller's interest continues to represent an undivided interest in the entire pool of receivables that exposes the holder of the seller's interest to a proportional or greater share of the credit risk of those receivables as compared with the share borne by the aggregate investor interests. Whether the allocations are fixed because an early amortization event has occurred or because investors have negotiated a higher allocation percentage in other scheduled amortization periods should not require distinction under the Final Rule. Therefore, clause (2) of the definition of seller's interest should, at a minimum, be modified to require the seller's interest to be *pari passu* with investors' ABS interests with respect to the allocation of collections only prior to any type of amortization period applicable to the ABS interests. Alternatively, if the Agencies believe that the typical "fixing" of allocation percentages during amortization periods is consistent with the *pari passu* requirement, then we urge the Agencies to provide guidance regarding the envisaged interplay between the seller's interest and the fixing of allocation percentages in the Final Rule.

[73] We use the term "invested amount" to mean either (i) the outstanding principal amount of the ABS interests as reduced by principal payments made on the ABS interests, or (ii) in the case of a series with an accumulation period, the outstanding principal amount of the ABS interests, as reduced by cash accumulated in a trust account for the payment of principal on the expected payment date.

Investors require, and have negotiated for, the use of a fixed allocation percentage during principal repayment periods to assure timely payment of principal. In addition, this feature is a common component of the ratings methodology for credit card ABS. Consequently, an amendment to such feature could cause an adverse impact on ratings for outstanding investors' ABS interests. As a result, it would not be possible to amend existing series of ABS interests to provide for a *pari passu* seller's interest as described in the Re-proposed Rule. We are hopeful that the Agencies did not intend master trust sponsors to receive no credit for existing seller's interests under the Re-proposed Rule solely due to a structural feature that is protective of investors. If existing seller's interests are not credited toward the 5% risk retention requirement, sponsors will be forced to either add duplicative risk retention, which would reduce efficiency in the market, or, at least for new master trusts, eliminate the fixed allocation feature, which would reduce investors' willingness to invest in the market.[74]

**b. A subordinated seller's interest that provides for the reallocation of its holder's share of collections to cover payment shortfalls on investors' ABS interests should not be disqualified as a permissible form of risk retention**

The Re-proposed Rule indicates that the Agencies are considering whether additional provisions for seller's interests that are subordinated are necessary. We believe that such provisions are necessary, and in fact, also in alignment with the intent of the risk retention regulations. In certain master trust securitization transactions, collections initially allocated to the seller's interest may be made available to cover shortfalls in payments on investors' ABS

[74] Such a result would seem wholly contrary to the intent expressed by the Agencies in the Re-proposed Rule in the following commentary: "The [SEC] preliminarily believes that aligning the requirements with current market practice will balance implementation costs for sponsors utilizing the master trust structure with the benefits that investors receive through improved selection of underlying assets by the sponsors. Maintaining current practice will be transparent and easy for the market to understand and will preserve current levels of efficiency and maintain investor's willingness to invest in the market. Codification of current practice will also provide clarity to market participants and may encourage additional participation given the removal of previous uncertainty about potential changes to current practices, thereby increasing capital formation." *See* Re-proposed Rule, 78 Fed. Reg. at 58013.

interests. In such cases, the holder of the seller's interest is exposed to an even greater credit risk than if collections allocated to the seller's interest were not made available to investors' ABS interests. When so subordinated, the seller's interest should not be precluded from qualifying under the Re-proposed Rule because it provides such additional credit support. We urge the Agencies to consider such subordination as a benefit to investors and allow such subordinated seller's interests to be valued based upon the unpaid principal balance of the related receivables rather than fair value, as would be the case if such seller's interests were to be treated as horizontal interests.

**2. The option for combined risk retention at the trust and series levels does not provide a viable horizontal risk retention option for master trusts**

Although Section __.5(f) allows a sponsor to reduce the 5% seller's interest required on each measurement date by retaining a corresponding percentage of the fair value of all ABS interests issued in each series in the form of an eligible horizontal residual interest that meets the requirements of Section __.4 or a horizontal interest meeting the requirements of Section __.5(f), neither alternative, as proposed, provides a viable horizontal risk retention option for master trusts. As noted in the Re-proposed Rule, the residual interests retained by sponsors under current master trust securitization structures would not meet the requirement of the proposed standard definition of eligible horizontal residual interest, which seeks to limit the rate of payments to the sponsor to the rate of principal payments made to the holders of the senior ABS interests.[75] In particular, this limitation on the rate of payments to the sponsor does not work for master trust structures if the sponsor's interest in excess spread is included in the calculation of the projected cash flow rate. In addition, the current construct of comparing the closing date projected cash flow rate for any payment date to the closing date projected principal repayment

[75] *See id.* at 57944.

rate for such payment date simply does not work for de-linked master trusts, in which subordinated tranches and senior tranches of a de-linked series are typically issued at different times, and subordinated tranches may be repaid before later-maturing senior tranches.

Because it is impossible for master trusts to satisfy their risk retention requirements through the holding of eligible horizontal residual interests under Section __.4, it is imperative that the combined risk retention option at the trust and series levels described in Section __.5(f) be reflective of current market practice for master trust structures, and be flexible enough to cover not only an interest in excess spread, but also horizontal interests issued by legacy trusts and interest-bearing subordinated classes of ABS interests.

**a. Subordinated certificates issued by revolving master trusts should be recognized as a common form of horizontal residual interests for multi-level trusts**

Section __.5(f) allows a sponsor to reduce the 5% seller's interest required on each measurement date by retaining a corresponding percentage of the fair value of all ABS interests issued in *each series* in the form of an eligible horizontal residual interest that meets the requirements of clauses (1) through (4) of Section __.5(f). We are concerned that the reference in such section to retaining an interest in "each series" refers only to each series issued by the master trust that issues the ABS interests to investors. As recognized by the Agencies in the Re-proposed Rule, a revolving master trust (the "legacy trust") may issue a collateral certificate representing a beneficial interest in all or a portion of the securitized assets held by that trust to another revolving trust (the "issuing entity"), which in turn issues ABS interests for which the collateral certificate represents all or a portion of the securitized assets. However, the Re-proposed Rule fails to recognize that the subordination for all ABS interests issued by an issuing entity may be provided by a certificate issued by the legacy trust, rather than in the form of one or more subordinated ABS interests in each series issued by the issuing entity. In such structures,

the subordinated certificate issued by the legacy trust provides credit enhancement to the collateral certificate that collateralizes the ABS interests issued by the issuing entity, and therefore to all series of ABS interests issued by the issuing entity.

As noted above, FIA utilizes such a structure.[76] Master Trust II has issued a collateral certificate and a Class D certificate, each as a part of Series 2001-D. The collateral certificate and the Class D certificate are investor certificates that represent an undivided interest in Master Trust II. The collateral certificate is BACCT's primary source of funds for the payment of principal of and interest on the investors' ABS interests. The Class D certificate is not entitled to receive any payments of interest and provides credit enhancement to the collateral certificate.

We request that Section __.5(f) be modified to clarify that the horizontal interest contemplated by Section __.5(f) may be held in the form of one or more subordinated certificates issued by a legacy trust, rather than exclusively as part of a series issued by the same revolving master trust that issues the ABS interests to investors.

**b. Section __.5(f) option for combined risk retention does not reflect typical master trust cash flows**

Clause (3) of Section __.5(f) requires the horizontal residual interest's claim to any part of the series' share of the interest and fee cash flows for any interest payment date to be subordinated to "all accrued and payable interest *and principal due* on the payment date to more senior ABS interests."[77] However, in the great majority of master trust structures, including Master Trust II, the interest and fee cash flows are not available to make principal payments due on the payment date to ABS interests (except to the extent such cash flows are applied with respect to defaulted or charge-off amounts and recharacterized as principal collections). Rather, interest and fee cash flows are typically applied to pay interest owed to ABS investors and

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[76] The diagram in Appendix B illustrates the master trust structure utilized by FIA.
[77] Re-proposed Rule, § __.5(f)(3), 78 Fed. Reg. at 58029 (emphasis added).

certain transaction expenses (for example, servicing fees and trustee fees) and to cover losses allocated to the ABS interest, whereas principal cash flows from the assets are applied to make principal payments on the ABS interests. Accordingly, we believe the reference to principal payments should be deleted from clause (3). We note that the requirements of clause (3) are described in the commentary to the Re-proposed Rule as follows, and such description does not reference the use of interest and fee collections to make principal payments:

> The sponsor's claim to any of the series' share of interest and fee proceeds each period pursuant to the horizontal residual interest is subordinated to *all interest* due to all ABS interests in the series for the period, and further reduced by the series' share of defaults on principal of the trust's securitized assets for that period (that is, charged off receivables).[78]

We believe that the standard described in the explanatory language more accurately reflects the current market practice for master trusts, and presume that the reference to principal payments in clause (3) of Section __.5(f) was inadvertent.

**c. The requirement that a horizontal interest's claim to interest and fee cash flows be reduced by the series' share of losses is ambiguous and does not reflect typical master trust cash flows**

Clause (3) of Section __.5(f) requires the horizontal residual interest's claim to any part of the series' share of the interest and fee cash flows for any interest payment to be "further reduced by the series' share of losses, including defaults."[79] It is unclear whether this requirement is intended to prohibit the horizontal interest from receiving interest payments prior to using interest and fee cash flows to cover losses allocated to the series. It is often the case that the most subordinated class of ABS interests would receive interest payments before interest and fee cash flows are applied to cover losses.

[78]Re-proposed Rule, 78 Fed. Reg. at 57945 (emphasis added).
[79]Re-proposed Rule § __.5(f)(3), 78 Fed. Reg. at 58029.

A very typical (and simplified) interest and fee cash flow waterfall for a revolving master trust would be as follows:

- first, to make deposits to the interest funding account to fund the payment of interest on the investor ABS interests (with interest paid sequentially to each class of ABS interests);
- second, to pay the servicing fee, plus any previously due and unpaid servicing fee, to the servicer;
- third, to be treated as principal collections in an amount equal to the amount of defaults allocated to the series for the preceding month and to cover any previous write-downs in the ABS interests due to defaults;
- fourth, to be treated as shared collections with other series, if any; and
- fifth, any excess spread to be paid to the issuing entity (or depositor).

As this waterfall illustrates, all classes of investors' ABS interests would receive interest payments prior to using interest and fee cash flows to cover losses. Therefore, we request that clause (3) of Section __.5(f) be revised to provide that the horizontal interest's claim to any part of the series' share of the interest and fee cash flows for any interest payment date shall be subordinated to all accrued and payable interest due on the payment date to more senior ABS interests in the series for the period. As noted above, because it is impossible for master trusts (particularly de-linked trusts) to satisfy the definition of eligible horizontal residual interest as currently proposed in Section __.4, it is critical that the special horizontal interest option in Section __.5(f) allow a sponsor to receive credit for interest-bearing subordinated classes and tranches of ABS interests, not just a residual interest in series-level excess spread.

However, if a sponsor retains a horizontal interest in the form of a residual interest in excess spread, then we agree that it would be appropriate to require that such horizontal interest's claim to any part of the series' interest and fee collections be further reduced by the series' share of defaults on the principal amounts of the securitized assets for the related period, to the extent that collections on such principal amounts would have been payable to more senior ABS interests in the series on the applicable payment date.

#### d. The requirement that a horizontal interest has the most subordinated claim to any part of the series' share of the principal repayment cash flows should be clarified for de-linked master trusts

Clause (4) of Section __.5(f) requires the horizontal interest to have the most subordinated claim to any part of the series' share of the principal repayment cash flows. As discussed in Section V.C.1.c. of the Bank of America Original Risk Retention Comment Letter,[80] de-linked trusts, like BACCT, may issue tranches of the most subordinated class of a series that have different expected payment dates and legal final maturity dates than senior tranches of the same series, and the expected payment dates and legal final maturity dates for certain subordinated tranches may occur *prior to* the expected payment dates or legal maturity dates for one or more senior tranches.

Although de-linked structures permit subordinated tranches to be paid principal prior to senior tranches, such trusts incorporate other structural features to ensure that adequate subordination is maintained for senior tranches. In a multiple tranche series issued by BACCT, subordinated ABS interests that reach their expected principal payment date, or that have an early redemption event, event of default or other optional or mandatory redemption, will not be paid to the extent that those ABS interests are necessary to provide the required subordination for

[80] Bank of America Original Risk Retention Comment Letter, *supra* note 4, at 92–93.

senior classes of ABS interests of the same series. If a tranche of subordinated ABS interests cannot be paid because of the subordination provisions of its respective indenture supplement, prefunding of the principal funding subaccounts for the senior ABS interests of the same series will begin. After that time, the subordinated ABS interests will be paid only to the extent that there is adequate subordination for senior classes of that series or the subordinated notes reach their legal maturity date. On the legal maturity date of a tranche of subordinated ABS interests, available principal amounts, if any, allocable to the subordinated tranche and proceeds from any sale of receivables will be paid to the holders of that tranche, even if payment would reduce the amount of available subordination below the required subordination for the senior classes of that series.

We therefore request that clause (4) of Section __.5(f) be clarified to require that the horizontal interest's claim to principal *collections* on any payment date be subordinated to all principal payments *due* or principal deposits required to be made, *on the payment date* to, or for benefit of, more senior ABS interests that are in accumulation or amortization periods to avoid any implication that subordinated tranches of de-linked notes may not receive principal payments before later maturing tranches of senior ABS interests. In addition, we have intentionally requested that clause (4) reference "principal collections" rather than principal repayment cash flows in order to allow a subordinated tranche to be paid from proceeds of any sale of receivables on the legal maturity date for such subordinated tranche as currently permitted under the BACCT program.

### B. The measurement date for the seller's interest and combined risk retention options and valuation of horizontal interests

#### 1. The measurement date for each horizontal interest should be the closing date on which the eligible horizontal interest is issued

Section __.5(c) provides that the 5 percent test for the seller's interest must be met "at the closing of each issuance of ABS interests by the issuing entity, and at every seller's interest measurement date specified under the securitization transaction documents, but no less than monthly."[81] We agree that it is appropriate to measure the seller's interest monthly and that such a requirement would not be burdensome given the current market practice to test the seller's interest on a monthly basis.

However, for purposes of the option to combine retention at trust and series levels under Section __.5(f), it is unclear whether the Agencies intended sponsors to revalue each horizontal interest on a monthly basis. Requiring valuation of a horizontal interest on a monthly basis would be inconsistent with the requirements for horizontal interests under the standard risk retention option and would be extremely burdensome for sponsors. In addition, a sponsor should not be required to increase its risk retention for a series to the extent the fair value of a horizontal interest declines after the closing date for the series. By way of illustration, if a horizontal interest in a series of ABS interests represents 2% of the fair value of all ABS interests as of the closing date for such series, then the sponsor should be considered to hold a 2% eligible horizontal interest for such series for the life of such series, without the need to re-value such horizontal interest on a monthly basis. In fact, requiring a sponsor to revalue the horizontal interest after its fair value changes based on performance of the underlying assets would in effect require the sponsor to hold a retained interest greater than 5%, which would be inconsistent with the treatment of securitizations using the standard horizontal risk retention option.

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[81] Re-proposed Rule § __.5(c)(1), 78 Fed. Reg. at 58028.

### 2. Monthly measurement should be clarified to incorporate cure periods provided for in transaction documents

To the extent the amount of seller's interest falls below the minimum seller's interest, a sponsor would typically add additional assets to the master trust or reduce the amount of outstanding investors' ABS interests. In order to provide the sponsor with sufficient time to add assets or reduce the outstanding amount of investors' ABS interests, transaction documents usually allow a cure period before a shortfall in the minimum seller's interest would cause an early amortization event. We request that, consistent with market practice, sponsors have the flexibility to cure deficiencies in the minimum risk retention requirement within a time period that would be consistent with the cure period for collateral deficiencies that is otherwise allowed under the sponsor's transaction documents for purposes of determining when an early amortization event is triggered.

### 3. A sponsor that retains multiple ABS interests that qualify, collectively, as a horizontal interest should not be required to disclose a valuation for any portion of such ABS interests that is not used to offset the 5% credit risk retention requirement

The Re-proposed Rule allows a horizontal interest to be composed of multiple classes, subclasses, or tranches that collectively meet the requirements of Section __.5(f). FIA already holds multiple ABS interests that collectively represent the most subordinated ABS interests that are collateralized by the securitized assets, including a residual interest in excess spread, the Class D Certificate issued by Master Trust II and junior classes of notes issued by BACCT. Given the high percentage of credit risk already retained by FIA through the seller's interest and certificated subordinated ABS interests, FIA may decide that it is not necessary to include its interest in excess spread as an offset to the 5% seller's interest requirement. We request clarification that where multiple interests qualify, collectively, as a horizontal interest under

Section __.5(f), a sponsor will not be required to value any component of such horizontal interest that is not treated as an offset to the 5% risk retention requirement.[82]

### C. Transition issues for revolving master trusts

In Section V.B.3.d of the Bank of America Original Risk Retention Comment Letter,[83] we requested that only ABS interests issued after the effective date of the Final Rule be included for purposes of determining the risk retention requirement for revolving master trusts. We note that the Agencies have declined to provide for a grandfathering of existing ABS interests issued by master trusts prior to the effective date of the Final Rule.

Given the gap between the Re-proposed Rule and current market practice, we again request that ABS interests issued prior to the effective date of the Final Rule be excluded for purposes of the risk retention requirements for master trusts. It will be burdensome, expensive and potentially impossible to restructure an existing master trust to comply with the risk retention requirements as currently proposed, and no other subset of the securitization market is required to comply with the risk retention rules on a retroactive basis. Unless the Agencies are able to craft a Final Rule that is flexible enough to be consistent with market practice for all master trusts, many master trust sponsors will be left with the choice to amend existing ABS (if practicable) or add duplicative risk retention to existing transactions. Finally, we note that bank sponsors of master trusts, like FIA, that rely on the grandfathering provisions of the FDIC's safe harbor rule for securitizations[84] (the "FDIC Safe Harbor") will be hesitant to amend existing structures in a way that could potentially affect sale treatment under GAAP as in effect for

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[82] We support the recommendation, made by the Structured Finance Industry Group in its comment letter on the Re-proposed Rule expected to be filed on or about October 30, 2013, to allow a sponsor to aggregate the values of all or, in the sponsor's discretion, only a portion of the ABS interests that meet the requirements for an eligible horizontal interest when determining the available offset against the 5% risk retention requirement. This would allow sponsors to exclude the residual interest in excess spread when valuing the series-level horizontal interests, making the calculation of the value of such horizontal interests less burdensome.

[83] Bank of America Original Risk Retention Comment Letter, *supra* note 4, at 83.

[84] 12 C.F.R. § 360.6(b)(5)(i)(A).

reporting periods before November 15, 2009, and thereby cause the master trust to fail to comply with the FDIC Safe Harbor.

**D. Clarification requested relating to event of default triggers in Section __.5(h)**

Section __.5(h) provides that a sponsor that relies on Section __.5 to satisfy the risk retention requirements does not violate such requirements if the seller's interest falls below the required level after an event of default triggers early amortization of all series of ABS interests, as specified in the securitization transaction documents. As a technical matter, most master trusts provide for two distinct sets of triggering events: (i) events of default and (ii) early amortization events. Early amortization events are events which trigger early amortization of ABS interests, whereas events of default are events that typically give rise to the right of an investor to exercise certain remedies, such as commencing legal proceedings to collect the debt and foreclosure on the trust assets. Events of default are typically included as a subset of early amortization events. Therefore we request the reference to "event of default" in Section __.5(h) be changed to "early amortization event".

**E. Disclosure**

Section __.5(g) requires a sponsor relying on the seller's interest option to disclose, within a reasonable period of time prior to the sale of the ABS interests, the value of the seller's interest expressed both as a percentage of the investors' ABS interests and a dollar amount. Because the dollar amount of the seller's interest will change on a daily basis, it not possible to disclose the dollar amount of the seller's interest to investors prior to the closing date. We therefore request that the dollar amount of the seller's interest be disclosed to investors as of the most recent measurement date provided in the securitization transaction documents prior to the date such disclosure is provided to investors (as adjusted as necessary on a pro forma basis for the issuance of ABS interests expected to be issued on or prior to the closing date and any

additions or removals of assets that has occurred between the measurement date and the date of the disclosure, other than through the creation of additional assets in previously designated revolving accounts or the liquidation of the securitized assets).

## VI. Auto Loan Comments

As a securitization sponsor, as well as underwriter of auto ABS, Bank of America appreciates the opportunity to submit comments in connection with the Original Proposal to address issues related to auto loan securitizations. As we noted in our comments to the Original Proposed Rule, securitization has been and continues to be a critical source of funding for auto loans. A vibrant auto loan securitization market is essential to the well-being of the millions of consumers who seek affordable loans to purchase automobiles and the automobile manufacturers, suppliers, and dealers whose respective businesses depend on the ability of consumers to obtain these loans.[85]

In the years 2009 through 2012, the auto loan securitization market comprised 39% of all ABS offerings.[86] Last year, the auto loan securitization market had the most active sponsors (36) and the largest issuance volume ($79.5B) of ABS among all asset classes.[87] That volume of auto loan ABS issuance is more than twice the level seen in 2008 and is comparable to the issuance volume from 2004 to 2007.[88] This rapid rebound and accelerated growth of auto ABS since the credit crisis demonstrates strong investor confidence in existing auto ABS market practices for aligning interests between sponsors and investors.

Regulation designed to align the interests of ABS sponsors and investors through risk retention necessarily requires a significant degree of flexibility to account for the multiple asset classes and myriad of structures in the securitization market. Accordingly, we strongly support Section __.3(a) of the Re-proposed Rule, which authorizes the sponsor to select the form of risk retention from a variety of options, thus permitting the sponsor to retain risk in a manner that

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[85] *See* Bank of America Original Risk Retention Letter, *supra* note 4, at 100.
[86] *See* Re-proposed Rule, 78 Fed. Reg. at 58007.
[87] *See id*. at 58007–08.
[88] *See id*. at 58008.

satisfies the funding, accounting, structural, and other considerations of the sponsor and its affiliates.[89] We are also appreciative of the revisions made by the Agencies in the Re-proposed Rule that permit majority-owned affiliates of the sponsor to be the initial holder of the retained interest and that omit the requirement that loss and scheduled principal be allocated under the eligible horizontal residual interest option. These revisions address concerns raised by Bank of America and other commenters to the Original Proposed Rule and help facilitate compliance by auto ABS sponsors with the risk retention requirement in a manner consistent with current sound transaction structuring practices for auto ABS transactions.

However, we believe that restoring the representative sample option, pursuant to which a sponsor could satisfy the risk retention requirement by retaining ownership of a randomly selected representative sample of assets, would be desirable to achieve the goals of Congress and the Agencies in implementing a risk retention requirement, while minimizing disruptions and inefficiencies in the currently well-functioning auto ABS market.

### A. The Agencies should include a representative sample option as a form of risk retention

The Agencies' Original Proposed Rule provided that a sponsor could satisfy the risk retention requirement for a securitization by retaining ownership of a randomly selected representative sample of assets, equal to at least five percent of the unpaid principal balance of all pool assets initially identified for securitizing that was equivalent in all material respects to the securitized assets. However, the Agencies elected to not include such an option in the Re-proposed Rule due, in part, to comments that a representative sample option "would be difficult to implement and may result in the costs of its utilization outweighing its benefit."[90] Although

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[89] *See* Re-proposed Rule § __.3, 78 Fed. Reg. at 58026.

[90] Re-proposed Rule, 78 Fed. Reg. at 57947 ("The agencies have considered the comments on the representative sample option in the original proposal and are concerned that, based on observations by commenters, the

we agree that certain requirements of the Original Proposal would have been challenging to apply, we believe that risk retention through representation sample, when appropriately designed, can still be an effective method for aligning sponsor and investor interests in a way that is not unduly burdensome to sponsors.

A representative sample option can serve the goals of the Agencies to incentivize sponsors to monitor and ensure the quality of the assets underlying a securitization while also promoting the Agencies' stated goal of providing increased flexibility to sponsors so as to not negatively impact the costs and availability of credit to consumers and businesses. Accordingly, we propose a representative sample option below that should effectively align sponsor and investor interests while providing sponsors a valuable option to satisfy accounting, structural and investor considerations without imposing unnecessary costs on sponsors.

### B. The designated pool should include a sufficiently large number of loans so that a sample may be both random and representative of the material characteristics of the securitized pool

We appreciate the Agencies' invitation to comment on how a representative sample option could be constructed, consistent with establishing meaningful risk retention. The representative sample option should maintain the two principal qualities that defined the Agencies' original representative sample proposal: randomness and representativeness. A randomly generated representative sample prevents manipulation of the sponsor's retained interest, while retention of a sample of assets that is representative of the securitized pool would incentivize sponsors to monitor the quality of the securitized assets. Accordingly, we support a risk retention option that combines those two features, along with the proper safeguards and disclosures to align sponsors' and investors' interests.

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representative sample option would be difficult to implement and may result in the costs of its utilization outweighing its benefits.").

To construct a random sample of the assets to be securitized, sponsors should begin by selecting a designated pool of assets for securitization. Then, using a random selection process that should not take into consideration any asset characteristics other than unpaid principal balance, the sponsor should randomly select assets with an aggregate unpaid principal balance equal to 5.00%, which will be the "representative sample," subject to the requirements and limitations set forth in Section __.12 of the Re-proposed Rule.[91] The remaining assets will be included in the securitized pool and will support the ABS interests.

To ensure that the sample is representative of the assets in the securitized pool, sponsors should be required to include a sufficiently large number of assets in the designated pool. Based on our statistical analysis and taking into account the material characteristics of an auto loan and the variability of those characteristics within a pool of auto loans, we believe that a representative sample randomly selected from a designated pool of not less than 5,500 auto loans should achieve with a high confidence level a representative sample with substantially similar characteristics to the related securitized pool for auto ABS.[92]

For a designated pool of assets of less than 5,500 auto loans, the technique described above for selecting the representative sample could result in a "maximum error rate"[93] that is greater than 5.00% for any material characteristic of the representative sample and the securitized pool. We propose that the sponsor could randomly select the representative sample from a designated pool of less than 5,500 auto loans, test the representative sample pool and, to the extent that the representative sample pool exceeds the maximum error rate, begin the process again. The sponsor could continue following this procedure until the material characteristics of the randomly selected representative sample as compared to the securitized pool are within the

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[91] *See* Re-proposed Rule § __.12, 78 Fed. Reg. at 58035.
[92] Appendix C describes the representative sample methodology and the related statistical analysis.
[93] For an explanation of the "maximum error rate," see Appendix C.

5.00% maximum error rate. This is similar to the test put forth by the Agencies in the Original Proposed Rule.[94]

The representative sample option should also require sponsors to establish certain safeguards to ensure that the representative sample has been randomly selected to mitigate investor concerns that the representative sample option is subject to manipulation. Specifically, the sponsor should be required to have in place, and adhere to, policies and procedures for: (i) identifying and documenting the material characteristics of the assets in the designated pool; (ii) selecting assets randomly from the designated pool for inclusion in the securitized pool and the representative sample; (iii) maintaining, for a period equal to that required for a vertical interest, documentation that clearly identifies the assets included in the representative sample; and (iv) prohibiting, for a period equal to that required for a vertical interest, assets in the representative sample from being included in the securitized pool or the designated pool of any other securitization, subject, in each case, to the activities permitted in Section __.12 of the Re-proposed Rule.

Additionally, the representative sample and the assets in the securitized pool should be serviced by the same servicer, using the same policies and procedures. Although management in the servicing department and personnel in other functional departments within the servicer (e.g., accounting) may have knowledge of the ownership of a serviced asset, the individuals responsible for the daily servicing of the assets should not be informed whether a serviced asset is included in a representative sample or a securitized pool. These requirements would serve to further align the interests of a sponsor and an investor in an ABS transaction and would therefore support investor confidence in an ABS transaction where representative sample is used to satisfy risk retention.

[94] *See* Original Proposed Rule § __.8(b)(3), 76 Fed. Reg. at 24159.

To ensure that investors and the Agencies can monitor and assess the sponsor's compliance with the requirements of the representative sample option, sponsors of auto ABS should be required to disclose, in a reasonable time prior to the issuance of the ABS and as part of the transaction:

(i) The following material characteristics of the assets in the securitized pool and the representative sample:

(a) The aggregate receivables balance;

(b) The average outstanding principal balance;

(c) The average original amount financed;

(d) The weighted average annual percentage rate;

(e) The weighted average original term to maturity;

(f) The weighted average remaining term to maturity;

(g) The percentage by principal balance of used auto loans;

(h) The percentage by principal balance of new auto loans; and

(i) The non-zero weighted average FICO score of obligors; and

(ii) A description of the policies and procedures that the sponsor used for ensuring that the process for identifying the representative sample complies with the risk retention rules.

The foregoing disclosures should be considered information regarding the pool assets for which a review by the issuer is required pursuant to Rule 193[95] of the Securities Act of 1933[96]

[95] 17 C.F.R. § 230.193.

[96] Securities Act of 1933, 15 U.S.C. § 77a *et seq.*

(the "Securities Act") and disclosure of such review is required pursuant to Item 1111(a)(7) of Regulation AB.[97]

### C. Including the representative sample option would benefit the securitization market and investors

As discussed below, a representative sample option would benefit both the securitization market and investors. First, the representative sample option would benefit the securitization market because the representative sample option provides a transparent risk retention method that encourages sponsors to monitor and ensure the quality of the assets underlying a securitization transaction. Second, because the representative sample option is already in use in auto loan transactions structured to comply with the FDIC Safe Harbor, sponsors could continue to structure, and investors could continue to invest in, auto ABS with the representative sample feature. Finally, a representative sample option would benefit borrowers by providing a credit risk retention option that may avoid the risk that implementation of new risk retention rules adversely affects the availability or cost of credit for borrowers.

A representative sample option would benefit the securitization market because it would provide a transparent risk retention method that encourages sponsors to monitor and ensure the quality of the assets underlying a securitization transaction. The principal features of the representative sample option—randomness and representativeness—benefit investors by providing a uniquely close alignment of interests between a sponsor and investors. Because a sponsor will be exposed to the effects of any poor underwriting or servicing through the representative sample, sponsors will have a strong incentive to underwrite and securitize quality assets. Additionally, the disclosure requirements suggested above for the securitized pool and the representative sample, together with the disclosure of the sponsor's policies and procedures for

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[97] 17 CFR 229.1111(a)(7).

identifying the representative sample, provide an ability for investors to evaluate and monitor the sponsor's compliance with the risk retention requirements.

A representative sample option would also benefit securitization market participants because sponsors could continue to structure, and investors could continue to invest in, auto loan ABS with the representative sample feature, thereby providing consistency with current market practice. Several auto loan ABS sponsors already use a representative sample option in order to comply with the risk retention requirements for transactions structured to comply with the FDIC Safe Harbor. To our knowledge, representative sample is the *only* risk retention option selected by sponsors of auto loan ABS structured to be FDIC Safe Harbor-compliant. Those transactions have been well received by investors and the representative sample option has proven to be both attractive and practical for the related sponsors. We believe that including a representative sample option for risk retention similar to the risk retention option in the FDIC Safe Harbor but with more robust investor protections would benefit all market participants.

Finally, a representative sample option would benefit borrowers by providing a credit risk retention option that may avoid the risk that implementation of new risk retention rules adversely affects the availability or cost of credit for borrowers. Although the Re-proposed Rule permits a sponsor to hold risk retention through a combination of methods, the retention of a vertical interest and/or an eligible horizontal residual interest may require consolidation of the issuing entity by the sponsor, thereby increasing regulatory capital charges to bank sponsors and resulting in adverse impact on the availability and cost of credit for borrowers. Although current GAAP may not result in consolidation, future revisions to GAAP may result in vertical or horizontal risk retention requiring consolidation and current International Financial Reporting Standards may require consolidation by the sponsor of an issuing entity whenever the sponsor or

its majority-owned affiliate retains a vertical interest or an eligible horizontal residual interest in the ABS interests. Representative sample provides an alternate risk retention option that aligns the interests of investors and sponsors without the potential for an adverse impact on the availability and costs of credit for borrowers resulting from the necessity of a sponsor to consolidate an issuing entity for financial and regulatory accounting purposes.

## VII. Resecuritization Comments

Bank of America appreciates the work of the Agencies in considering the many comments related to the exemptions for certain resecuritization transactions in the Original Proposed Rule. We further appreciate the work of the Agencies in expanding the exemption to take into account resecuritizations of certain RMBS that are structured to address pre-payment risk. While this is certainly a step in the right direction, Bank of America respectfully suggests building on the exemption for the resecuritization of compliant or exempted ABS in order to allow for unrestricted tranching in a resecuritization transaction consisting of a single tranche of compliant or exempted ABS.

Further, Bank of America believes that this expanded exemption furthers the balance the Agencies have sought to achieve between the creation of risk retention rules that ensure good underwriting and increased transparency for investors and minimizing the disruption to the functioning of the resecuritization market. This exemption would not impact the way that assets are selected because resecuritizations of this type are primarily a portfolio management tool used by existing investors seeking to manage their existing portfolios. They are used when an existing investor desires to either leverage the senior piece of its holdings or transfer the subordinate piece. Permitting investors to resecuritize in this fashion improves their ability to finance their portfolio and frees capital for investments in other interests, whether RMBS, CMBS, or otherwise.

Our proposal addresses the complexity and lack of transparency that could exist in a pooled ABS resecuritization by limiting the resecuritization to a single tranche of non-pooled compliant or exempt ABS. It is unnecessary to provide complex rules specifying whether the investor who owns the underlying asset or the broker-dealer who arranges the transaction is the securitizer, and it is unnecessary to draw elaborate distinctions between resecuritizations and

CDOs. By limiting the exemption for resecuritizations to transactions backed by one asset that is determined at the inception of the securitization, but fully exempting the transaction from risk retention, the Agencies would permit investors to manage their portfolios at a reasonable expense without a risk that complex CDO or SIV-like products could "sneak" through the exemption.

Bank of America understands the concerns relating to managed CDOs, and for that reason, proposes that no resecuritization of exempt or compliant ABS would be permitted to revolve, reinvest or be subject to portfolio management.

In conclusion, we believe expanding the existing exemption to allow credit and other tranching of a single compliant or exempted ABS in a non-pooled resecuritization will enable investors to continue to manage their portfolios efficiently and will not expose resecuritization investors to any concentration of risk that could not have been structured as part of the original offering of the compliant or exempt single tranche of ABS .

## VIII. Municipal Bond Repackaging/Tender Option Bond Comments

Bank of America appreciates the proposal for the additional risk retention options for certain municipal bond repackagings ("MBRs"), and in particular the proposed option for municipal tender option bonds ("TOBs"); however, while the apparent intent of these proposals was to "reflect and incorporate the risk retention mechanisms currently implemented by the market"[98], the proposals then add a number of additional conditions the effect of which is to severely restrict the types of MBRs that might benefit from the proposed options and substantially impair the current MBR market. Moreover, while the Re-proposed Rule includes a description of the comments that were made regarding MBRs and, insofar as Bank of America's comments in the Bank of America Original Risk Retention Letter are concerned, does so accurately, there is no substantive explanation for the Agencies' rejection of the requested complete exemption for MBRs that Bank of America and other commenters had urged.

Representatives of Bank of America have been active participants in the preparation by the Structured Finance Industry Group ("SFIG") of a response to the Re-proposed Rule regarding MBRs for SFIG's comment letter on the Re-proposed Rule expected to be filed on or about October 30, 2013 (the "SFIG Comment Letter"). Bank of America supports the comments of SFIG as to the Re-proposed Rule's treatment of MBRs. Specifically, Bank of America supports the request by SFIG for a full exemption for MBRs, which Bank of America still views as the appropriate treatment for MBRs (for the reasons stated in the Bank of America Original Risk Retention Letter and noted above). To the extent a full exemption is not included in the Final Rule, Bank of America supports SFIG's request for the modification of the requirements for proposed risk retention MBR option as generally described in the SFIG Comment Letter and, in particular, modifications to (among other things):

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[98] Re-proposed Rule, 78 Fed. Reg. at 57965.

- permit the requirements to be satisfied by someone other than the sponsoring bank, including the holder of the residual interest in the MBR transaction and, as proposed by the SFIG Comment Letter in the suggested new definition of "qualified municipal residual interest," reflect typical residual or other subordinate interests in MBR transactions and by additional forms of credit enhancement or liquidity coverage as proposed in the SFIG Comment Letter;
- apply the modified risk retention requirements to MBR issuers that do not qualify under IRS Revenue Procedure 2003-84 and to MBRs that do not utilize a "tender option termination event" concept;
- apply the modified risk retention requirements to repackaging vehicles issuing instruments that are not necessarily Rule 2a-7 compliant, since the proposed Rule 2a-7 eligibility criterion would exclude certain MBRs and certain investors and would create a compliance issue for certain sponsors and issuers;
- for tender option MBRs, permit optional purchase on more than 30 days' notice as this is common for MBRs with a "term mode" option, especially if the corresponding requirement is removed from Rule 2a-7 as a result of the pending review thereof by the SEC or otherwise;
- permit repackagings of taxable municipal bonds and beneficial interests in municipal bonds, not just municipal bonds themselves; and
- permit certain hedging and transfers of municipal bond positions.

In addition, Bank of America supports the proposed replacement of the definition of "qualified tender option bond entity" with the definition of "qualified municipal repackaging entity" as proposed in the SFIG Comment Letter.

Bank of America believes that it is critical that the Agencies either grant a full exemption for MBRs or broadly modify the proposed risk retention requirements, including the two additional options included in the Re-proposed Rule, to accommodate the existing market practice for MBRs. Otherwise, a substantial portion of this market would cease to exist in its current form with no benefit to the municipal bond market or the economy that is supported by it.

## IX. Corporate Debt Repackaging Comments

As the Bank of America Original Risk Retention Letter noted, it is the expansive (and, in Bank of America's view, overly broad) proposed definition of "securitization transaction" that unnecessarily sweeps into the ambit of risk retention a wide variety of corporate debt (bond or loan) repackagings ("CDRs") that (i) are not originate-to-distribute products and (ii) are unrelated to the perceived failures in the securitization markets that gave rise to Section 15G of the Securities Exchange Act of 1934[99] (the "Exchange Act"). Even if risk retention is applied to CDRs, the underlying core legislative purpose of Section 15G will not be advanced and CDRs will either cease to exist in their current form (with the adverse effects that will flow therefrom) or become substantially more expensive (as the affected transaction participant will seek recovery of the required increased transaction costs), which will reduce the CDR market significantly.

Moreover, while the Re-proposed Rule includes a description of the comments that were made regarding CDRs and, insofar as Bank of America's comments in the Bank of America Original Risk Retention Letter are concerned, does so accurately, there is no substantive engagement or other response (other than an implicit rejection) by the Agencies to the reasons for the rejection of the proposed exemption for CDRs that Bank of America and other commenters had urged.

Representatives of Bank of America have been active participants in the preparation by SFIG of a response to the Re-proposed Rule regarding CDRs. Bank of America supports the comments of SFIG as to the Re-proposed Rule's treatment of CDRs. In particular, Bank of America supports the request by SFIG for a full exemption for CDRs, which Bank of America continues to view as the appropriate treatment for CDRs (for the reasons stated in the Bank of

[99] Securities Exchange Act of 1934, 15 U.S.C. § 78o-11.

America Original Risk Retention Letter). To the extent a full exemption is not included in the Final Rule under Section 15G of the Exchange Act, Bank of America supports SFIG's request for the modification of the risk retention requirements from those included in the Re-proposed Rule for CDRs to, (among other things):

- exempt any CDR transaction that: (i) repackages securities that could be sold to investors in the transaction directly without risk retention, (ii) is a pass-through of all principal and interest payments on the underlying securities (net of any related trust or other issuer expenses and swap payments if any), and (iii) does not involve credit tranching;
- specify that 5% of single class or class that is *pari passu* with the class representing the CDR investor interests qualifies as an eligible vertical retained interest for purposes of 15G and the regulations thereunder to satisfy any related risk retention requirement; and
- restores a "representative sample" option for CDRs so that sponsors could hold 5% of the underlying security(ies) and thereby satisfy the related risk retention requirements.

Unless these modifications are made in the Final Rule, in Bank of America's view the CDR market will either cease to exist or be significantly reduced as affected CDR participants will materially increase their related transaction costs in order to recover the increased costs of CDRs as a result of required risk retention. Institutional investors will be adversely affected as a result without any attendant benefit.

## X. Collateralized Loan Obligations Comments

For the reasons set forth in this section and consistent with the Bank of America Original Risk Retention Supplemental Letter,[100] Bank of America continues to believe that broadly syndicated collateralized loan obligation transactions ("CLOs") should not be subject to the risk retention requirements of Section 941 of the Dodd-Frank Act. In the event, however, that the Agencies were to determine in the Final Rule that broadly syndicated CLOs[101] are appropriately subject to Section 941, the options in the Re-proposed Rule for broadly syndicated CLOs to satisfy the risk retention requirements are unfortunately unworkable in light of the realities of the operation of the CLO market and the syndicated loan and leveraged finance markets more generally.[102] Bank of America, as a member of several industry groups, has worked to develop several alternative approaches to the risk retention requirements that would satisfy Section 941 while not negatively impacting the CLO, commercial loan or Term Loan B markets.[103]

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[100] *See* Bank of America Original Risk Retention Supplemental Letter, *supra* note 5, at Section II.

[101] When used herein, references to "broadly syndicated CLOs" are intended to refer to the typical broadly syndicated loan or cash flow arbitrage CLO seen in the current CLO market and, while in some respects similar to the proposed definition of "open market CLO" used by the Loan Syndication and Trading Association in several of their comment letters to the Original Proposed Rule, it is not the same and, in addition, is significantly different from, and is not to be confused with, the Re-proposed Rule's definition of "open market CLO."

[102] As the Agencies are aware, the LSTA has previously submitted several sets of comments to the Original Proposed Rule, including comments dated August 1, 2011, September 2, 2011, April 1, 2013, and July 29, 2013. Bank of America agrees with the points raised by the LSTA with respect to open market CLOs and believes that the Re-proposed Rule does not adequately address the concerns raised in the LSTA's comment letters.

[103] Part D of this section summarizes these alternatives, which are also described in more detail in the industry comment letters being submitted by the LSTA, SFIG and certain other financial industry groups. As a member of these industry groups, Bank of America has been and continues to be involved in the development of those alternatives. Given the unusually truncated comment period provided in the Re-proposed Rule, we will continue to consider alternatives internally and with the industry groups indicated above. We reserve the right to supplement this letter with respect to these alternatives as details related to the alternatives are more fully developed.

### A. CLOs are not subject to or, in the alternative, should be exempted from the requirements of Section 941

#### 1. Managers of broadly syndicated CLOs are not "securitizers" and are therefore not subject to Section 941

Section 941 of the Dodd-Frank Act requires 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."[104] Section 941 defines "securitizer" to mean: "(A) the 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."[105]

As we explained in the Bank of America Original Risk Retention Supplemental Letter[106] and as argued by various parties in their comment letters submitted in response to the Original Proposed Rule,[107] the definition of "securitizer" in Section 941 cannot be reasonably construed to include broadly syndicated CLO managers. Broadly syndicated CLOs are a unique subset of the ABS market. The collateral manager of a broadly syndicated CLO acts as an agent of the CLO and selects the loans that the CLO acquires in constructing its portfolio, monitors the performance of the loans, and can sell underperforming loan assets. The CLO manager thus may organize and initiate a securitization transaction, but it does so by selecting assets for the CLO to

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[104] 15 U.S.C. § 78o-11(b)(1).
[105] § 78o-11(a)(3).
[106] *See* Bank of America Original Risk Retention Supplemental Letter, *supra* note 5, at Section II.
[107] *See, e.g.*, Loan Syndications and Trading Association, Comment Letter on the Credit Risk Retention Proposed Rule 7–14 (August 1, 2011), *available at* http://www.fdic.gov/regulations/laws/federal/2011/11c184ad74.PDF (hereafter "LSTA August 1, 2011 Comment Letter"); Loan Syndications and Trading Association, Comment Letter on the Credit Risk Retention Proposed Rule 16–19 (April 1, 2013), *available at* http://www.fdic.gov/regulations/laws/federal/2011/11c287AD74.pdf (hereafter "LSTA April 1, 2013 Comment Letter").

purchase in the open market, *not* by selling or transferring assets. The CLO manager itself does not hold or own the loans that the CLO acquires and thus cannot sell or transfer those loans.[108]

In the Re-proposed Rule, however, the Agencies conclude that a CLO manager meets the statutory definition of "securitizer" because it "organizes and initiates a securitization transaction by indirectly transferring assets to the issuing entity."[109] The Agencies also conclude that to the extent there is any ambiguity in the statutory definition of "securitizer," they may rely on basic canons of statutory construction—reading the statute as a whole and giving effect to all of its provisions.[110] Without any specific statutory support, it is not entirely clear how these canons of construction support a broad interpretation of the definition of "securitizer." The Agencies also point out in general terms that Congress intended for risk retention to be held by collateral asset managers who determine credit risk profiles and therefore need regulatory incentives to monitor the quality of the assets they cause to be transferred to an issuing entity.

Bank of America agrees that Section 941 should be read as a whole, giving effect to all of its provisions. Ultimately, of course, as the U.S. Supreme Court has noted, we are bound by "one, cardinal canon before all others. [The Supreme Court has] stated time and again that courts must presume that a legislature says in a statute what it means and means in a statute what it says there."[111]

The plain language of Section 941 clearly illustrates that Congress never intended to treat CLO managers as "securitizers" subject to risk retention requirements. First, as explained in

[108] Indeed, in many respects, a CLO manager is more akin to a manager of a mutual (rather than a typical securitizer) and mutual funds are not subject to the risk retention requirements of Section 941.
[109] Re-proposed Rule, 78 Fed. Reg. at 57962.
[110] *Id.*
[111] *Conn. Nat'l Bank v. Germain*, 503 U.S. 249, 253-54 (1992). *See also Jimenez v. Quarterman*, 555 U.S. 113, 118 (2009) ("As with any question of statutory interpretation, our analysis begins with the plain language of the statute. It is well established that, when the statutory language is plain, we must enforce it according to its terms."); *INS v. Cardonza-Fonseca*, 480 U.S. 421, 452–53 (1987) (Scalia, J., concurring) ("Judges interpret laws rather than reconstruct legislators' intentions. Where the language of the law is clear, we are not free to replace it with an unenacted legislative intent.").

detail in prior comments, a CLO manager does not organize and initiate an ABS transaction "by selling or transferring assets, either directly or indirectly . . . , to the issuer," and therefore does not fit within Section 941's definition of "securitizer."[112] Second, reading Section 941 as a whole, the Agencies' core statutory directive under Section 941 is to prescribe regulations requiring securitizers to retain credit risk "for any asset that the securitizer, through the issuance of an asset-backed security, transfers, sells, or conveys *to a third party*."[113]

In this context, the Agencies' interpretation of 15 U.S.C. § 78o-11(a)(3) is untenable. According to the Agencies, a manager working for a CLO is a "securitizer" because it selects loans for the CLO to purchase and therefore "indirectly transfer[s] assets" to the CLO.[114] But the CLO manager is only an agent of the CLO itself. The CLO manager is not transferring assets—directly or indirectly—to a third party through the issuance of an asset-backed security. The CLO, acting through its manager, is purchasing assets for itself.

#### 2. Risk retention is not necessary or appropriate for broadly syndicated CLOs and, as such, broadly syndicated CLOs should be exempted from Section 941

Section 941 allows the Agencies to provide for total or partial exemptions for a particular asset class "as may be appropriate in the public interest and for the protection of investors."[115] Broadly syndicated CLOs should be specifically exempted from the requirements of Section 941 because they do not present the risks inherent in "originate-to-distribute" securitizations that are the focus of the Agencies in the Re-proposed Rule.

As the Agencies explain in the Re-proposed Rule, although securitization markets have important benefits, problems arise when incentives are not properly aligned and there is a lack of

[112] 15 U.S.C. § 78o-11(a)(3).
[113] § 78o-11(b)(1) (emphasis added).
[114] Re-proposed Rule, 78 Fed. Reg. at 57962.
[115] § 78o-11(c)(1)(G)(i).

discipline in the credit origination process.[116] During the financial crisis, some transactions—particularly those involving the "originate-to-distribute" model, such as residential mortgage backed securities—were perceived as vulnerable to informational and incentive problems.[117] Congress intended the risk retention requirement of Section 941 to help address these problems in the securitization markets.[118] As the Agencies note, "the credit risk retention requirements of section 15G are an important part of the legislative and regulatory efforts to address weaknesses and failures in the securitization process and the securitization markets."[119]

None of the concerns that led to the passage of Section 941 implicate broadly syndicated CLOs. As we explained in the Bank of America Original Risk Retention Supplemental Letter, broadly syndicated CLOs are not "originate-to-distribute" structures and, as such, do not suffer from the same risks as other securitization structures.[120] As the Loan Syndications and Trading Association (the "LSTA") has noted, broadly syndicated CLOs did not have a part in causing the financial crisis and performed well through the crisis.[121] Indeed, the Agencies have not cited any evidence that broadly syndicated CLOs suffer from a lack of discipline in selecting syndicated loans or that incentives are not properly aligned. Syndicated loans are typically made only after a robust credit approval process involving thorough due diligence. A wide variety of investors purchase syndicated loans, including institutional investors, CLOs, retail funds, hedge funds, and others. Broadly syndicated CLOs and their managers are sophisticated, institutional investors and have every incentive to thoroughly screen the loans they acquire. Because a broadly syndicated CLO typically owns only approximately 100-150 loans, a broadly syndicated CLO manager is

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[116] Re-proposed Rule, 78 Fed. Reg. at 57931.
[117] *Id.* at 57931–32; *see also id.* at 58005 ("The 'originate-to-distribute' model was blamed by many . . . , as the originators and securitizers were compensated on the basis of volume rather than quality of underwriting.").
[118] *Id.* at 57932.
[119] *Id.*
[120] *See* Bank of America Original Risk Retention Supplemental Letter, *supra* note 5, at Section II.C1.
[121] LSTA August 1, 2011 Comment Letter, *supra* note 107, at 7.

very familiar with each individual loan and continues to actively manage and monitor the CLO's loan portfolio.

Importantly, managers of broadly syndicated CLOs already have "skin in the game" by virtue of their compensation structure and reputational incentives. CLO managers do not profit from the CLO's purchase of commercial loans at the time of sale, but rather derive the bulk of their compensation from the successful performance of the CLO. CLO managers are paid through a small senior management fee, larger subordinate management fee (payable only after current debt service is met), and an incentive fee which the manager will receive only if and after the equity investors have received back all of their capital and a specified, market-driven return. And as with any investment adviser who hopes to attract additional investors in the future, a CLO manager has a strong reputational incentive to build a quality portfolio of syndicated commercial loans.

In addition to these market-based incentives for broadly syndicated CLO managers to construct a quality portfolio of syndicated commercial loans, existing regulations promulgated by several of the Agencies already provide additional and meaningful protections against imprudent underwriting, including the Shared National Credit Program,[122] the Interagency Guidance on Leveraged Lending,[123] and the Dodd-Frank Act's amendments to the Investment Advisers Act of 1940 requiring CLO managers to register as investment advisers under that Act.[124]

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[122] *See, e.g., Shared National Credit Program*, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, http://www.federalreserve.gov/bankinforeg/snc.htm (last visited Oct. 22, 2013).
[123] Interagency Guidance on Leveraged Lending, 78 Fed. Reg. 17766 (March 22, 2013).
[124] Dodd–Frank Wall Street Reform And Consumer Protection Act § 403, 124 Stat. at 1571 (amending section 203(b) of the Investment Advisers Act of 1940, 15 U.S.C. 80b–3(b)).

### B. The Re-proposed Rule, if applied to the CLO market, would have significant negative affects

In the Re-proposed Rule, the Agencies acknowledged that "the standard forms of risk retention in the original proposal could, if applied to broadly syndicated CLO managers, result in fewer CLO issuances and less competition in this sector."[125] We agree with this observation. As a practical reality, it is financially prohibitive for most managers of broadly syndicated CLOs to hold the risk retention piece. The Agencies' acknowledgement is supported by a recent LSTA survey of CLO managers, the results of which were included in a comment letter submitted by the LSTA.[126] According to the LSTA's survey, the Agencies' standard risk retention rules could reduce new CLO formation by 75 percent. Of the managers surveyed, five managers predicted the requirement would cut the U.S. CLO industry in half, while the rest thought the rule would cause the industry to decline by 75% (26 managers) or to cease altogether (four managers).[127]

As noted in Section II.B above, there are material issues for many securitization structures with the Re-proposed Rule's additional restrictions on permissible cash flow distributions to an eligible horizontal residual interest. This is certainly the case for CLOs. Unlike some other securitization structures, broadly syndicated CLOs have separate principal and interest waterfalls that effectively subordinate the return of equity capital to the prior payment of principal of, and interest on, all debt tranches of the CLO. CLO equity does typically receive the residual interest collections on the underlying loan portfolio, but only after all current interest has been paid to senior tranches, the CLO manager has received the base and subordinated management fees, and all current reimbursable deal expenses (including hedging

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[125] Re-proposed Rule, 78 Fed. Reg. at 57962.

[126] *See* Loan Syndications and Trading Association, Comment Letter on the Credit Risk Retention Proposed Rule (July 29, 2013), *available at* http://www.fdic.gov/regulations/laws/federal/2011/11c287AD74supp.pdf (hereafter "LSTA July 29, 2013 Comment Letter).

[127] *See id.* at 3–10.

costs, if any) have been paid. In addition, the interest waterfall will often include a diversion test that will cause interest otherwise distributable to the CLO equity instead to be used to acquire additional collateral for the senior tranches or to repay senior tranches according to relative priority. Broadly syndicated CLOs typically have substantially more than 5% equity, but due to the typical CLO reinvestment period (during which prepayments and sale proceeds are used to acquire additional/replacement collateral for the senior tranches) would not be able to meet the Re-proposed Rule's additional eligible horizontal residual interest restrictions. Moreover, Bank of America does not understand the policy that requires additional restrictions on the form of retention that the Agencies have indicated is preferred.[128] The practical effect of this restriction is to preclude the distribution of otherwise available proceeds to the holders of the related equity/first-loss tranches in circumstances that may have little (or nothing) to do with the actual performance of the underlying securitized assets. The further effect of such restrictions is to make equity investment more difficult to obtain and less likely in the amounts required to support existing ABS markets. The result of this restriction is either that sponsors (and other retaining holders) hold eligible vertical interests rather than eligible horizontal residual interests or, more likely, that ABS markets shrink dramatically as the availability of equity decreases or the costs thereof increase to make related securitizations less attractive financing options.

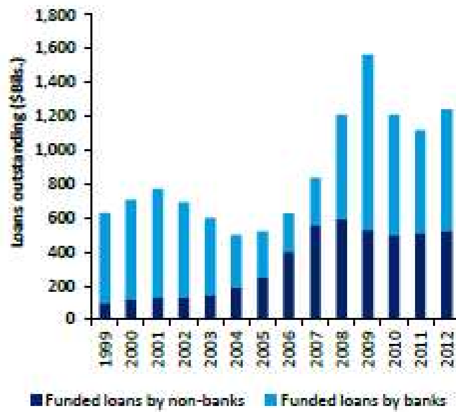
CLOs are a critical segment of the syndicated loan market and, by extension, the U.S. economy as a whole. CLOs provide essential financing to borrowers through syndicated institutional term loans that are commonly referred to as "TLBs" or "Term Loan Bs." In 2012, there was more than $1.2 trillion in outstanding syndicated loans in the U.S., and broadly

[128] Re-Proposed Rule, 78 Fed. Reg. 57938 ("The inclusion of more of a vertical interest could reduce the significance of the risk profile of the sponsor's economic exposure to the securitization vehicle.").

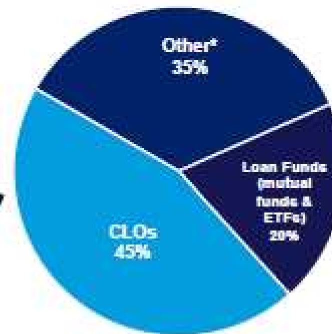
syndicated CLOs alone provided approximately $290 billion of loan capital to companies that benefit from CLOs as shown in the chart below:

**Banks and non-banks provide funded loans to U.S. companies; CLOs provide nearly 25% of ALL funded loans**

**Funded Loans Outstanding**




**Types of Non-bank Lenders**




*Other includes hedge funds, separate/commingled accts and TRS

- In 2012, there were more than $1.2 trillion of funded loans outstanding
- Today, non-banks provide more than $600 billion of these funded loans
- CLOs alone supply $285 billion – nearly 50% of non-bank loans, and nearly 25% of ALL funded loans to U.S. companies

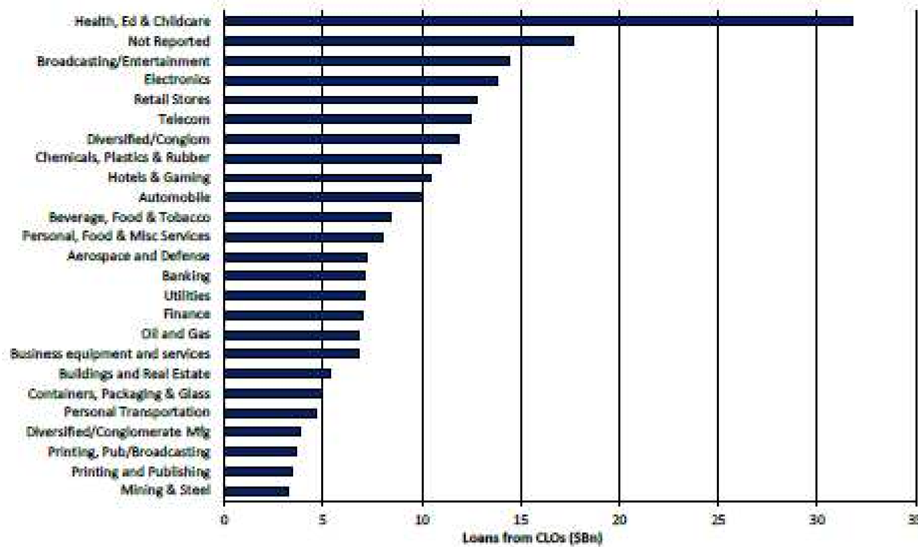
Source: Dec, OCC, FDIC SNC data; S&P/LCD/Capital IQ.

CLOs are the largest non-bank segment of the syndicated market and purchase approximately 50% of such loans. In addition, CLOs are active in the secondary syndicated loan markets and contribute substantial transparency and price-discovery as a result. Many of the borrowing companies in the syndicated loan market are small or medium sized businesses who

depend on the CLO market for access to capital, especially to certain industries responsible for important growth and job creation for the U.S. economy as shown below:

**CLOs Provide Financing to Critical Industries**

**Volume of loans from CLOs**

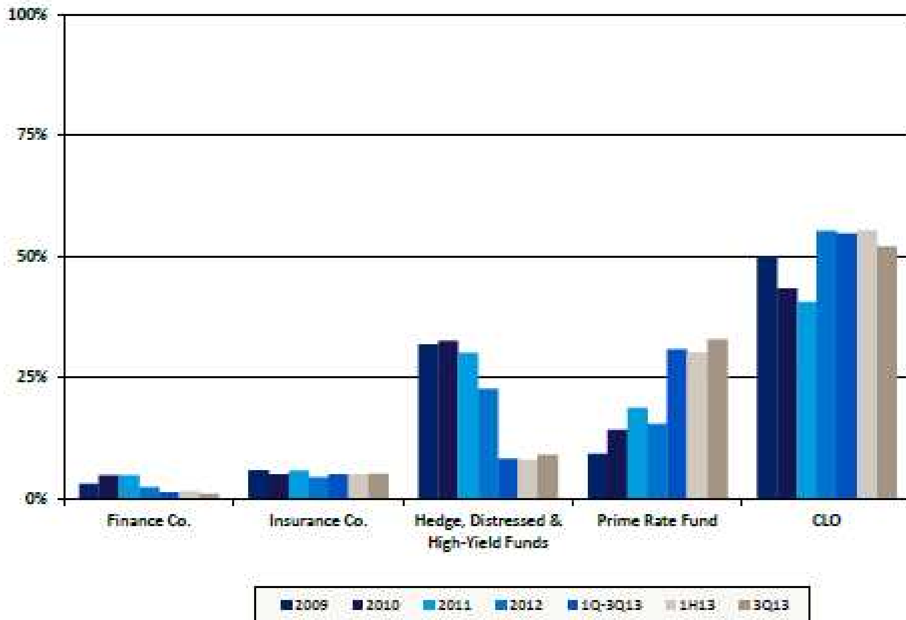



Source: Bank of America Merrill Lynch.

CLOs provide substantial credit capacity to the commercial loan market and a robust “bid” that generally serves to lower interest rates for borrowers, particularly to corporate and other borrowers that may not have ready access to alternative capital markets financing.

As the following table shows, CLOs are a critical segment of the syndicated loan market:

**The CLO Market is the Largest Non-Bank Purchaser of Institutional Loans in the Primary Market**

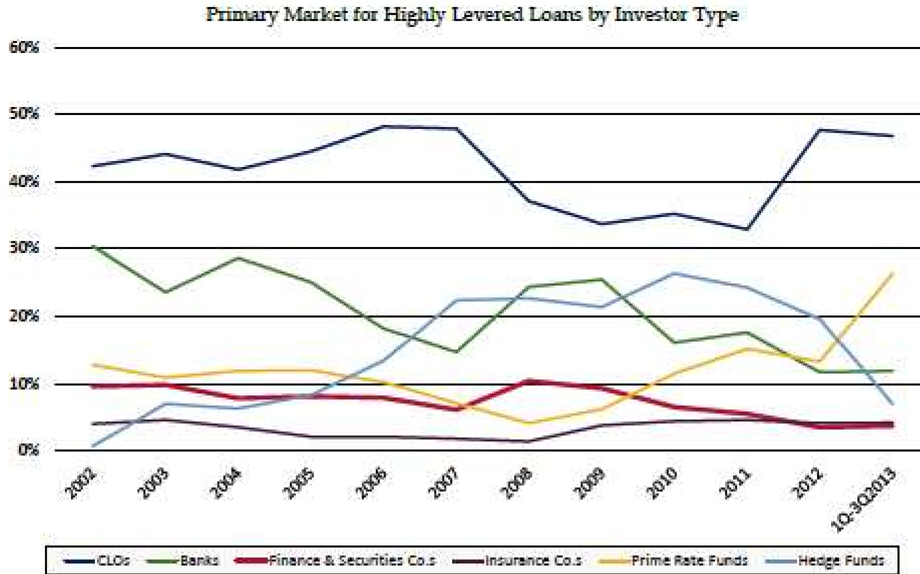



Source: LCD Quarterly 2013Q3.

Unlike open end prime rate mutual funds and hedge funds, CLO's are not subject to daily or monthly client redemptions and the potential price and volume volatility that can arise

therefrom. This volatility is shown in the following chart:

**The CLO Market Has Become More Important to the Primary Loan Market as Banks and Securities Firms Reduce Purchases**



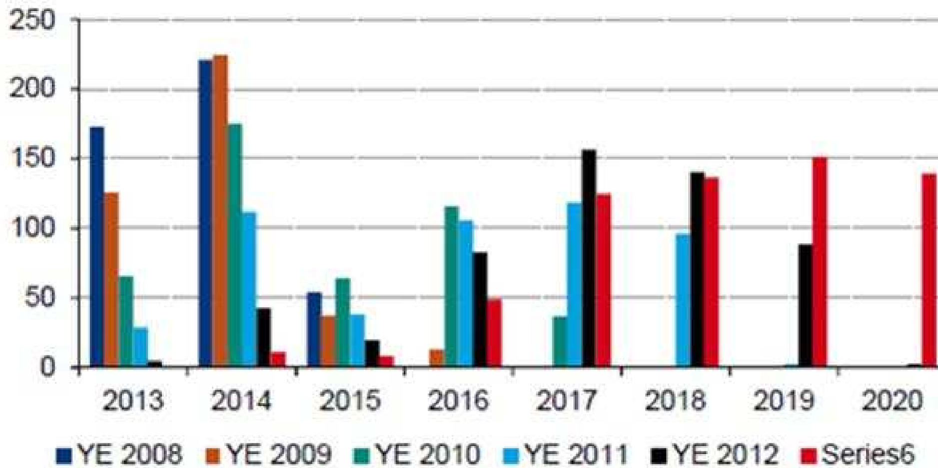

Source: LCD Quarterly 2013Q3.

CLO structures offer the benefits of long-term funding, generally lower return requirements and lack of sensitivity to market price changes. These features of CLO's contribute to lower interest costs for borrowers, lower price volatility, and generally lower systemic risk to the market as a whole.

The importance and value of CLOs to the commercial loan market has been recently highlighted by the recently resurgent CLOs' substantial participation in the refunding of the

"refinancing wall" that was widely forecast for 2010-2011 and evidenced by the general extension of loan maturities to beyond 2017 as shown in the following chart:

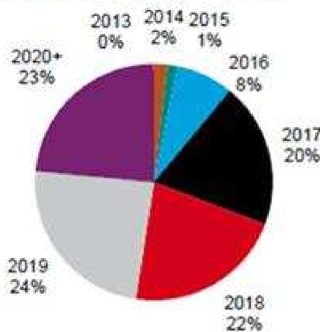
Chart 14: US Leveraged Loan Maturity Schedule ($bn)




Source: S&P LCD

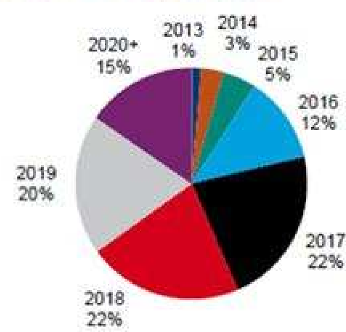
CLOs have broadly participated in this maturity extension as shown in the charts below:

Chart 15: US Leveraged Loan Maturity Distribution




Source: S&P LCD

Chart 16: US CLO Loan Maturity Distribution




Source: BofA Merrill Lynch Global Research, Intex

Of course, if risk retention is applied to CLOs and, as expected, this reduces CLO formation and activity, this new maturity "wall" beginning in 2017 and beyond will present significant loan market challenges and will risk a material increase in related loan defaults and/or much more expensive borrowings (which inevitably will have a dampening economic effect).

As the LSTA explained in its August 1, 2011 comments,[129] and as the Agencies acknowledge,[130] the SEC is required to engage in a cost-benefit analysis for new rules. Section 23(a)(2) of the Exchange Act requires the SEC, when making rules under the Exchange Act, to consider "the impact any such rule or regulation would have on competition" and "not adopt any such rule or regulation which would impose a burden on competition not necessary or appropriate in furtherance of the purposes of [the Exchange Act]."[131] Section 3(f) of the Exchange Act also requires the SEC to consider whether a proposed rule "will promote efficiency, competition, and capital formation" when determining whether the rule is necessary or in the public interest.[132] If the SEC fails to adequately assess the economic effects of a new rule, the rule will be vacated.[133]

In the Re-proposed Rule, the SEC acknowledges that the costs and benefits of the proposed risk retention requirements depend largely on the specific market and asset characteristics for each asset class.[134] Yet, the SEC's economic analysis says little to nothing about broadly syndicated CLOs. At one point, the Agencies acknowledged that the standard risk retention requirement could result in fewer CLO issuances and less competition in the sector.[135] But the SEC never analyzes the costs and benefits of the newly proposed lead arranger alternative, and does not set forth any reasonable basis for concluding that the substantial burdens that it proposes to impose on broadly syndicated CLOs are necessary and appropriate to advance the purposes of Section 15G of the Exchange Act. Instead, the SEC provides an analysis of the cost of financing a retained risk interest with a number of required assumptions, many of

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[129] LSTA August 1, 2011 Comment Letter, *supra* note 107, at 3, n.7.
[130] Re-proposed Rule, 78 Fed. Reg. at 58004.
[131] 15 U.S.C. § 78w(a)(2).
[132] 15 U.S.C. § 78c(f). *See also* 15 U.S.C. § 77b(b).
[133] *See, e.g., Bus. Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011); *Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166 (D.C. Cir. 2010); *Chamber of Commerce v. SEC*, 412 F.3d 133 (D.C. Cir. 2005).
[134] Re-proposed Rule, 78 Fed. Reg. at 58006.
[135] *Id.* at 57962. *See also id.* at 58015.

which are not realistic in actual cases, but which, in any event, only captures a small (and we think mostly unimportant) aspect of the costs and other consequences of the Re-proposed Rule on broadly syndicated CLOs.

Subjecting broadly syndicated CLOs to risk retention requirements will have real economic impacts and, in the form and manner proposed by the Re-proposed Rule, will almost certainly increase corporate borrowing costs and reduce capital investment and job creation.[136] As both a leading arranger of syndicated loans as well as of CLOs, Bank of America is acutely aware of these impacts.

### C. The "Arranger Option" is not a workable risk retention tool given the operation of the CLO and loan markets and would harm the public interest

In the Re-proposed Rule, the Agencies, in an effort to avoid "having the general risk retention requirements create unnecessary barriers,"[137] proposed an alternative method for "open market CLOs"[138] to satisfy the risk retention requirement. Bank of America appreciates the Agencies' attempt to provide an alternative to the CLO manager holding the required risk retention. However, as discussed below, the Agencies' "Arranger Option" does not provide a workable alternative to the standard risk retention requirements. More specifically, we have

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[136] These and other likely effects of subjecting CLOs to risk retention requirements were noted in the Bank of America Original Risk Retention Letter, *supra* note 4, at 29–30. Similar effects were also noted in other comment letters to the Original Proposed Rule. *See* LSTA August 1, 2011 Comment Letter, *supra* note 107, at 14–17; LSTA April 1, 2013 Comment Letter, *supra* note 107, at 14–16; LSTA July 29, 2013 Comment Letter, *supra* note 126, at 3–9; Securities Industry and Financial Markets Association, Comment Letter on the Credit Risk Retention Proposed Rule 70 (June 10, 2011), *available at* http://www.fdic.gov/regulations/laws/federal/2011/11c09ad74.PDF; American Securitization Forum, Comment Letter on the Credit Risk Retention Proposed Rule 137 (June 10, 2011), *available at* http://www.fdic.gov/regulations/laws/federal/2011/11c66ad74.PDF; JPMorgan Chase & Co., Comment Letter on the Credit Risk Retention Proposed Rule 50 (July 14, 2011), *available at* http://www.fdic.gov/regulations/laws/federal/2011/11c86ad74.PDF; Financial Services Roundtable, Comment Letter on the Credit Risk Retention Proposed Rule 32 (August 1, 2011), *available at* http://www.fdic.gov/regulations/laws/federal/2011/11c260ad74.PDF; Wells Fargo & Company, Comment Letter on the Credit Risk Retention Proposed Rule 29 (July 28, 2011), *available at* http://www.fdic.gov/regulations/laws/federal/2011/11c142ad74.PDF; White & Case LLP, Comment Letter on the Credit Risk Retention Proposed Rule 2 (June 10, 2011), *available at* http://www.fdic.gov/regulations/laws/federal/2011/11c45ad74.PDF.

[137] Re-proposed Rule, 78 Fed. Reg. at 57962.

[138] The Agencies' use of this term risks confusion with the LSTA's definition/proposals regarding "Open Market CLOs."

serious concerns that the option is inconsistent with current bank regulations, would cause illiquidity that is not currently in this market, and could create adverse systemic risk.

Under the Re-proposed Rule, if a lead arranger (defined as the party that holds 20% or more of the aggregate principal balance at origination, and no one holds more at closing) of a syndicated credit facility agrees to hold 5% of a specified tranche of the related syndicated credit facility for the life the financing, such tranche would be a CLO-eligible loan tranche. An "open market CLO" solely comprised of such CLO-eligible loan tranches and related servicing assets would not require risk retention by the collateral manager.

Bank of America has worked with several industry groups in evaluating the Lead Arranger Option and has found it unworkable and that it would be harmful to the market if adopted. In the interest of facilitating the Agencies' review of the various comment letters being submitted in response to the Re-proposed Rule, we are not reproducing the analysis or conclusions of these groups in this letter. Rather, we would like to note our support of the reasoning and conclusions on this topic in the LSTA's comment letter on the Re-proposed Rule expected to be filed on or about October 30, 2013 (the "LSTA Comment Letter") and in the SFIG Comment Letter. In addition, we would like to note for the Agencies that the LSTA has conducted a thorough market survey regarding the feasibility of the Arranger Option.[139] Arranging banks uniformly reported that the proposed alternative is unworkable and would be harmful to the market and investors for multiple reasons, as described in detail in the LSTA Comment Letter.

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[139] The LSTA has surveyed a wide range of business representatives covering all disciplines of the banks that have acted as lead arrangers in the overwhelming percentage of domestic syndications that produce loans purchased by CLOs. Those officials are responsible for the banks' origination units, underwriting and credit assessments, risk reporting and management, trading, regulatory compliance, and other functions. According to Thomson Reuters LPC Institutional Loan Bookrunner league tables, they represent banks who are members of the LSTA and include the top 10 syndicated loan arrangers by volume, together comprising a domestic market share exceeding 75 percent in 2012.

### D. Bank of America is working with several industry groups to develop alternatives for the CLO market to comply with Section 941

Bank of America, as a member of several industry groups, has been actively assisting in the development of several alternatives methods for broadly syndicated CLOs to satisfy the requirements of Section 941 while not adversely impacting the CLO market or the lending market more generally. We highlight some of those possible alternatives here.

#### 1. Reduce the amount of risk to be retained for CLOs because 5% of fair value substantially exceeds 5% of the credit risk in a CLO

Bank of America acknowledges that section 15G of the Exchange Act permits the amount of risk required to be retained to be at least 5% of the related credit risk, but notes that the LSTA's April 1, 2013 comments included an analysis by Professor Victoria Ivashina of the Harvard Business School showing that, for a typical CLO and using conservative assumptions, approximately 99.6% of the likely CLO losses are borne by the bottom 20% of the CLO capital structure.[140] Professor Ivashina's analysis concludes as follows: "by holding *5% of the CLO equity* CLO manager is exposed to *4.55% of CLO credit risk* in the 6-year scenario and 4.45%-4.47% of CLO credit risk in the 10-year scenario."[141]

Bank of America respectively suggests that Professor Ivashina's analysis is instructive and that the Re-proposed Rule's requirement to hold an eligible horizontal residual interest of 5% of the fair value of the CLO would require holding approximately 10 times the minimum required 5% credit risk without any justification for such a grossly disproportionate requirement.

Bank of America urges the Agencies to reconsider Professor Ivashina's analysis and conclusion and to set a required minimum risk retention for CLOs that is much more

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[140] LSTA April, 1, 2013 Comment Letter, *supra* note 107, app. A at 4.
[141] *Id.* at 6 (emphasis added).

proportionate to the actual credit risk in CLOs and far closer to the statutory-mandated minimum of 5%.

### 2. Qualified Commercial Loans

In the LSTA Comment Letter, the LSTA has proposed that broadly syndicated CLOs holding qualified commercial loans (with the modified requirements and revised characteristics described in the LSTA Comment Letter) would be subject to a proportionate reduction of otherwise required risk retention. Bank of America, as a member of the LSTA, was active in the development of this option. In the interest of facilitating the Agencies' review of the various comment letters being submitted in response to the Re-proposed Rule, we are not reproducing the analysis or conclusions of the LSTA in this letter. Rather, we would like to note our general support of the reasoning and conclusions on this topic in the LSTA Comment Letter. Bank of America expects to continue to work internally and with the LSTA and other industry groups to try and formulate an appropriate definition for qualified commercial loans that would include well-underwritten commercial loans that fall outside of the Re-proposed Rule's current definition. Given the unusually truncated comment period for the Re-proposed Rule, Bank of America and other similarly situated institutions have not had an adequate opportunity to develop and formulate an alternative definition.

### 3. Third Party Risk Retention

In the SFIG Comment Letter, SFIG has proposed that broadly syndicated CLOs could satisfy the risk retention requirement through a third-party retention holder option. Bank of America, as a member of these groups, was active in the development of this option. In the interest of facilitating the Agencies' review of the various comment letters being submitted in response to the Re-proposed Rule, we are not reproducing the analysis or conclusions of these groups in this letter. Rather, we would like to note our support of the reasoning and conclusions

on this topic in the SFIG Comment Letter. Bank of America expects to continue to work internally and with SFIG and other industry groups to try and formulate an appropriate third party retention holder option.

#### 4. Reduce the period for which risk must be retained

The Re-proposed Rule fails to state the basis for the Agencies' determination that an appropriate retention period for CLOs is the latest of 2 years, when the CLO securities have been amortized to less than 33% of their original principal amount, or when the outstanding principal balance of the underlying loan portfolio is less than 33% of its original amount. For the vast majority of CLOs this is substantially all of the life of a CLO since amortization after the reinvestment period is a function of scheduled loan maturities and early prepayments and the amortization of CLO liabilities and the reduction in the outstanding portfolio principal balance can be protracted. As a practical matter, CLO equity investors are likely to call for an early optional redemption well before this amortization would have occurred. Due to the typical reinvestment period of 3 to 5 years required in CLO structures and the weighted average life of the loans in the underlying portfolio of approximately 6 years, Bank of America believes that inferior selection of the underlying initial loan portfolio will be evident far earlier than the Re-proposed Rule's proposed minimum retention period and, further, notes that the CLO structure will typically include an option for the CLO equity to call for an early optional redemption, which option is likely to be exercised if the CLO's performance fails to meet investor expectations. Accordingly, Bank of America urges the Agencies to reconsider required minimum retention period and respectfully suggests that a minimum retention period of the later of 2 years after the closing date or the end of the applicable no-call period (if any) as being far more appropriate for CLOs.

## XI. International Transactions Comments

### A. "Passporting" will reduce conflicts, inefficiencies and undue burdens which can be triggered by requirements to comply with the risk retention regimes of multiple jurisdictions

The differing regulatory approaches to risk retention proposed by multiple jurisdictions, most notably, the United States and the European Union (the "EU"), will inevitably cause conflicts, inefficiencies, and undue burdens in connection with cross border securitizations and even domestic securitizations by EU credit institutions located in the United States. Variations in local market practices and customs, including differing securitization structures, will add to such hardships and require issuers of certain "global" ABS interests to comply simultaneously with risk retention rules of multiple jurisdictions, which are not necessarily in alignment with each other as to form and process, notwithstanding any overarching common goals of investor protection.

These conflicting rules could prevent certain transactions from occurring and make costs too prohibitive to consummate other transactions, which is not the desired result in a global capital market. For example, compliance with the risk retention requirements in the EU pursuant to Article 122a of the Capital Requirements Directive[142] ("Article 122a"), which requirements will be governed by Articles 404-410 of the Capital Requirements Regulation and the Regulatory Technical Standards, would be difficult where securitizers in both the United States and the EU are required to comply with risk retention under both regimes, as certain forms of risk retention available to certain asset classes in the United States do not satisfy the requirements of the EU and vice versa.

[142] Council Directive 2006/48, 2006 O.J. (L 177) 1 (EC), *amended by* Council Directive 2009/111, 2009 O.J. (L 302) 97 (EC).

The Agencies have previously considered comments requesting a "mutual recognition" framework and rejected the concept on the basis that "given the many differences between jurisdictions, finding comparability among securitization frameworks that place the obligation to comply with risk retention requirements upon different parties in the securitization transaction" among other things "it likely would not be practicable to construct such a 'mutual recognition' system that would meet all the requirements of Section 15G of the Exchange Act."[143] While we agree that it would be extremely burdensome to come up with a system of pure mutual recognition, a "passporting" system would allow global ABS issuers subject to multiple risk retention regimes to satisfy such risk retention requirements by complying with the requirements to which it is mandatorily subject, so long as the regime to which it is mandatorily subject is an approved retention jurisdiction (an "Approved Retention Jurisdiction").

A jurisdiction could qualify as an Approved Retention Jurisdiction upon the determination of the Agencies (or a special task force thereof) that the risk retention rules in such jurisdiction meets the requirements of a comparability determination. The Agencies (or special task force) could evaluate whether a risk retention regime and any related disclosure and/or registration requirements are comparable to that of the United States or, if not specifically comparable, achieve the same intended result as the Re-proposed Rule on an ongoing jurisdiction-by-jurisdiction basis. Given the fact that Article 122a has been in effect for two years now, we would propose that the EU be approved as an Approved Retention Jurisdiction.

Approved Retention Jurisdictions would minimize conflicts, inefficiencies, and undue burdens associated with compliance with multiple risk retention regimes while preserving the global market economy as well as the Agencies' ability to determine whether such risk retention rules "meet the requirements of section 15G of the Exchange Act" notwithstanding any

[143] Re-proposed Rule, 78 Fed. Reg. at 57977.

differences or conflicts with the Re-proposed Rule. Upon the determination that a jurisdiction is an Approved Retention Jurisdiction, compliance with the risk retention requirements of the United States in connection with a securitization transaction would be excused, so long as compliance with the risk retention requirements of the relevant Approved Retention Jurisdiction is demonstrated and maintained for the time periods required under the Re-proposed Rule. Additionally, the Agencies (or a special task force thereof) could provide parameters or limitations around the method of compliance that would be acceptable, so as to not be required to accept a form a compliance which is out of line with the Re-proposed Rule, where there is an alternative available that would not conflict with the Re-proposed Rule. For example, a sponsor would be required to comply with Article 122a for purposes of satisfying risk retention for purposes of the Re-proposed Rules regardless of whether any EU credit institution was an investor thereof.

While the Agencies may be reluctant to adopt a "passporting" type framework given that such a framework has not been generally adopted in non-U.S. jurisdictions, the United States has taken the lead on adopting "passporting" approaches in other contexts to promote the establishment of consistent international standards. Namely, the Commodity Futures Trading Commission adopted a substituted compliance framework in connection with specified regulatory requirements applicable to cross-border swaps and the SEC proposed its own version of a substituted compliance framework for four specified categories of regulatory requirements applicable to cross-border security-based swaps. We therefore respectfully request that the Agencies adopt a "passporting" regime in connection with compliance with the Re-proposed Rule.

**B. Regulation S compliant transactions should not be included in the ten percent calculations within the foreign safe harbor**

Section __.20(b) of the Re-proposed Rule exempts certain transactions, so long as, among other things, "[n]o more than 10 percent of the dollar value (or equivalent amount in the currency in which the ABS is issued, as applicable) of all classes of ABS interests in the securitization transaction are sold or transferred to U.S. persons or for the account or benefit of U.S. persons."[144] If the intention of the Agencies with the addition of "or transferred" was to limit the safe harbor to transactions with less than 10% ABS interests ever held by U.S. persons, the safe harbor would now only be available to very closely held entirely private transactions that are not in book-entry form. Given that many ABS issuances by non-U.S. issuers would not meet this criteria as they are transferred in the capital markets and are held in book-entry form, we do not think that this is what the Agencies intended by such addition.

We therefore request that the Agencies confirm that any ABS interests issued in compliance with Regulation S[145] are in fact excluded from the 10% limit. As the Agencies are aware, the Regulation S safe harbor provides an exemption from registration under the Securities Act for offers and sales by issuers, distributors, their respective affiliates and other persons acting on their behalf and certain resales of securities by others due to a reduced likelihood that the ABS interests would flow back into the United States. The availability of the Regulation S safe harbor is subject to compliance with two general conditions: (i) the transaction must be an "offshore transaction"; and (ii) no "directed selling efforts" may be made in the United States by an issuer, distributor, their respective affiliates and other persons acting on their behalf in connection with the transaction.[146]

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[144] Re-proposed Rule __.20(b), 78 Fed. Reg. at 58044.
[145] 17 C.F.R. § 230.901 *et. seq.*
[146] § 230.903.

In order to satisfy the first condition relating to "offshore transactions" of Regulation S, an offer cannot be made to any person in the United States and the buyer must be (or reasonably believed to be) physically outside of the United States or the transaction occurs on a trading floor of an established foreign securities exchange.

Additionally, in order to satisfy the second condition for determining compliance with the safe harbor provisions regarding "directed selling efforts," the offer or sale must not include any selling efforts or other activity taken "for the purpose of, or that could be reasonably expected to result in, conditioning the U.S. market for the relevant securities."[147] Furthermore, where there is an increased likelihood that ABS interests may come to rest in the United States, Regulation S imposes safeguards in the form of additional restrictions, limitations and conditions on such ABS interests instead of an outright exclusion from the safe harbor.

It is important to note that compliance with Regulation S, in particular by non-U.S. issuers, does not ensure that securities will never be sold or transferred to U.S. persons. Non-U.S. issuers are not required to monitor or restrict the transfer of Regulation S securities other than at the initial issuance and, in some cases, at the end of a 40-day distribution compliance period. While U.S. issuers utilizing Regulation S are required to include transfer restrictions throughout the life of a transaction, U.S. issuers of course are excluded from the foreign safe harbor in the Re-proposed Rule in any event pursuant to Section __.20(b)(3).

Excluding Regulation S compliant transactions appears to be consistent with the intent of the foreign safe harbor in that, like the registration requirements of the Securities Act, we suspect that the Re-proposed Rules are not intended to apply to transactions that do not materially impact U.S. investors. We therefore respectfully request confirmation that ABS interests issued in

[147] § 230.902(c)(1).

accordance with Regulation S are excluded from the 10% calculation in Section __.20(b)(3) of the Re-proposed Rule.

## XII. Conclusion

Securitization provides much-needed liquidity for all aspects of the market. If properly conducted, subject to prudent regulation and oversight, securitization provides benefits to borrowers, investors, and securitizers alike. Subject to the considerations addressed above, we believe that the proper balance between careful lending and returning economic growth can be achieved.

* * * * *

We are grateful for the chance to provide these comments to the Re-proposed Rule. If there are any questions arising from our comments or any other aspect of this topic, we welcome the opportunity to provide assistance in any way helpful. Please feel free to contact Paul Kurzeja (paul.kurzeja@bankofamerica.com, 980-386-8509) or the undersigned (kenneth.l.miller@bankofamerica.com, 980-386-6669) at any time.

Respectfully Submitted,

Kenneth L. Miller

Deputy General Counsel

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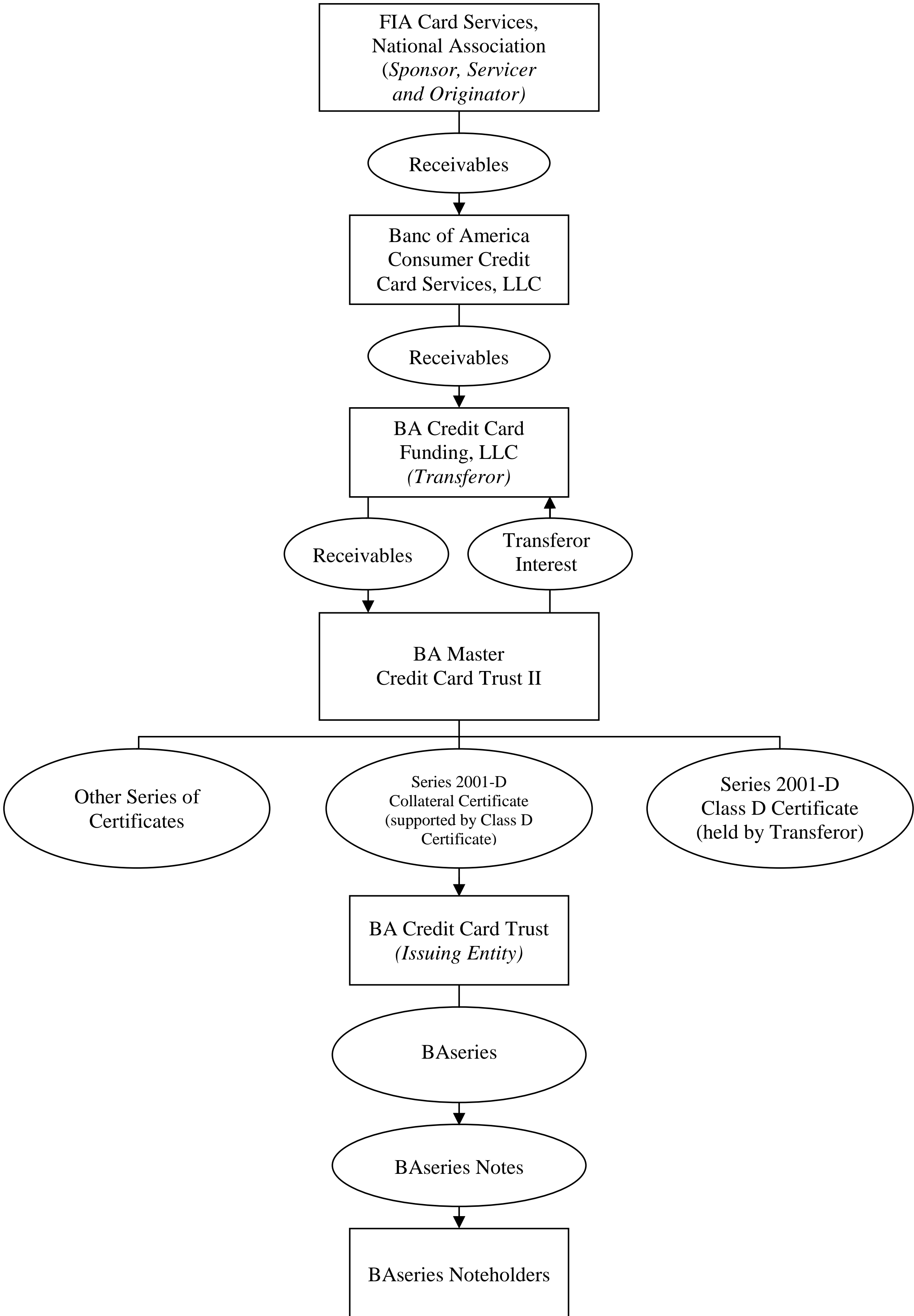
## Appendix B

## Bank of America Credit Card Structure



# Appendix C

## Representative Sample Technique

**Representative sample methodology:**

1. Selection of the representative sample
    a. The sponsor will select a designated pool of assets for securitization based on the sponsor's usual eligibility criteria .A random sample equal to 5.00% of the designated pool will be selected to create the representative sample pool. The remaining 95% of the designated pool of assets will be included in the securitized pool.

    b. A random pool sample can be constructed using a random sample function in a database system. For the purposes of selecting a representative sample pool, the parameters would be set so that a random 5.00% (by unpaid principal balance) of the designated pool of assets is selected.

2. To test the statistical viability of the foregoing technique, we ran an analysis which demonstrates that this technique should provide a "representative sample" so long as the designated pool of auto loans is greater than or equal to approximately 5,480 loans.

3. The following material characteristics of the assets in the securitized pool and the representative sample should be disclosed by the sponsor of auto ABS:
    a. aggregate receivables balance
    b. average outstanding principal balance
    c. average original amount financed
    d. weighted average annual percentage rate
    e. weighted average original term to maturity
    f. weighted average remaining term to maturity
    g. percentage by principal balance of used auto loans
    h. percentage by principal balance of new auto loans
    i. non-zero weighted average FICO score of obligors

**Representative Sample Analysis:**

***Definitions:***

*The* ***Confidence Level*** *tells you how sure you can be of the test results. For instance, a 95% Confidence Level with a 5% Confidence Interval indicates that in 100 tests of the sample, the results will fall within the 5% margin of error 95 times.*

*The **Confidence Interval** is the margin of error in the test results and is reported as a plus-or-minus figure in the test results. For example, a poll of a limited sample size of voters indicates that 50% of voters favor a particular candidate with a margin of error of 4%. The actual number of favorable opinions that would be obtained if one sampled the entire voting population (instead of just a sample) will likely fall between 46% to 54% of voters.*

The ***Expected Error Rate*** *is, for each material characteristic, the anticipated percentage variance of the representative sample pool from the designated pool of assets. A low percentage requires a low sample rate because the occurrence of error is remote.*

***<u>Assumptions:</u>***

***Confidence Level**: 2 standard deviations, 95.45% confidence level*

***Confidence Interval**: 2%, assumption*

***Expected Error Rate:** 3%, consistent with other market metrics of similar intent*

***Maximum Error Rate:** 5% (Expected Error Rate + Confidence Interval)*

*Given the assumptions above, testing indicates that at a population size of 5,480 loans (with a sample size of 276 loans which is 5.03% of 5480) the representative sample drawn from the designated asset pool would result in a representative sample that would be within the appropriate Confidence Level of the securitized pool . A population size less than of 5,480 loans may not result in the desired outcome of falling within the parameters above. In other words, if the number of auto loans in the designated pool of assets is less than 5,480 loans, the 5% representative sample would be too small to expect that the representative sample would fall within the targeted Confidence Level of two standard deviations (95.45% confidence).*

Consistent with the Original Proposal, the sponsor could randomly select the representative sample from a designated pool of less than 5,500 auto loans, test the representative sample pool and, to the extent that the material characteristics of the representative sample pool exceeds the Maximum Error Rate, begin the process again. The sponsor could continue following this procedure until the material characteristics of the randomly selected representative sample as compared to the securitized pool are within the 5.00% Maximum Error Rate.

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Sample size formula for a large population:

$$\text{SampleSize} = \frac{\text{CL}^2 * \text{ER} * (1 - \text{ER})}{\text{CI}^2}$$

where CL = Confidence Level expressed as number of standard deviations (ex. 2)

ER = Error Rate (ex. 3%)

CI = Confidence Interval (ex. 2%)

The sample size adjustment for a finite population is

$$\text{NewSampleSize} = \frac{\text{SampleSize}}{1 + \frac{\text{SampleSize} - 1}{\text{Population}}}$$

## Appendix D

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