



# Risk Retention Re-Proposal

Follow up from 12/6/13 Auto Meeting

January 17, 2014

# Agenda

- Representative Sample
- Eligible Horizontal Residual Interest (EHRI)
  - Revolving Transactions – Self Adjusting Approach
  - Simplified Approach for Simplified Structures
  - Relief for Truly Private Transactions
- We'd also be happy to further discuss Limitations on EHRI Distributions and the related Ford spreadsheet if desired by the regulators

# Representative Sample

- In our meeting, the joint regulators appeared open to permitting the representative sample method if provided with assurance that it would be “representative” rather than merely “random”
- Construction of Representative Sample
  - Select a “Designated Pool” equal to 105.264% of unpaid principal balance of targeted securitized pool
  - Create the “Representative Pool”
    - Using a sampling method, select receivables totaling 5% of the unpaid principal balance from the Designated Pool
  - Validate the representativeness of the Representative Pool within a 95% confidence interval by measuring the following attributes:
    - Average Principal Balance
    - Weighted Average Remaining Term
    - Top 5 geographic percentages
    - We’d also be happy to include credit scores if consistent with the regulators’ goals

# Representative Sample

- Prospectus (or Offering Memo) Disclosure:
  - Description of the policies and procedures used by the sponsor to:
    - Construct the Representative Pool
    - Test the representativeness of the Representativeness of the Representative Pool
    - Maintain isolation of Representative Pool during the period required under the Rules
  - Stratifications of Designated Pool and Representative Pool including:
    - Principal Balance
    - Remaining Term
    - Top 5 geographic percentages
    - We'd also be happy to include credit scores if consistent with the regulators' goals
- Servicing Standards: Servicers would be required to use the same collection and enforcement standards for both the Representative Pool and the Securitized Pool

# EHRI - Revolving Transactions

- In our meeting, regulators requested information about revolving transactions that are not master trusts
- Two kinds of revolving auto loan/lease ABS transactions:
  - Revolving term transactions (example: Capital Auto Receivables Asset Trust 2013-4)
    - <http://www.sec.gov/Archives/edgar/data/893958/000119312513452816/d630108d424b5.htm>
    - Future additions of assets after initial closing date
  - Warehouse facilities provided by banks and ABCP conduits (see, for example, Exhibits 10.5 through 10.7 to the GM Financial Form 10-K)
    - <http://www.sec.gov/Archives/edgar/data/804269/000080426913000010/acf12311210-k.htm#sEBA1B1E5E6D11227DA15B72364B3FE86>
    - Future additions of assets after initial closing date
    - Future additional fundings after initial closing date
    - Commitments typically get renewed, so you don't know when amortization will begin
- These structures are used extensively by auto finance companies and are an important component of liquidity for them
- Problem: Difficult to project future cash flows/fair value without knowing the assets/funding/amortization in the future

# EHRI - Revolving Transactions

- Proposed “Self Adjusting” Approach to EHRI:
  - Test fair value (or simplified approach) at each time additional assets are added (or incremental amounts are invested)
  - 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

- Very important to our members to have an alternative that would be simpler
  - Consider a simpler alternative with greater than 5% retention (perhaps 6%)
  - Alternative could be permissible only with simpler 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

# EHRI –Relief for Truly Private Transactions

- These transactions fall into two categories
  - Term transactions between small issuers and a single investor such as an insurance company negotiating their own note purchase agreement
  - Bank or ABCP-funded transactions often involving a single bank
- In these private transactions, typically there is:
  - No offering memo
  - Due diligence conducted by the investor
- Some of these transactions are structured as securitizations rather than typical bank loans
  - Issuer can get a lower cost of funds due to bankruptcy-remoteness
  - Investor has a safer investment due to bankruptcy-remote structure
- The Simplified Approach would be particularly useful in these situations
- Alternatively, we'd like to request an exemption for transactions offered under the following conditions:
  - Offering under Section 4(2) of the Securities Act of 1933
  - Investor is a QIB
  - No offering memo
  - Investor has the opportunity to perform due diligence
- Without relief, likely alternative is that these transactions would not be structured as securitizations



# 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, including:
  - Simple, proven, plain vanilla auto ABS structures that maintain substantially more than 5% risk retention over their lives
- As an alternative, we suggest a direct measure to achieve the same objective (as illustrated in the attachment):
  - *On the closing date, the projected fair value of the amount retained as of each payment date will not be less than the required 5% risk retention amount*