

MAYER • BROWN

Securitization

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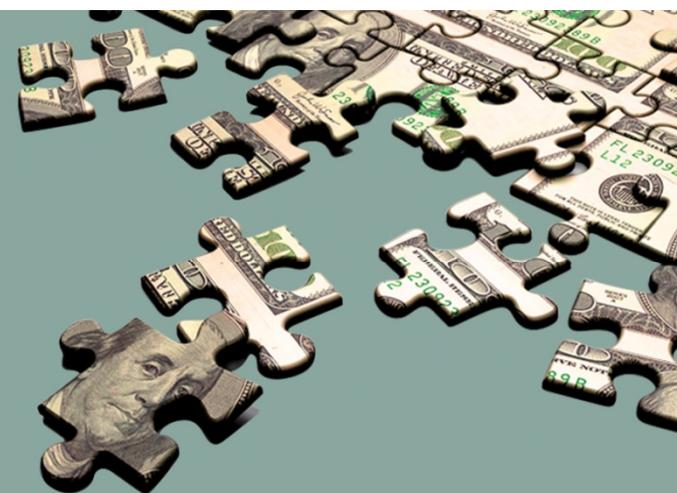
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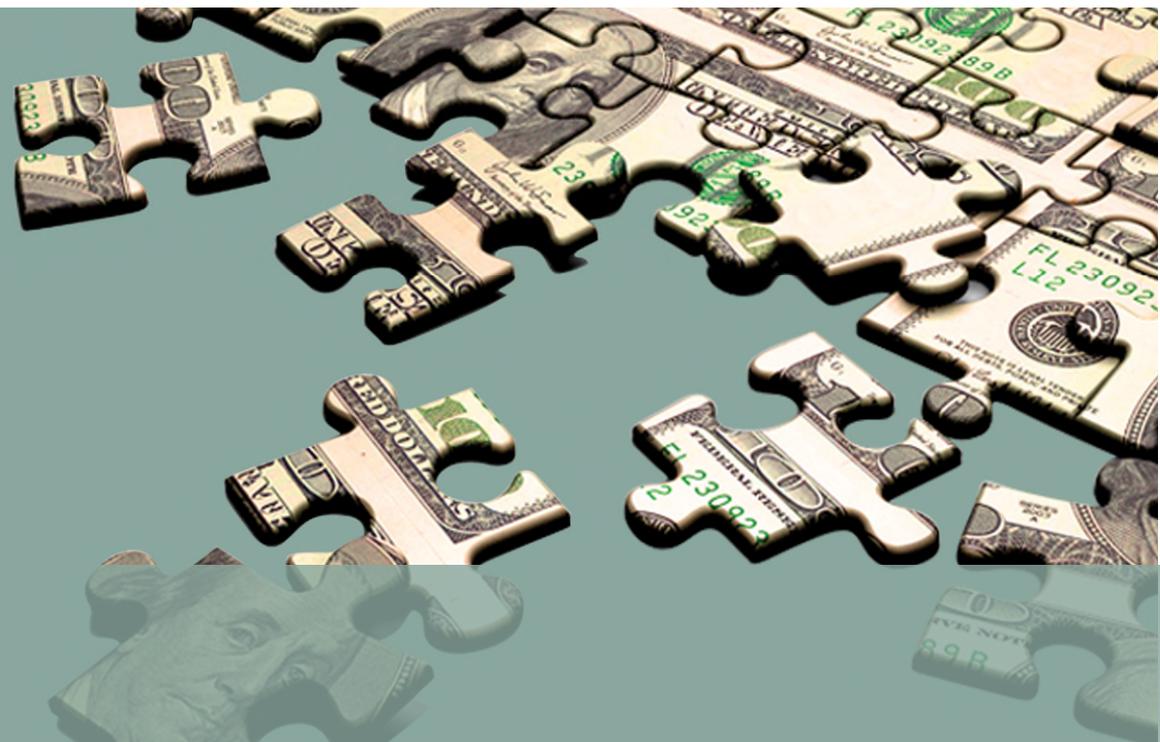
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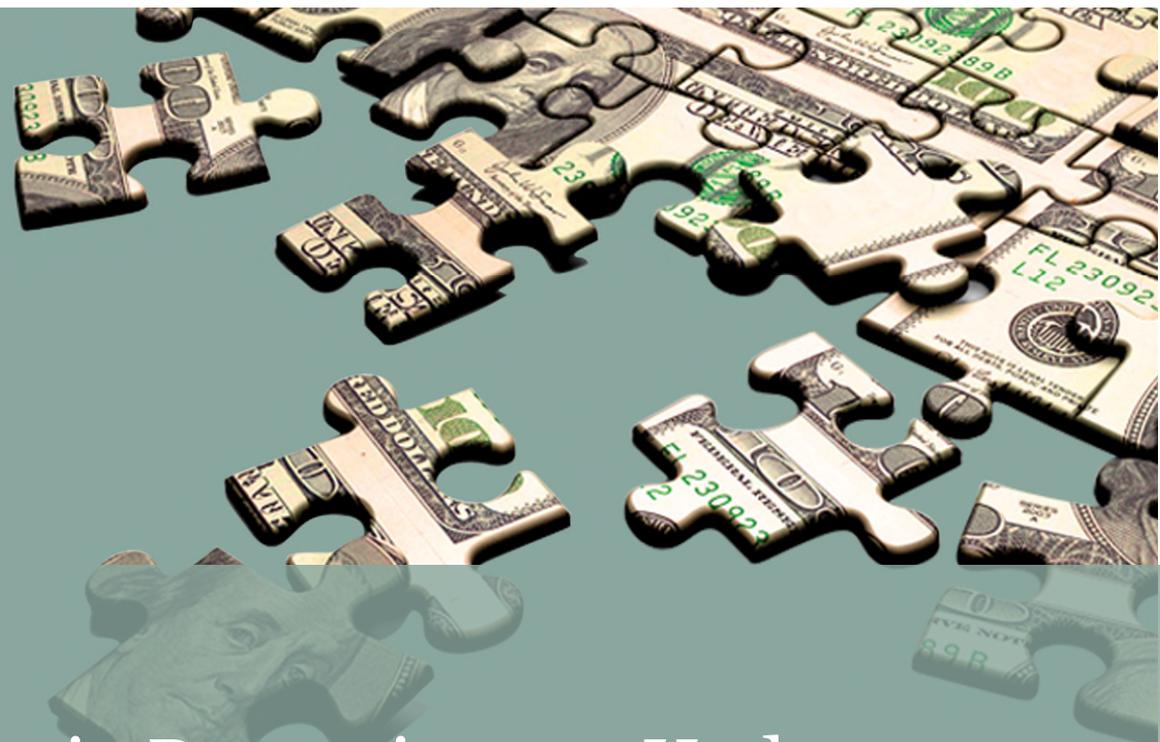


US and EU Regulatory Capital Landscape for Securitization

Current US Regulatory Capital Framework for Securitizations



- 2013 US Basel III Regime, effective 1/1/14 for AA banks and 1/1/15 for SA banks
- Broad scope of securitization exposures for AA and SA banks – includes more than Exchange Act ABS
- Replacement of ratings-based approach with Simplified Supervisory Formula Approach (SSFA) (plus SFA for AA)
 - Ties capital to risk-weights and performance (delinquencies) of underlying exposures and relative position of exposure in structure (attachment/detachment)
(SFA more granular)
- 20% risk-weight floor
- 1250% risk-weight penalty for inadequate due diligence



Comparing Capital Ratio Denominators Under Modified Basel I, US Basel II, US Final Rule and Basel Securitization Framework

Securitization Exposure Approach Hierarchies



Modified Basel I	US Basel II (Advanced)	US Final Rule (Standardized)	US Final Rule (Advanced)	Basel Securitization Framework (December 2014)
<ol style="list-style-type: none"> 1. RBA, if opt-in - for ABS only - 20% floor 2. Otherwise, 100% RW 	<ol style="list-style-type: none"> 1. RBA - 7% floor - can use RBA for unrated position senior to a rated position 2. SFA/IAA 3. Otherwise, deduction from capital 	<ol style="list-style-type: none"> 1. SSFA - 20% floor - data \leq 91 days old 2. Gross-up - RW of underlyings allocable to exposure plus all senior positions 3. Otherwise, 1250% 	<ol style="list-style-type: none"> 1. SFA - 20% floor 2. SSFA - 20% floor 3. Otherwise, 1250% 	<ul style="list-style-type: none"> • IRBA (15% floor) • ERBA/IAA (15% floor) • SA (15% floor) • Otherwise, 1250% <p>* All resecuritizations must use a modified SA and a 100% floor</p>

Competitive Landscape



	US	BCBS
Floor	20%	7% now; 15% 2018
SSFA	Yes	No, now; yes, 2018
IAA	No	Yes, now (ABCP) and in 2018; plus SSFA for ABCP in 2018
RBA	No	Yes, now and in 2018

- Senior tranches benefit from lower BCBS floor

Qualifying Securitizations – STS and STC



- Increasing recognition, particularly in Europe, that regulatory and structural impediments are inhibiting return of securitization markets
- Attempts to design criteria for qualifying securitizations (meeting specified criteria) that would have more favorable capital treatment and possibly other regulatory benefits
- EU has adopted this concept in existing and proposed legislation:
 - Liquidity coverage ratio (LCR) high quality liquid assets (HQLA) – “Level 2B” securitizations
 - Solvency II “Type 1” securitizations – less punitive capital requirements for insurance investors
 - Proposed Securitisation Regulation and securitization amendments to Capital Requirements Regulation (CRR) – “simple, transparent and standardized” (STS) securitizations
- Basel Committee published (together with IOSCO) criteria for “simple transparent and comparable” (STC) securitizations and adopted (non-mandatory) additional criteria and modified capital requirements for STC under revised securitisation framework (BCBS 374, July 2016)
- US regulators unlikely to adopt STC or otherwise reduce capital requirements for any securitization exposures

EU Securitisation Regulation and CRR Amendments



- EU legislative package on securitisation:
 - Securitisation Regulation
 - Unified definitions and rules on risk retention, due diligence, disclosure/transparency for all securitizations
 - Criteria and procedures for STS securitizations
 - CRR securitisation amendments
 - Adopt revised Basel securitisation framework
 - Include additional criteria and modified capital requirements for STS+ securitizations
 - Others to follow:
 - Review of and amendments to Solvency II, LCR, others
- Application:
 - Investments in or exposures to securitisation by EU regulated entities
 - Securitizations by sponsors (narrowly defined) or originators established in EU
- Status:
 - European Commission proposed September 2015
 - “Political agreement” between EU co-legislators 30 May 2017
 - Near-final draft end June 2017? Publication end 2017?

Significant Trilogue Outcomes



- 5% risk retention will not be increased
- STS is part of framework
 - risk of sanctions if exposure does not or fails to meet conditions
 - significant compliance requirements, including data maintenance and periodic audits
 - originator, sponsor and SPE must be established in EU
 - low concentration limits (2%) may exclude some sovereigns, among others
 - very difficult for ABCP programs to qualify – need each underlying transaction to be STS, plus meet program-level requirements
 - synthetic securitisation generally not STS, though, under CRR amendments, senior positions in some synthetic securitizations of at least 70% SME credits can qualify

Significant Trilogue Outcomes (*continued*)

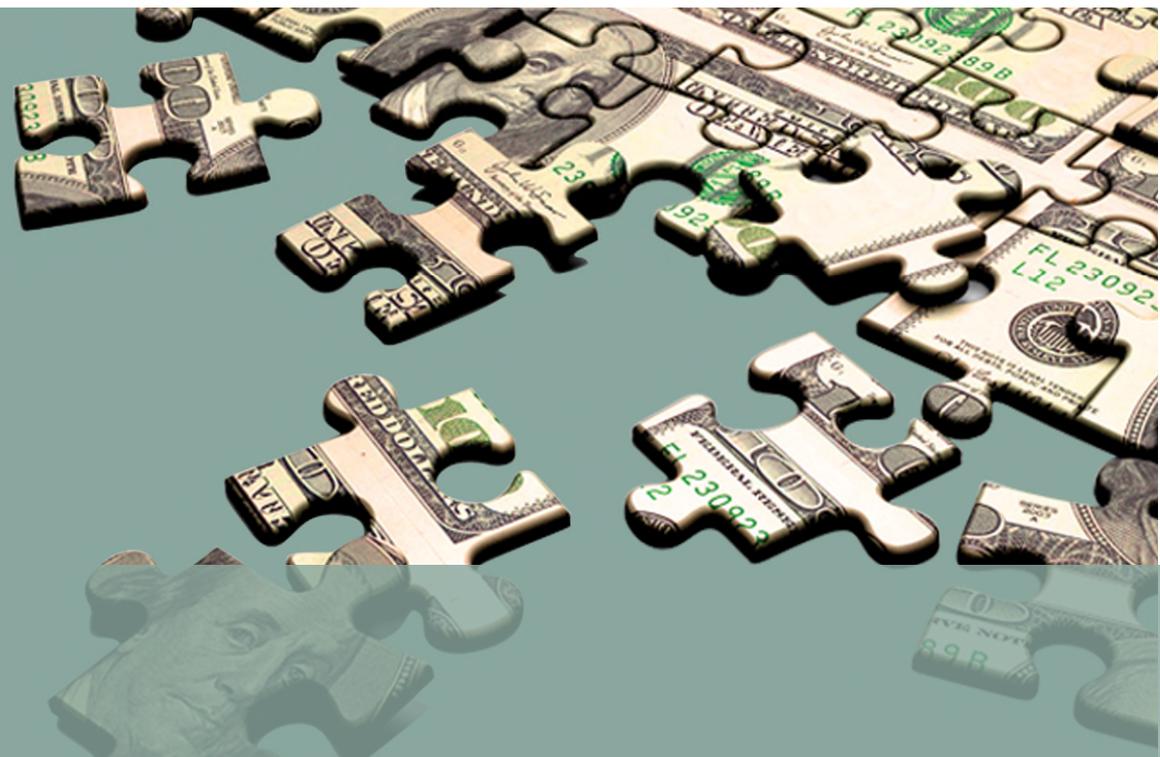


- Implements December 2014 Basel Securitization Framework
 - 15% floor for non-STS
 - 10% floor for STS
 - Modified hierarchy places SEC-SA ahead of SEC-ERBA, but only for high credit quality STS positions other than auto finance or equipment lease
- Implementation dates to be confirmed
 - Applicable from July 1, 2018
 - Capital treatment of existing positions may be maintained until end 2019
 - Challenge of completing related amendments and regulatory technical standards before implementation date

Some Predictions



- Banks will shift away from AAA/AA externally rated positions in light of RW floor of 15% unless part of fee business
 - May be mitigated to some extent if STS
- IAA availability will continue to be critical for unrated exposures
- Availability of SA will assist investments in unrated non-conduit positions
- However, lack of asset granularity and of recognition of excess spread will make IAA a better option for many high quality asset classes
- Consequently, expect new interest in ABCP funding



Asset-Level Data and Other Regulation AB II Updates

Asset-Level Data Overview

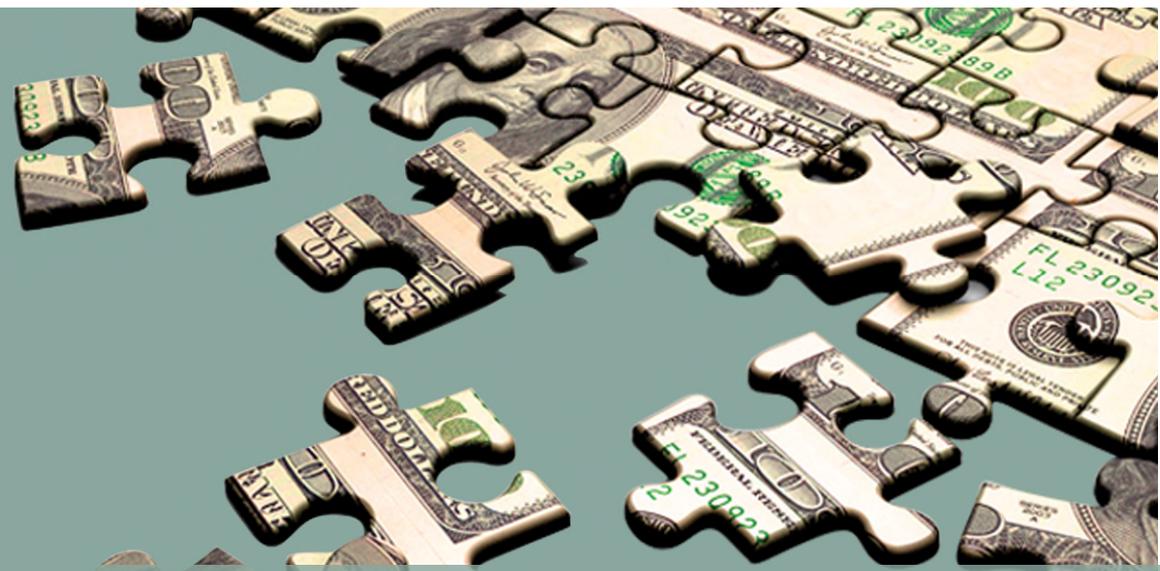


- Rule have been in effect for more than six months
- Applies to public ABS offerings backed by residential mortgages, commercial mortgages, auto loans, auto leases, debt securities and resecuritizations
- SEC did not adopt asset-level data disclosure for any other asset classes and stated that it is continuing to consider whether such disclosure would be useful to investors and thereby warranted
 - Adoption for other asset classes seems unlikely under current administration
- Requirements are mandatory, and intended to be standardized across issuers
- Required in the prospectus and in ongoing reports
- Schedule AL (Regulation AB Item 1125) lists the asset-level data requirements
- Filings on new electronic Form ABS-EE in XML format

Some Asset-Level Data Issues



- Problems for Bank/144A Deals
 - CFPB letter protects against Fair Credit Reporting Act (FCRA) violations to asset-level disclosure requirements only if filed on EDGAR under SEC Rules
 - CFPB Letter may not protect a 144A deal or disclosure of anything not explicitly required by SEC rules, including disclosure under FDIC Safe Harbor
- Reverse Engineering
- Statistical Pools
 - Same contracts plus top-ups to replace the assets that fall out
 - Maybe best to “overshoot the mark”
 - Top-up receivables are selected so that a set of material pool characteristics are maintained
 - Top-ups don’t exceed __% of the pool. Some guidance suggests 1%
 - Full disclosure in the Red that explains exactly what’s going to happen in the final pool



Risk Retention

Overview of US Risk Retention Rules



- Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010
- Six Federal Regulatory Agencies responsible for implementation: OCC, Federal Reserve, FDIC, SEC, Federal Housing Finance Agency and HUD
- Final Rules adopted October 22, 2014
- Compliance Dates: December 24, 2015 (RMBS) and December 24, 2016 (everything else)

Risk Retention Generally



- Sponsor must retain at least 5% of the fair value of the “ABS Interests” (subject to exceptions)
- Retention may be held by the sponsor or a “majority-owned affiliate” (subject to exceptions)
- A variety of forms (and exemptions), some applicable only to specific asset-classes:
 - Horizontal Interest (including Cash Reserve Account)
 - Vertical Interest
 - Combination
 - Seller’s Interest
 - CMBS B-piece buyer
 - Qualifying assets (mortgages, auto loans, commercial loans, real estate loans)
 - ABCP Safe Harbor
 - Foreign securitizations

Compliance Requirements



- Hedging and Risk Transfer Limitations
- Fair Value Determinations and Disclosure
- Ongoing reporting and maintenance requirements

Emerging Market Practice



- ABS
 - Autos and Equipment
 - Master Trusts
 - Other Asset Classes
- ABCP Conduits
- CMBS
- CLOs
- RMBS

Compliance Issues and Concerns



- Is the transaction Grandfathered?
- Is it Exchange Act ABS?
- Eligible Horizontal – Assumptions and Disclosure

Due Diligence by Underwriters / Initial Purchasers



- Due diligence on the Fair Value calculation?
 - SIFMA diligence questionnaire
 - Asking about all of the inputs – Before Printing!!
- Getting comfortable with the accounting judgment that fair value is determined “under GAAP”
 - Fair value is the price that would be agreed between a willing buyer and willing seller without compulsion
 - No accountants are willing to provide comfort
 - Ordinary situations: Just get comfortable that issuer is using “market” assumptions
 - MOA consolidation judgment is the most difficult
 - How do you get comfortable with the consolidation of a MOA with a less than majority interest?
 - Test: (a) Activities that most significantly affect economic performance and (b) a variable interest that could potentially be significant
 - What activities most significantly affect economic performance when the MOA passively holds a residual and the noteholders in the deal are the “controlling class”?

Legal Memos



- Some bank internal counsel are requiring memos
- Some issuers have resisted
- For EHRI:
 - Structure of retained interest satisfies definition of Eligible Horizontal Residual Interest (should level)
 - Disclosure appears on its face to address the required line items
- Other topics:
 - Who is the “sponsor”
 - Majority-owned affiliates
- Nobody appears to be giving opinions that “the sponsor has complied with Regulation RR”

The Perils of “Repeat” Transactions



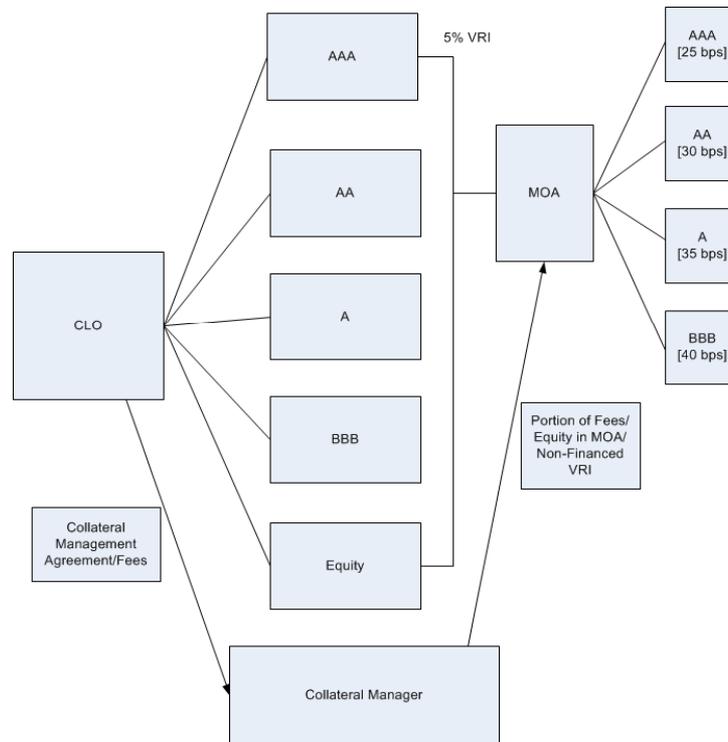
- Fair value is dynamic, and potentially changes whenever anything changes in the discounted cash flow model
- Issuers and underwriters must take changes into account in subsequent deals
 - Discount rate probably needs to change with interest rate changes
 - Changes in default/loss assumptions should change as economy/unemployment rate and default/loss experience changes
- EHRI disclosure results in projections
 - Will these projections affect bond values like earnings guidance affects the equity markets?
 - Risk of liability, including losses suffered in secondary market trading

Financing Risk Retention



- A retaining sponsor may not sell or otherwise transfer any interest or assets that the sponsor is required to retain except to a majority-owned affiliate.
- A retaining sponsor and its affiliates may not purchase or sell a security, or other financial instrument, or enter into a derivative or other position if:
 - Payments under the arrangement are materially related to the credit risk of the retained interest
 - The arrangement in any way reduces or limits financial exposure to the credit risk of the retained interest
- Exception for “full recourse” financings
- A CLO Case Study

CLO Financing – A Case Study

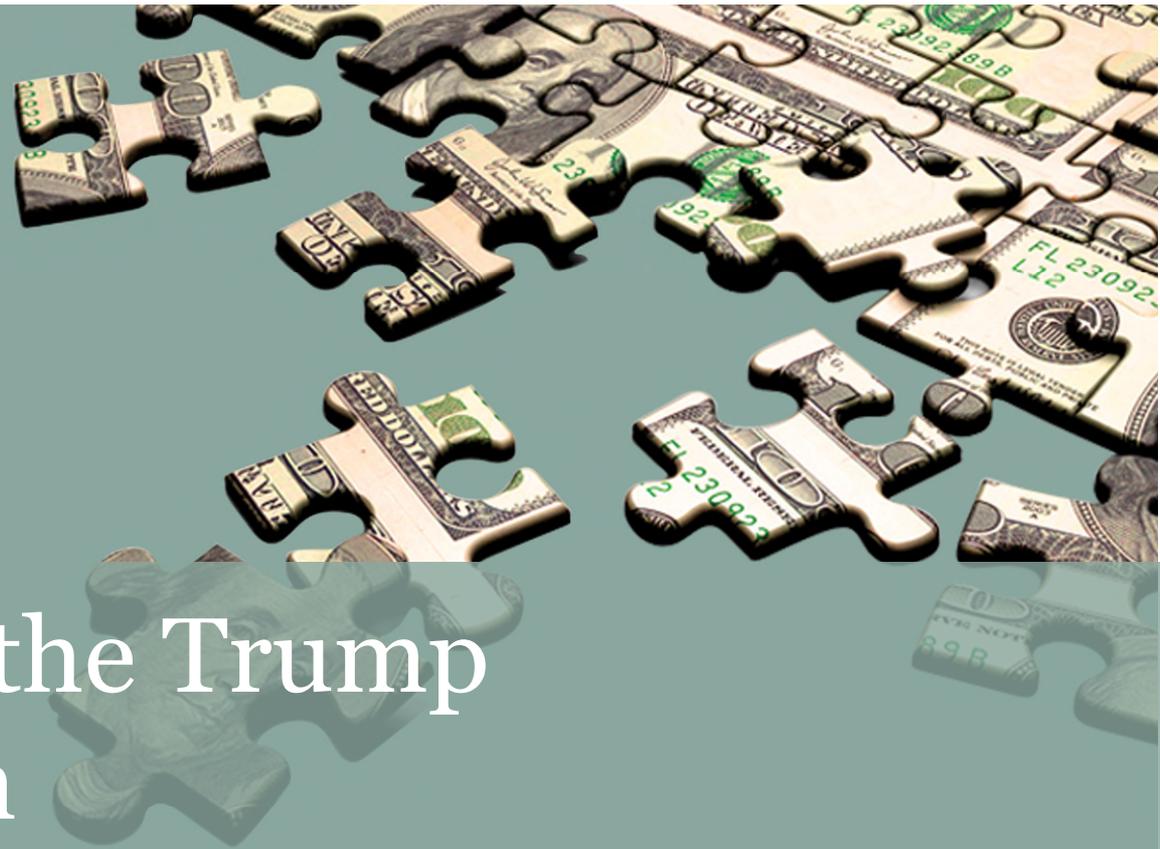


Observations and Predictions



- Compliance with EU Risk Retention (new rules pending)
- Disclosure and document provisions anticipating repeal
- Interpretation Challenges
- Reliance on “Market Practice”

Reform under the Trump Administration



Reform under the Trump Administration



- Will the Administration right itself and have the power to prepare and obtain adoption of Regulatory Reform Regulations or Legislation?
- Significant importance of Regulatory vs. Legislative Reform

The SIFMA Securitization Agenda



Proposal

Capital Reform (All Regulatory)

1. CCAR Rules for calculating capital to deal with defined shocks are excessive and should be reformed
2. Global Shock Scenario
 - Recognize reform
 - Differentiate among asset classes
3. Basel III revisions shouldn't be adopted, or, should be adjusted, and in any event the following reforms should be made for both trading and banking books:
 - Risk weight floor reduced to 15%

Commentary

1. Perhaps
2. Perhaps
3. Basel III, etc.
 - Risk weight floor: optimistic

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1. Agree
2. Probably Agree
3. Basel III, etc.
 - Risk weight floor: agree

The SIFMA Securitization Agenda (*continued*)



Proposal

Capital Reform (*continued*)

- “p” factor should remain at .5
- “kg” factor used in SSFA should be made more risk sensitive
- SSFA should be adjusted to take account of credit enhancement when position bought at a discount
- Recalibrate the effect of tranche maturity on capital in the advanced approach

4. Limit total capital

- In trading book, position’s then market value

Commentary

- “p” factor: cautiously optimistic
- “kg” factor: perhaps
- SSFA and discount: perhaps
- Tranche Maturity: perhaps

4. Limit total capital

- Trading Book: perhaps

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- “p” factor: probably agree
- “kg” factor: probably agree
- SSFA and discount: unclear
- Tranche Maturity: probably agree

4. Limit total capital

- Trading Book: probably agree

The SIFMA Securitization Agenda (*continued*)



Proposal

Commentary

Treasury Recommendation 12 June 2017 Appendix B

Capital Reform (*continued*)

- | | | |
|---|---|---|
| <ul style="list-style-type: none">– In banking book, lesser of (x) dollar amount of the position and (y) total capital for the pool | <ul style="list-style-type: none">– Banking Book: cautiously optimistic | <ul style="list-style-type: none">– Banking Book: unclear |
| 5. Securitizations that transfer credit risk should have reduced capital, notwithstanding accounting outcomes for the transaction | 5. RBC vs. Accounting: cautiously optimistic | 5. RBC vs. Accounting: unclear but probably agree |
| 6. GSE RMBS should receive Level 1 HQLA LCR status so long as US Treasury support | 6. GSE RMBS: perhaps | 6. GSE RMBS: unclear |
| 7. High Quality RMBS and ABS should qualify for Level 2B HQLA LCR status | 7. ABS and RMBS: perhaps | 7. ABS and RMBS: unclear |

The SIFMA Securitization Agenda (*continued*)



Proposal

Commentary

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Regulation AB Reform (Regulatory)

- | | | |
|---|---|-------------------|
| 1. Rationalize number of data fields for types of ABS and RMBS and provide for more flexible compliance | 1. Data fields and flexible compliance: cautiously optimistic | 1. Agree |
| 2. Reg. AB II should permit a comply or explain option for data not reasonably obtainable | 2. Comply or explain: cautiously optimistic | 2. Probably Agree |
| 3. Withdraw application of asset level data to private offerings | 3. Asset level data for private offerings: optimistic | 3. Probably Agree |
| 4. Reform 3 day waiting period for active issuers | 4. Three day waiting period: cautiously optimistic | 4. Unclear |

The SIFMA Securitization Agenda (*continued*)



Proposal

Commentary

Treasury Recommendation 12 June 2017 Appendix B

Credit Risk Retention Reform (Regulatory)

- | | | |
|--|--|-------------------------------|
| 1. Permit other forms of retention, including those under EU Rules, such as contingent, unfunded or retained interest in the underlying assets | 1. Other forms of retention: cautiously optimistic | 1. Unclear but probably agree |
| 2. Make qualifying exceptions for commercial loans, commercial real estate and autos more workable | 2. More workable exceptions: cautiously optimistic | 2. Unclear but probably agree |
| 3. Adopt SIFMA's proposed CLO exception | 3. SIFMA CLO exception: cautiously optimistic | 3. Unclear |
| 4. Reduce conflicts between US and EU Rules | 4. Conflict between US and EU Rules: perhaps | 4. Unclear |

The SIFMA Securitization Agenda *(continued)*



Proposal

Commentary

Treasury Recommendation 12 June 2017 Appendix B

Derivatives: Margin Requirements for Securitization (Regulatory)

1. Margin requirements for swaps for SPEs treated in substantially same manner as swaps with non financial end users

1. Swaps for SPEs: cautiously optimistic

1. Unclear

Qualified Mortgage Standards (Regulatory)

1. CFPB should review and revise QM standard for determining monthly debt and income (especially for self-employed)
2. CFPB should implement responsive guidance process

1. Monthly debt and income: perhaps
2. Guidance: perhaps

1. Agree
2. Agree

The SIFMA Securitization Agenda (*continued*)



Proposal

Commentary

Treasury Recommendation 12 June 2017 Appendix B

Volcker (Regulatory)

1. Securitization structure and SPEs should not be captured as “covered funds”

1. No Covered Funds: cautiously optimistic

1. Agree

TRID (Regulatory)

1. CFPB should reduce TRID complexity

1. TRID complexity: perhaps

1. Agree

The SFIG Reform Agenda



Proposal

Commentary

Treasury Recommendation 12 June 2017 Appendix B

Credit Risk Retention (Regulatory)

1. Make “qualified loan” exceptions more practical for autos, equipment and other high performing assets such as FFELP loans

1. Qualified loan exception: cautiously optimistic

1. Likely agree

Regulation AB II (Regulatory)

1. Alternative disclosure package for credit and charge card Receivables
2. Auto floorplan alternative disclosure package

1. Credit and charge card: cautiously optimistic
2. Auto floorplan: cautiously optimistic

1. Likely agree
2. Likely agree

The SFIG Reform Agenda *(continued)*



Proposal

Regulation AB II *(continued)*

3. Equipment loans and leases and floorplan alternative disclosure package
4. Student loan alternative disclosure package
5. Final action with regard to proposed but not finished part of the Rule

Commentary

3. Equipment loans and leases floorplan: cautiously optimistic
4. Student loan: cautiously optimistic
5. Final action on unfinished Rule: optimistic

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3. Likely agree
4. Likely agree
5. Likely agree

The SFIG Reform Agenda *(continued)*



Proposal

Commentary

Treasury Recommendation 12 June 2017 Appendix B

Banking Regulation

1. Capital Regulation (Regulatory)

- Basel III Securitization Framework: recalibrate securitization hierarchy
 - maturity factor
 - keep “p” factor at .5
- Fundamental Review of the Trading Book
 - recalibrate consistently with Basel III recommendations
- Separate GAAP outcome from RBC Outcome

- Basel III Securitization Framework: recalibrate securitization hierarchy
- Basel Framework: cautiously optimistic
- FRTB: cautiously optimistic

- GAAP vs. RBC: optimistic

- Basel III: agree
- Basel Framework: agree
- FRTB: agree

- GAAP: probably agree

The SFIG Reform Agenda (*continued*)



Proposal

Commentary

Treasury Recommendation 12 June 2017 Appendix B

Banking Regulation (*continued*)

2. Liquidity Regulation (Regulatory)

- ABS should receive credit as HQLA for the LCR and NSFR at least equal to corporate bonds
- RMBS should receive some credit as HQLA for LCR and NSFR

- ABS LCR and NSFR Credit: perhaps
- RMBS LCR and NSFR Credit: perhaps

- ABS LCR and NSFR Credit: unclear
- RMBS LCR and NSFR Credit: unclear

The SFIG Reform Agenda *(continued)*



Proposal

Commentary

Treasury Recommendation 12 June 2017 Appendix B

3. High Quality Securitization (Regulatory)
 - ABS and RMBS that meet CRR and disclosure requirements receive level 2B LCR/NSFR treatment
4. Daily Margin Posting and Collection (Regulatory)
 - No posting for securitization SPEs and permanent no action relief
5. Volcker (Regulatory)
 - Carve out from definition of “covered fund”
6. (See also Appendix 1 to SFIG Letter to Mike Crapo dated 4/14/17)

3. Level 2B treatment: cautiously optimistic
4. Margin posting: cautiously optimistic
5. “Covered Fund” definition: cautiously optimistic

3. Unclear
4. Unclear
5. Agree

Choice Act of 2017



- Legislative instead of Regulatory
- What will happen in Senate?
- Again, will Administration get its “Act” together

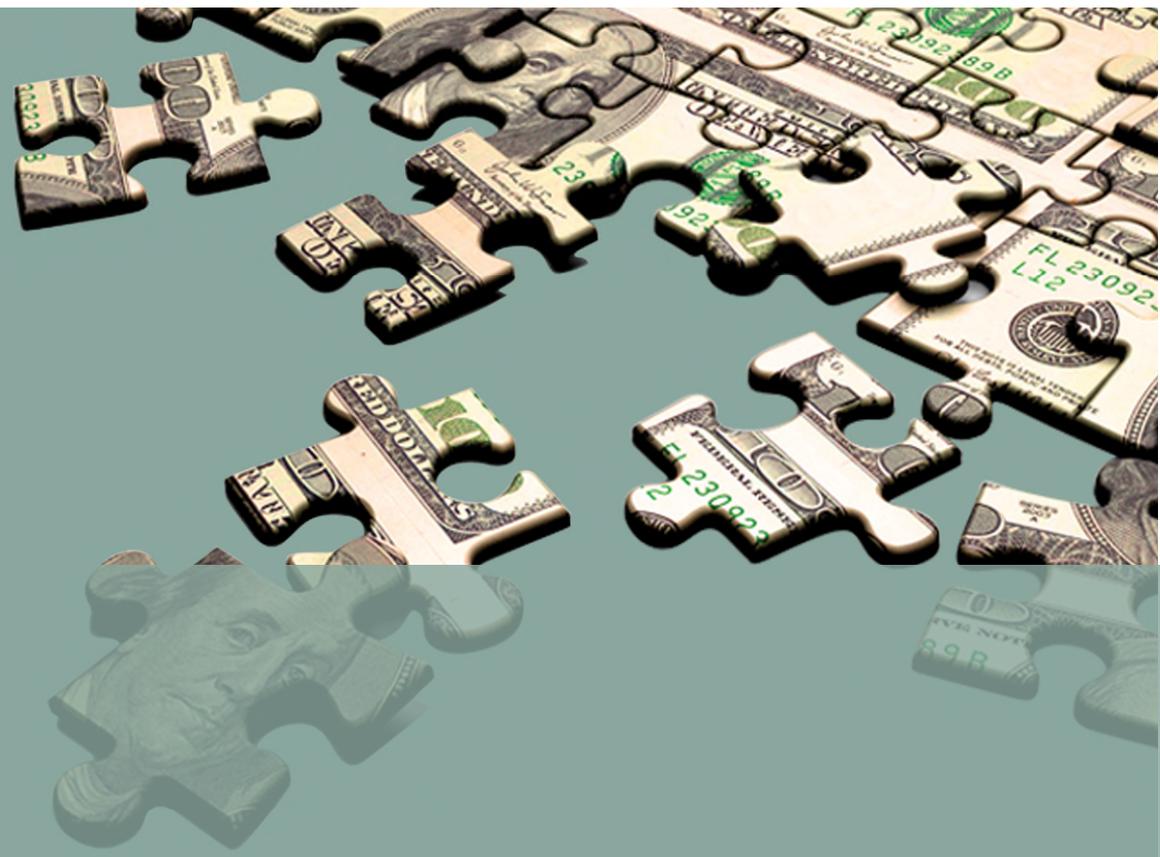
Relevant Securitization Items:

1. CRR eliminated except for residential mortgage ABS
2. If a bank maintains supplemental leverage ratios (“SLR”) of 10% or more may choose to be a QBO and exempt from:
 - Capital requirements in addition to SLR
 - LCR and NSFR
 - Certain enhanced prudential standards and ratios

Choice Act of 2017 (*continued*)



3. Volcker eliminated
4. Conflict of Interest Rule for Securitization eliminated
5. Madden Case “fixed” under “valid when made” doctrine
6. Broaden eligibility for QM



Questions?

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