



# Risk Retention Re-Proposal

Meeting on Participations

February 20, 2014

# Agenda

- What is a participation?
- Reasons to use participations
- Some Illustrations
  - Receivables pool held by issuing entity; 5% participation held by sponsor or depositor
  - Receivables pool held by sponsor or depositor; transfer of a 95% participation to issuing entity
- Proposed Definition of “Eligible Participation Interest”
- Helpful additional request

# What is a Participation?

- A “participation” or a “participating interest” is a right to receive a percentage of the cash flows from an asset
- Example 1: Issuing entity owns \$1 million of receivables and grants a 5% participation to the depositor
  - When the issuing entity receives \$1 of collections on the receivables, the issuing entity would be obligated to pay 5 cents to the depositor on the following settlement date
  - The depositor would suffer 5% of all losses
- Example 2: Sponsor owns \$1 million of receivables and grants a 95% participation to the depositor, which the depositor transfers to the issuing entity
  - When the sponsor receives \$1 of collections on the receivables, the sponsor would be obligated to pay 95 cents to the issuing entity on the following settlement date
  - The sponsor would suffer 5% of all losses
- Similar to an Eligible Vertical Interest
  - A participation is a “vertical slice” of the securitized assets rather than a vertical slice of the securities sold to investors
  - Re-proposal currently permits eligible vertical interests with respect to the securities but omits a vertical interest with respect to the securitized assets

# Reasons to use Participations

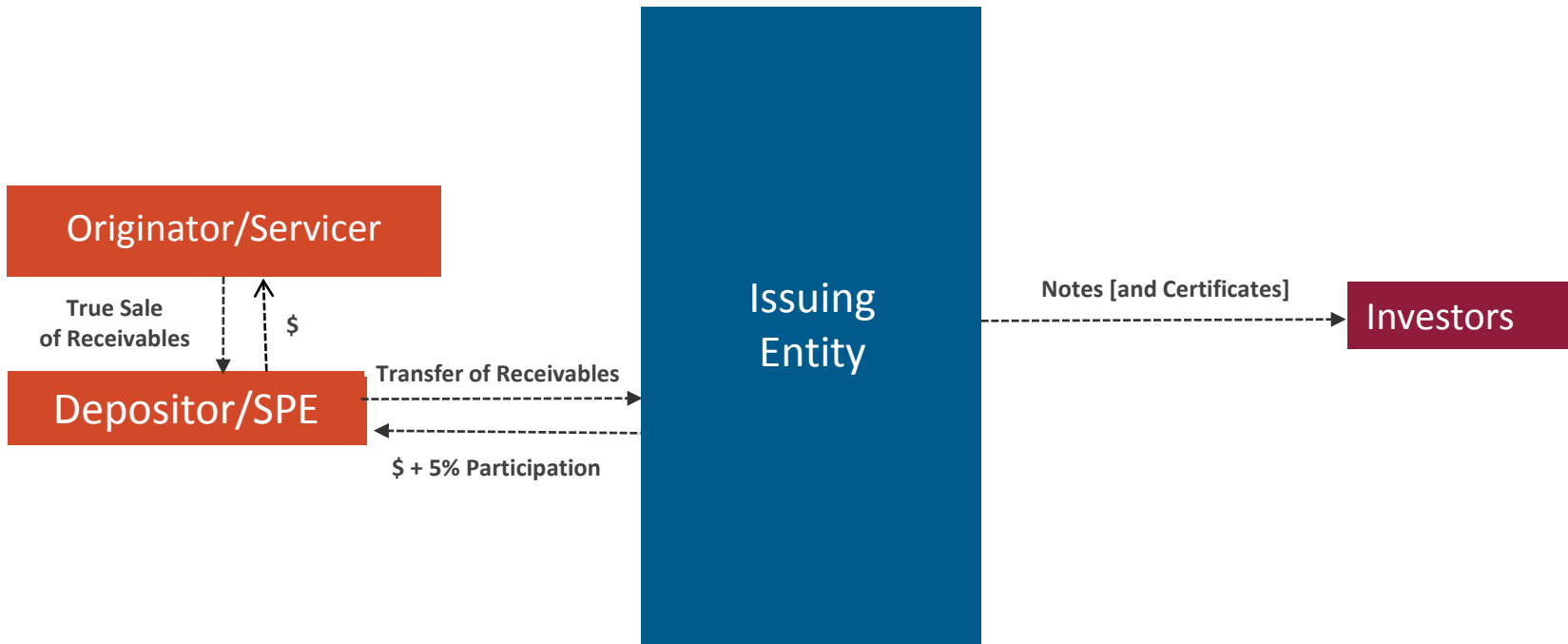
- The “most representative” of all representative samples
  - It’s an interest in the actual securitized pool rather than a sample of other receivables
  - Because it’s just a percentage interest in the securitized pool, there’s no concern that the retained interest won’t be “representative”
- Easy to create at low cost
  - The participation provisions can be as short as one paragraph
- Simpler disclosure; less complicated for sponsors
  - Consistent with our position on vertical interests, no need for disclosure of “fair value”
  - No need to restrict distributions

# Reasons to use Participations (cont.)

- Accounting Benefits
  - Paragraph 8B of FAS 166 (§ 860-10-40-6A of the FASB Accounting Standards Codification) explicitly allows for sale accounting treatment for participations
- Regulatory capital benefits compared with other methods of risk retention
  - Under the proposed Basel Securitisation Framework, a retained interest in receivables may have a lower capital charge than a retained interest in a securitization exposure
- FDIC Safe Harbor
  - The FDIC has explicitly provided a safe harbor for participations without recourse (12 CFR 360.6(d)(1))
  - Assures that participations by banks will be respected, even in a receivership
- Bankruptcy remoteness
  - If issuing entity holds a participation, courts have recognized that participations are treated as “true sales” of the interest transferred, even in bankruptcy under appropriate circumstances
  - See, for example, *In re Coronet Capital Co.*, 142 B.R. 78 (Bankr. S.D.N.Y. 1992)
- Comparison to traditional securitizations without a participation
  - If the issuing entity holds the receivables, there are no differences
  - If the issuing entity holds a participation, similar to securitization of the underlying assets

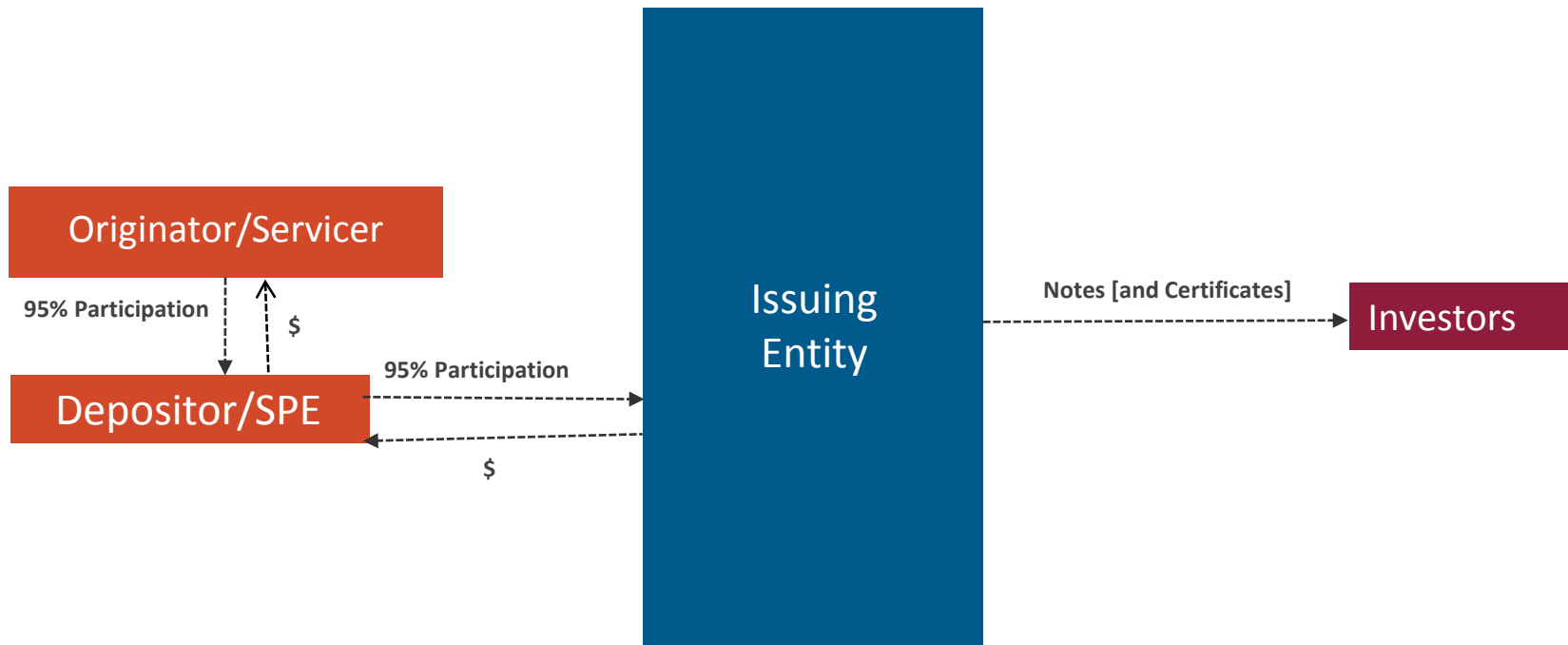
# Illustration 1:

- a. Receivables pool held by issuing entity;
- b. 5% participation held by sponsor or depositor



## Illustration 2:

- Receivables pool held by sponsor or depositor;
- Transfer of 95% participation to issuing entity



# Proposed Definition of “Eligible Participation Interest”

- An interest in an underlying asset or pool of underlying assets that:
  - (a) is an undivided percentage interest;
  - (b) constitutes either
    - (i) an owner’s interest, where the issuing entity holds a participant’s interest, or
    - (ii) a participant’s interest, where the issuing entity holds the owner’s interest;
  - (c) in respect of all rights to cash flow from the underlying assets, is *pari passu* with the interest held by the issuing entity; and
  - (d) does not provide the holder of the participant’s interest with recourse against the owner due to the lack of creditworthiness of any obligor on an underlying asset
- “Owner’s interest”
  - The interest of the owner of the underlying asset or pool of underlying assets who has granted a participation interest in each such underlying assets to another party
- “Participant’s interest”
  - The interest of a participant that has acquired a participation interest in each such underlying asset directly or indirectly from the owner of the underlying assets



# Helpful Additional Request

- It would be helpful, but not essential, for the SEC to provide a limited exemption from Rule 190
  - Would allow the public offering of ABS backed by a 95% participation without registration of the participation
  - Would treat the participation as a securitization of the loans rather than as a securitization of an underlying security