Risk Retention Re-Proposal

December 6, 2013

Importance of this meeting

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

Agenda

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

Representative Sample

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

EHRI – Key Issues of the Fair Value Approach

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

EHRI - Limitations on EHRI Distributions

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

EHRI - Revolving Transactions - Self Adjusting Approach

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

EHRI - Simplified Approach for Simple Structures

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

EHRI - Relief for Truly Private Transactions

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

Qualifying Auto Loan Exemption

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

Floorplan

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

Other General Issues

- Certification Requirements
  - Dodd-Frank provides for certification only for ABS *"collateralized exclusively by"* QRMs
    - Certification should be required only for RMBS
    - For RMBS transactions, should be required only for QRM transactions exempt from standard risk retention
  - Provide only to SEC and bank regulators
    - Rule 193 and Regulation AB Item 1111(a)(7) are already required
    - Rule 15Ga-1 requires reporting of repurchases
    - Repurchases are already required for inclusion of non-qualifying assets
  - Retain certification for no longer than five years
    - Consistent with SEC retention requirements for signature pages
- Need for a No-Action Letter/Interpretive Process
  - Innovation in the ABS market will necessarily result in new structures and related interpretive issues
  - Very difficult to get six agencies to convene and focus on individual transactions