

As published in

## **Derivatives: Financial Products Report**

December 2014

**(Thomson Reuters/Tax & Accounting)**

### **A CLOSER LOOK AT U.S. CREDIT RISK RETENTION RULES**

*Author: JERRY MARLATT, MELISSA BECK and KENNETH KOHLER*

*JERRY MARLATT is senior of counsel and MELISSA BECK is of counsel, both located in the New York office of Morrison & Foerster LLP, and KENNETH KOHLER is senior of counsel, located in the firm's Los Angeles office. Copyright 2014 Morrison & Foerster LLP. All rights reserved.*

*This article examines the key provisions of the final rule adopted by several regulators implementing the credit risk retention requirements of section 941 of the Dodd-Frank Act for asset-backed securities.*

In a flurry of regulatory actions on October 21 and 22, 2014, the Federal Deposit Insurance Corporation (the "FDIC"), the Office of the Comptroller of the Currency, the Federal Reserve Board, the Securities and Exchange Commission, the Federal Housing Finance Agency (the "FHFA"), and the Department of Housing and Urban Development (collectively, the "Joint Regulators") each adopted a final rule (the "Final Rule") implementing the credit risk retention requirements of section 941 of the Dodd-Frank Act for asset-backed securities ("ABS"). The section 941 requirements were intended to ensure that securitizers generally have "skin in the game" with respect to securitized loans and other assets.

The risk retention rules were initially proposed by the Joint Regulators in March 2011 (the "Original

Proposal") and re-proposed in August 2013 (the "Re-Proposal"). The Final Rule will become effective one year from the date of publication in the Federal Register for residential mortgage-backed securities ("RMBS") and two years from the date of publication in the Federal Register for all other ABS. The Final Rule generally tracks the requirements of the Re-Proposal with minor changes made to address comments submitted or to clarify meaning.

Following is an overview of the key provisions of the Final Rule:

## **BASIC RISK RETENTION REQUIREMENT**

As required by the Dodd-Frank Act, the Final Rule generally requires "sponsors" of both public and private securitization transactions to retain not less than 5 percent of the credit risk of the assets collateralizing any ABS issuance. "Sponsor" is defined in the Final Rule as "a person who organizes and initiates a securitization transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuing entity." The Final Rule provides that the credit risk required to be retained and held by a sponsor or any other person under the Rule may be acquired and held by any of such person's majority-owned affiliates, other than the issuing entity. If there is more than one sponsor of a securitization transaction, it is the responsibility of each sponsor to ensure that at least one of the sponsors (or at least one of their majority-owned affiliates, as applicable) retains the required credit risk.

## **STANDARD RISK RETENTION METHODS**

The Final Rule generally permits risk retention to be accomplished through one or a combination of methods: an eligible vertical interest, an eligible horizontal residual interest ("EHRI"), or some combination of the two (an "L-shaped interest"). The percentage of the vertical, horizontal, or L-shaped interest to be retained by the sponsor must be determined as of the closing date of the securitization transaction. Horizontal risk retention may be accomplished by holding ABS issued in the transaction or by establishing a cash reserve account for the transaction.

Notably, the Final Rule does not include as a standard risk retention method the "representative sample" method included in the Original Proposal but removed in the Re-Proposal. This method would have permitted a sponsor to satisfy its risk retention obligation by holding, outside of the issuing entity, assets substantially similar to those transferred to an issuing entity in the amount of 5 percent of the assets transferred to the issuing entity. Many commenters on the Re-Proposal urged that this option be restored in

the Final Rule, but the Joint Regulators nonetheless declined to adopt this method. Similarly, the Joint Regulators declined to provide options for sponsors to satisfy risk retention requirements by retaining a participation interest in assets transferred to the issuing entity, by providing unfunded credit support such as a guaranty, or through overcollateralization (with limited exceptions).

It should be noted that the Joint Regulators' decision not to permit the retention of a "representative sample" as a risk retention method also impacts another, existing securitization regulation. Specifically, in 2010, the FDIC substantially amended its rule for securitizations (set forth at 12 C.F.R. § 360.6) that sets forth the conditions under which the FDIC will provide a "safe harbor" to investors by agreeing not to repudiate certain contracts or reclaim assets in connection with certain securitizations by insured financial institutions. This FDIC securitization rule in some circumstances requires insured depository institutions to retain credit risk in connection with their securitizations, and specifically permits the retention of a "representative sample" of assets of the same type as those securitized. The FDIC securitization rule also contains, however, an "auto-conform" provision to the effect that the risk retention provisions of the securitization rule will be automatically conformed to those ultimately adopted by the Joint Regulators pursuant to Section 941 of the Dodd-Frank Act. Accordingly, insured institutions will no longer be permitted to rely on the "representative sample" retention method in order to avail themselves of the FDIC's securitization safe harbor.

## **Eligible vertical interest**

An "eligible vertical interest" must constitute either (i) a single vertical security entitling the sponsor to the same percentage of amounts paid on each class of ABS interests, or (ii) an interest in each class of ABS interests constituting the same proportion of each class of ABS interests.

The Final Rule eliminated the requirement included in the Re-Proposal that an eligible vertical interest be valued using the "fair value" concept applicable to horizontal interest. Accordingly, a sponsor using the eligible vertical interest approach may in effect value the retained interest at par for purposes of the Final Rule.

## **Eligible horizontal residual interest**

An "eligible horizontal residual interest," or "EHRI," is an ABS interest in a single class or multiple classes in the issuing entity that represent the most subordinated claim to payments of principal and interest by the

issuing entity (with the exception of any non-economic REMIC residual interest, which is not considered an "ABS interest"). An EHRI's terms must provide that, if the issuing entity has insufficient funds to satisfy its obligation to pay all contractual interest or principal due, any resulting shortfall will reduce amounts payable to the EHRI prior to any reduction in amounts payable to any other ABS interest. Notably, the Final Rule eliminates a provision of the Re-Proposal that would have restricted the payment of cash flow to the EHRI in order to limit how quickly the sponsor could recover in cash the fair value of the interest.

A sponsor utilizing an EHRI to satisfy risk retention requirements must retain an EHRI having a "fair value" (as determined in accordance with GAAP methodologies) of at least 5 percent of the fair value of all ABS interests issued in the transaction. The Final Rule contains extensive requirements for disclosure by the sponsor of its methodology for determining the fair value of the EHRI and of all ABS interests issued.

A reasonable period of time prior to the sale of the ABS, the sponsor must disclose:

- the fair value of all ABS interests to be issued,
- if the fair values of the specific prices, sizes, or rates of interest of each class are not available, a range, and the method to determine the range, of fair values of all ABS interests issued,
- the material terms of the EHRI, and
- a description of the methodology used to calculate fair values, including a description of key inputs and assumptions.

A reasonable time after the closing of the transaction, the sponsor must disclose, based on the actual sale prices and finalized class sizes of the ABS interests:

- the actual fair value of the retained EHRI at closing,
- the amount the sponsor was required to retain at closing under the Final Rule, and
- any material differences between the actual valuation methodology or inputs and assumptions used from those used for the pre-sale disclosures.

The Final Rule provides sponsors with the option, in lieu of retaining all or any part of an EHRI, to establish and fund, in cash, an "eligible horizontal cash reserve account," or EHCRA, in the amount equal to the required fair value of an EHRI. Amounts in the EHCRA are to be used to satisfy payments on ABS interests in the issuing entity on any payment date on which the issuing entity has insufficient funds to satisfy an amount due on any ABS interest, or to pay critical expenses of the trust unrelated to credit risk on any payment date on which the issuing entity has insufficient funds to pay such expenses. The EHCRA must be

held by the trustee until all ABS interests are paid in full.

## **L-shaped interest**

If a sponsor opts to retain both an eligible vertical interest and an EHRI as its required risk retention, the percentage of the fair value of the EHRI and the percentage of the eligible vertical interest must equal at least 5 percent. These percentages must be determined as of the closing date of the securitization transaction.

## **SPECIAL RISK RETENTION METHODS**

In addition to the standard risk retention methods, the Final Rule includes special risk retention provisions for various specific asset types of transactions. These are described below.

### **Revolving pool securitizations**

The Final Rule contains special rules for risk retention by sponsors of "revolving pool securitizations," a structure often referred to in industry parlance as the "master trust" structure (whether or not the issuing entity is actually a trust). This structure is widely used for securitizations of credit card receivables and other revolving assets. The Final Rule defines a "revolving pool securitization" as "an issuing entity that is established to issue on multiple issuance dates more than one series, class, subclass, or tranche of asset-backed securities that are collateralized by a common pool of securitized assets that will change in composition over time, and that does not monetize excess interest and fees from its securitized assets."

The Final Rule permits sponsors of revolving pool securitizations to satisfy their risk retention requirement by maintaining a "seller's interest" of not less than 5 percent of the aggregate unpaid principal balance of all outstanding investor ABS interests in the issuing entity. The Final Rule defines a "seller's interest" as an ABS interest or ABS interests:

- that is collateralized by the securitized assets and servicing assets owned or held by the issuing entity, with certain exceptions,
- that is *pari passu* with each series of investor ABS interests issued, or partially or fully subordinated to one or more series in identical or varying amounts, with respect to the allocation of all distributions and

losses, and

- that adjusts for fluctuations in the outstanding principal balance of the securitized assets in the pool.

The Final Rule also permits sponsors of revolving pool securitizations to satisfy risk retention requirements by retaining a horizontal subordinated interest in the pool, with some modifications to the standard requirements for an EHRI to accommodate common features of revolving securitizations. A sponsor may also combine a seller's interest with such an eligible horizontal residual interest to satisfy the 5 percent risk retention requirement.

## Eligible ABCP Conduits

For issuers of asset-backed commercial paper ("ABCP"), the Final Rule provides "eligible ABCP conduits" with an option to satisfy risk retention requirements in lieu of using a standard risk retention option. The requirements to qualify as an "eligible ABCP conduit" are complex, and beyond the scope of this overview. Generally, however, the assets of an eligible ABCP conduit must be ABS interests, and must be issued by one or more intermediate special purpose vehicles ("SPVs"). Perhaps most importantly, the eligible ABCP conduit risk retention option requires that an originator-seller of assets to the intermediate SPV retain the requisite 5 percent credit risk exposure, and that a regulated liquidity provider (as defined) has entered into a legally binding commitment to provide 100 percent liquidity coverage to all ABCP issued by the ABCP issuer by lending to, purchasing ABCP issued by, or purchasing assets from, the ABCP conduit in the event that funds are required to repay maturing ABCP issued by the ABCP conduit. The eligible ABCP conduit must also comply with extensive disclosure requirements in order to avail itself of this risk retention option.

## Commercial MBS

As in the Re-Proposal, CMBS issuers will have the option of satisfying risk retention requirements by transferring up to two *pari passu* EHRIs, or "B-pieces," to third-party purchasers ("B-Piece Buyers"). A B-Piece Buyer must perform its own due diligence of the underlying commercial mortgage loans, and may be affiliated with the special servicer. The B-Piece option may be used to satisfy the entire risk retention requirement, or may be used in combination with the retention of a vertical interest by the sponsor.

The Final Rule requires that an operating advisor be appointed for any securitization in which the sponsor uses the B-Piece option. The operating advisor is required to act in the best interest of, and for the benefit of, all investors. The operating advisor's purpose is to consult with special servicers on major decisions after

the unpaid principal balance of B-Pieces held by third parties is reduced to 25 percent or less of the original principal balance of such B-Pieces, taking into account appraisal reductions and realized losses.

The Final Rule allows transfers of the B-Piece after five years from the closing date of the securitization, whether the B-Piece was retained by the sponsor or by a B-Piece Buyer, provided that the transferee satisfies the requirements applicable to B-Piece Buyers generally. The Final Rule also added a clarification that the risk retention obligation for CMBS terminates once all of the mortgage loans in a CMBS transaction have been fully defeased.

## **Fannie Mae and Freddie Mac ABS**

The Final Rule exempts Fannie Mae and Freddie Mac from the risk retention requirement if such entity fully guarantees the timely payment of principal and interest on all ABS interests issued by the issuing entity in the securitization transaction, for so long as Fannie Mae or Freddie Mac, as applicable, is operating under the conservatorship or receivership of the FHFA with capital support from the U.S. Government. This exemption will also apply to any limited-life regulated entity succeeding to the charter of either Fannie Mae or Freddie Mac, provided that the entity is operating with capital support from the U.S. Government.

## **Open market CLOs**

The Final Rule treats managers of collateralized loan obligations ("CLOs") as sponsors and generally requires them to satisfy the 5 percent risk retention requirement. The Final Rule also includes a transaction-specific risk retention option for "open-market CLOs" that, subject to certain conditions, permits lead arrangers of senior secured syndicated loans held by the CLO to retain the requisite 5 percent risk, rather than the CLO manager.

## **Qualified tender option bonds**

The Final Rule provides that a sponsor with respect to an issuance of tender option bonds (a type of security issued in many securitizations of underlying municipal securities) by a "qualified tender option bond entity" may satisfy its risk retention requirements by holding outside of the issuing entity municipal securities from the same issuance of municipal securities deposited in the qualified tender option bond entity, the face value of which retained municipal securities is equal to 5 percent of the face value of the municipal

securities deposited in the qualified tender option bond entity.

A "qualified tender option bond entity" is an issuer of tender option bonds meeting certain requirements, including that the entity be collateralized solely by servicing assets and by municipal securities that have the same municipal issuer or source of payment. Notably, similar to the requirement applicable to an eligible ABCP conduit, the issuing entity must have a legally binding commitment from a regulated liquidity provider to provide a 100 percent guarantee or liquidity coverage with respect to all of the issuing entity's outstanding tender option bonds. The sponsor must also provide, or cause to be provided, to potential investors certain required disclosures within a reasonable period of time prior to the sale of the bonds. The Final Rule also provides such issuers an option to convert a retained EHRI into an eligible vertical interest upon the occurrence of a "tender option termination event" as defined in Section 4.01(5) of IRS Revenue Procedure 2003-84.

## **TRANSFER OF RISK RETENTION**

Allocation to an originator Under the Final Rule, the sponsor may allocate its risk retention requirement to the originator of the securitized assets under the standard risk retention options, subject to the agreement of the originator and to certain other conditions. "Originator" is defined to include only the original creditor that created the asset through an extension of credit or otherwise, and does not include a subsequent purchaser or transferee of the asset. Any risk retention allocated to an originator reduces the sponsor's risk retention requirement commensurately.

The originator must acquire the eligible interest from the sponsor at the closing of the securitization transaction and retain such interest in the same manner and proportion (as between horizontal and vertical interests) as the sponsor. Additionally, the ratio of the percentage of the risk position acquired and retained by the originator to the total percentage of the risk position otherwise required to be retained by the sponsor may not exceed the ratio of the unpaid principal balance of all securitized assets originated by the originator to the unpaid balance of all the securitized assets in the transaction.

Moreover, the originator must acquire and retain at least 20 percent of the aggregate risk retention amount otherwise required to be held by the sponsor, and must comply with the hedging, transfer, and other restrictions (described below) with respect to such interest as if the originator were the sponsor.

## **Hedging, transfer and financing prohibitions**

The Final Rule generally prohibits a sponsor from selling or otherwise transferring any retained interest other than to majority-owned or wholly owned affiliates of the sponsor. Moreover, a sponsor and its affiliates may not hedge their required risk retention positions or pledge those positions as collateral for any obligation (including a loan, repurchase agreement, or other financing transaction), unless the obligation is with full recourse to the pledging entity.

Certain hedging activities are not prohibited. Sponsors and their affiliates are permitted to:

- hedge interest rate or foreign exchange risk, or
- hedge based on an index of instruments that includes ABS, subject to certain limitations.

The restrictions on sponsors and their affiliates hedging or transferring retained interests for specified periods after the securitization remain unchanged from the Re-Proposal:

- For RMBS transactions, the restrictions will expire on or after the date that is (1) the later of (a) five years after the closing date or (b) the date on which the total unpaid principal balance of the securitized assets is reduced to 25 percent of the original unpaid principal balance as of the closing date, but (2) in any event no later than seven years after the closing date.
- For all other ABS transactions, the restrictions will expire on or after the date that is the latest of (1) the date on which the total unpaid principal balance of the securitized assets that collateralize the securitization are reduced to 33 percent of the original unpaid principal balance as of the closing date, (2) the date on which the total unpaid principal obligations under the ABS interests issued in the securitization are reduced to 33 percent of the original unpaid principal obligations as of the closing date, or (3) two years after the closing date.

## **EXCEPTIONS AND EXEMPTIONS**

The Final Rule exempts certain types of securitizations from risk retention requirements, including "qualified residential mortgage" loans, or "QRMs," and securitizations backed by auto loans, commercial loans, and commercial real estate loans that meet specified strict underwriting standards.

### **Qualified residential mortgages (QRMs)**

Under the Final Rule, a sponsor will be exempt from the risk retention requirement for securitizations consisting solely of QRMs. The Final Rule defines "qualified residential mortgage," or QRM, to mean a "qualified mortgage" or QM, as defined in Section 129(C) of the Truth In Lending Act and regulations issued thereunder, as amended from time to time, that is not currently 30 or more days past due. The detailed definition of QM is currently set forth in regulations adopted by the Consumer Financial Protection Bureau ("CFPB") under [Section 129\(C\)](#) for purposes of the CFPB's "ability-to-repay" rules.

After much debate, the Joint Regulators determined not to adapt the "QM-Plus" concept floated in the Re-Proposal under which QRM would have been defined as a QM that satisfied additional conditions, including a minimum down payment requirement. Thus, under the Final Rule, there is no minimum down payment requirement for a QRM.

The Final Rule also added two limited exemptions from the risk retention requirement for certain residential mortgage loans in order to conform with the "ability-to-repay" rules of the CFPB. The first is an exemption for securitization transactions backed solely by certain community-focused residential mortgage loans (such as loans made through state housing agency programs and certain community lender programs) and servicing assets. The second is an exemption for qualifying 3-to-4 unit residential mortgage loans and servicing assets. There are also provisions permitting sponsors to blend community-focused loans with non-exempt residential mortgages, in which case the minimum risk retention requirement will be 2.5%. or qualifying 3-to-4 unit loans with QRMs, in which case the risk retention requirement will be zero.

## **Qualifying commercial loans, commercial real estate loans, and auto loans**

The Final Rule provides an exemption from risk retention requirements for securitizations consisting of "qualifying" commercial loans, commercial real estate ("CRE") loans and automobile loans. Specifically, securitizations of such "qualifying" assets are subject to a 0 percent risk retention requirement provided that:

- the assets meet the specific stringent underwriting standards set forth in the Final Rule for each such asset type,
- the securitization transaction is collateralized solely by loans of the same asset class and by servicing assets,

- the securitization transaction does not permit reinvestment periods, and
- the sponsor provides, or causes to be provided, to potential investors, a description of the manner in which the sponsor determined the aggregate risk retention requirement for the securitization transaction.

The underwriting requirements for each of these classes of "qualifying" assets are summarized below.

## **Qualifying commercial loans**

The underwriting standards for qualifying commercial loans include the following, among others:

- prior to the origination of the commercial loan, the originator must have verified and documented the financial condition of the borrower at the end of the borrower's two most recently completed fiscal years and during the period, if any, since the end of its most recently completed fiscal year,
- the originator must have determined that, based on the previous two years' actual performance, the borrower had:
  - a total liabilities ratio (as defined) of 50 percent or less,
  - a leverage ratio (as defined) of 3.0 or less, and
  - a debt service coverage (DSC) ratio (as defined) of 1.5 or greater, and
- the originator must also have conducted an analysis of the borrower's ability to service its overall debt obligations during the next two years, based on reasonable projections, and determined that, based on such projections, which include the new debt obligation, following the closing date of the loan, the borrower will have:
  - a total liabilities ratio of 50 percent or less,
  - a leverage ratio of 3.0 or less, and
  - a DSC ratio of 1.5 or greater.

## **Qualifying commercial real estate loans**

The Final Rule defines a qualifying commercial real estate (QCRE) loan as a first lien loan on commercial real estate and improvements, including a ground-leased land loan on improved property, that meets the following underwriting standards, among others:

- a DSC ratio of 1.25 for qualifying multi-family property loans (as defined), 1.5 for qualifying leased CRE loans (as defined), and 1.7 for all other CRE loans,
- a 30-year maximum amortization period for multi-family loans and a 25-year amortization period for other CRE loans,
- a maximum loan-to-value (LTV) of 65 percent and a maximum combined LTV of 70 percent,
- the CRE loan must be fixed rate or swapped to a fixed rate through an interest rate swap or capped with an interest rate cap, and
- the CRE loan may not be interest only or have an interest-only period.

## **Qualifying automobile loans**

The Final Rule defines a "qualifying auto loan" as an automobile loan (but not an automobile lease) that satisfies the following underwriting criteria, among others:

- the originator must have verified specified aspects of the borrower's credit history,
- the loan must have a debt-to-income (DTI) ratio of less than or equal to 0.36, as verified through payroll stubs and the borrower's credit report, and
- the borrower must make a down payment of at least (i) 10 percent of the vehicle purchase price plus (ii) all title, tax, and registration fees, dealer fees, and other add-ons.

## **Blending pools of qualifying, exempt and non-exempt assets**

Sponsors of RMBS will generally not be allowed to reduce their risk retention requirements by commingling QRM and non-QRM loans in a single securitization, with a limited exception for commingling QRMs and exempt 3-to-4 unit residential mortgage loans, as described above. However, sponsors of commercial, commercial real estate, or auto loans will be able to reduce their risk retention requirement in proportion to the percentage of "qualifying" assets included by up to 50 percent (that is, to 2.5 percent) using such "blended pools." The issuer must also disclose any material differences between the qualifying and non-qualifying assets included in the pool.

## **Certain foreign-related transactions**

The Final Rule includes a limited exemption, or "safe harbor," excluding from the risk retention requirement

certain predominantly foreign securitizations. The foreign securitization safe harbor is available only if all of the following conditions are met:

- registration of the ABS interests is not required under the [Securities Act of 1933](#) ,
- not more than 10 percent of the value of all classes of ABS interests (including ABS interests retained by the sponsor) are sold to U.S. persons,
- neither the sponsor nor the issuing entity is organized under U.S. law or is a branch located in the United States of a non-U.S. entity, and
- not more than 25 percent of the securitized assets were acquired from an affiliate or branch of the sponsor organized or located in the United States.

## **General exemptions**

The Final Rule includes a number of "general exemptions" from the risk retention requirements (in addition to the exemptions for certain community-focused residential mortgage loans and certain 3-to-4 unit residential mortgage loans described above), including the following:

- certain U.S. Government-backed securitizations of residential, multi-family, or healthcare facility mortgage loans that are insured or guaranteed (in whole or in part) by the United States or an agency of the U.S. Government, or involves the issuance of ABS that are collateralized solely by residential, multi-family, or healthcare facility mortgage loans, which ABS are insured or guaranteed by the United States or an agency of the U.S. Government,
- certain State and municipal securitizations where the ABS are issued or guaranteed by a State, a political subdivision of State, or by certain public instrumentalities of a State,
- certain qualified scholarship funding bonds,
- certain pass-through resecritizations that are collateralized solely by servicing assets and by ABS for which the requisite credit risk was previously retained or that were exempt from the credit risk retention requirements, provided that the resecritization is structured so that it involves the issuance of only a single class of ABS interests,
- certain first-pay-class securitizations structured to reallocate prepayment risk and not credit risk,
- securitizations collateralized solely by "seasoned loans" and by servicing assets,
- certain public utility securitizations, and
- securitizations sponsored by the FDIC acting as conservator or receiver for a financial institution.

There is also a reduced risk retention requirement for certain student loan securitizations where the student loans were made under the Federal Family Education Loan Program (FFELP). The risk retention requirement for such securitizations is either 0 percent, 2 percent, or 3 percent, depending on the degree to which such FFELP loan is guaranteed as to default in principal and accrued interest.

## **Additional exemptions**

The Final Rule provides that the Joint Regulators may jointly adopt or issue exemptions, exceptions or adjustments to the risk retention requirements of the Final Rule. Notably, the Final Rule does not give such authority to individual regulatory agencies.

## **PERIODIC REVIEW OF QRM DEFINITION AND RELATED EXEMPTIONS**

The Joint Regulators must review the QRM definition, and the related exemptions for community-focused and 3-4 unit residential mortgage loans, four years from the effective date of the Final Rule and every five years thereafter, or at any time upon request by one of the Joint Regulators, to determine if the CFPB's QM definition at such time is still the appropriate definition to use to define QRM and whether such related exemptions are still appropriate.

## **MARKET IMPACTS**

The Final Rule is expected to have a significant impact on securitization markets generally, although the impact is likely to vary considerably among specific asset classes and transaction structures. The impact of the Final Rule extends to the far reaches of the securitization markets, both because it covers privately placed ABS transactions, such as Rule 144A and Regulation D offerings, in addition to publicly offered ABS transactions, and because it applies to foreign issuers who are not willing or able to limit their offerings in the United States to less than 10 percent of the total transaction even in cases where the offering is predominantly foreign in nature.

Sponsors, and in turn originators, will have substantial incentives to produce "qualifying" assets that are exempt from risk retention requirements when securitized. This will be more easily achieved for some asset classes than others. Due to the significant "loosening" of the requirements for QRMs since the Original Proposal in response to widespread concerns that the definition would inhibit mortgage lending to low-and

moderate-income borrowers, it is expected that a relatively large percentage of residential mortgage loans originated in the United States will qualify as QRMs, and can therefore be securitized without a risk retention requirement. In contrast, the requirements for commercial loans, commercial real estate loans and auto loans remain nearly as strict as were initially proposed, and relatively small percentages of loans of these asset types are expected to be "qualifying" assets, such that securitizers of these assets are much more likely than RMBS sponsors to be required to retain risk in accordance with the Final Rule.

This outcome is perhaps most ironic in the case of automobile securitizations and CLOs. While RMBS securitizations were a contributing factor to, and some would claim the principal cause of, the 2008 financial crisis, auto loan securitizations and CLOs performed relatively well through the crisis. Now, under the new risk retention rules, auto loan securitizers and CLO managers are much more likely than residential mortgage loan securitizers to be required to retain "skin in the game" through risk retention.

The Final Rule is one of the last securitization "reforms" to be put in place as the result of the Dodd-Frank Act and other remedial legislation and regulation, as well as accounting rule changes, adopted following the financial crisis. Considering the restrictive requirements that have already been put in place by federal legislation and numerous regulatory agencies, it will be instructive to see whether the addition of risk retention requirements will significantly improve the performance of and confidence in the markets, or whether, instead, it will unnecessarily constrain markets that have largely corrected themselves and performed well since the financial crisis.