Office of the Comptroller of the Currency
U.S. Department of the Treasury

OCC BULLETIN 2013-25
Subject: Credit Risk Retention of Securitized Assets
Date: October 18, 2013
To: Chief Executive Officers of All National Banks, Federal Savings Associations, Federal Branches and Agencies, Department and Division Heads, and All Examining Personnel

Description: Notice of Proposed Rulemaking

Summary

The Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the U.S. Securities and Exchange Commission, the Federal Housing Finance Agency, and the U.S. Department of Housing and Urban Development (the agencies) are seeking comment on a notice of proposed rulemaking (NPR) that would implement the credit risk retention requirements of section 15G of the Securities Exchange Act of 1934 (15 USC 78o-11), as added by section 941 of the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd–Frank). The proposal would require sponsors of asset-backed securities (ABS) to retain at least 5 percent of the credit risk of the assets underlying the securities and would not permit sponsors to transfer or hedge that credit risk. This proposal replaces an earlier proposal (original proposal) published by the agencies on April 29, 2011 (76 FR 24090).

Highlights

- The new proposal would expand the permissible forms of risk retention from those originally proposed to accommodate additional securitization structures, and would replace the Premium Capture Cash Reserve Account approach with a fair value measurement for the risk retention instruments.
- As with the original proposal, the new proposal would require securitizers to be the entity that retains the risk; loan originators would only retain risk in limited circumstances and at their option.
- The new proposal would set the requirements for the qualified residential mortgage (QRM) exemption to be co-extensive with the qualified mortgage safe harbor established by the Consumer Financial Protection Bureau (CFPB). Comments are sought on an alternative that would incorporate additional factors into QRM, such as borrower credit history and a 70 percent loan-to-value (LTV) cap.

Note for Community Banks

The new proposal imposes requirements on financial firms that package financial assets into ABS. Since community banks rarely act as securitizers, the rule would only apply to a limited number of community banks.

Background

The risk retention requirements added by section 15G are intended to help address problems in the securitization markets by requiring that securitizers, as a general matter, retain an economic interest in the credit risk of the assets they securitize. Requiring a securitizer to retain an interest in the assets it securitizes provides a strong incentive for the securitizer to monitor and ensure the quality of the assets underlying a securitization transaction. Retaining this interest aligns the securitizer's economic interest with those of investors in the ABS. The new proposal would provide securitization sponsors with various options for meeting Dodd–Frank's risk retention requirements.

Section 15G includes a variety of exemptions from these requirements for assets and securitizations that the agencies determine pose low credit risk, including an exemption for ABS that are collateralized exclusively by residential mortgages that meet the standard for QRMs. The agencies propose to define a QRM as any residential mortgage loan that meets the definition of a qualified mortgage (QM), as recently defined by the CFPB pursuant to the creditors' safe-harbor from "ability-to-repay" liability under the Truth in Lending Act. The agencies believe that aligning the QM and QRM definitions would best minimize the potential indirect costs stemming from the QRM definition with existing regulations and market conditions that might negatively affect the availability of mortgage credit. However, the agencies recognize that aligning the QRM and QM definitions has the potential to intensify bifurcation in the mortgage market between QM and non-QM loans.

The agencies invite comment on an alternative formulation of QRM, called QM-plus, that would incorporate a limited number of additional factors into QRM, such as a borrower credit history standard and a 70 percent LTV cap. Under this approach, significantly fewer mortgages would qualify for QRM-exempt status, but those mortgages would be significantly less likely to default than QMs. The agencies request comment as to whether this alternative approach might increase investor acceptance of residential mortgage-backed securities without intensifying any potential bifurcation of QMs and non-QMs. The agencies also request comment as to whether a "blended pool" approach to the QRM exemption—as the agencies are proposing for certain other asset classes under the new proposal—would mitigate the market segmentation concerns underlying the proposal to align QRM with QM.

The new proposal has a zero percent risk retention requirement for ABSs collateralized exclusively by commercial loans, commercial real estate loans, or automobile loans that meet certain underwriting standards. These underwriting standards are designed to ensure that the loans backing the ABS are of very low credit risk.

Significant Changes From Original Proposal

The agencies have made numerous substantive changes compared with the original proposal. These significant changes include the following:

- **Additional vertical risk retention option.** The agencies are proposing to allow a securitization to issue a single vertical security to the sponsor backed by 5 percent of the cash flows of every tranche of the securitization.
- **Flexible-L.** The agencies are proposing to allow a sponsor to meet the minimum 5 percent risk retention requirement with any combination of horizontal and vertical interests totaling that amount.
- **Fair value measurement.** The agencies propose to measure the risk retention interest at fair value rather than par value. The agencies believe fair value more appropriately reflects the economic value of the risk retention. In connection with this change, the agencies are not including the premium capture cash reserve account in the new proposal.
- **Open-market Collateralized Loan Obligation (CLO) option.** The agencies are proposing an alternative risk retention option for certain CLO securitizations. Under this option, the commercial loan syndicate lead arranger may hold 5 percent risk retention on the loan tranches placed in the secondary loan market, where a CLO manager may acquire them for securitization without further risk retention.
- **Sunset of hedging and transfer restrictions.** The new proposal would end the hedging and transfer restrictions on the risk retention interest after a certain period of time. For residential mortgage-backed securitizations, the sunset would occur between five and seven years after origination of the securitization, based on prepayment activity. For all other asset classes, the sunset would generally occur when the unpaid balance of the underlying assets or issued ABS falls to 33 percent of their balance at origination, but no earlier than two years after origination.
- **Blended pools for automobile loans, commercial loans, and commercial real estate loans.**

For these asset classes, the agencies are proposing to allow a mix of loans that meet the underwriting criteria with those that do not meet the criteria into a single securitization. The sponsor would not need to hold risk retention on the portion of assets in the pool that meets the underwriting criteria.

- **Revised QRM definition.** As previously mentioned, the agencies propose to define a QRM as any loan that meets the CFPB's ability-to-repay requirements for a QM, including the current QM exemptions for small lenders, rural lenders, and loans that qualify for purchase by Fannie Mae or Freddie Mac. The agencies invite comment on an alternative that would incorporate additional factors into QRM, such as a borrower credit history standard and a 70 percent LTV cap.

The NPR was published in the *Federal Register* on September 20, 2013. Comments on the proposal are due on or before October 30, 2013. Because of its length, the NPR is not attached to this bulletin but can be found at the Related Link listed below.

Further Information

The NPR describes appropriate methods to submit comments on the proposal to the OCC and other agencies. In addition, the NPR includes contact information for agency staff.

Amy S. Friend
Senior Deputy Comptroller and Chief Counsel

Related Link:

Federal Register, "Credit Risk Retention; Proposed Rule"