December 3, 2012

Federal Housing Finance Agency
Office of Strategic Initiatives
400 7th Street, S.W.
Washington, D.C. 20024
SecuritizationInfrastructure@fhfa.gov

Re: FHFA White Paper: Building a New Infrastructure for the Secondary Mortgage Market

The Securities Industry and Financial Markets Association ("SIFMA")[1] is pleased to respond to the request for input by the Federal Housing Finance Agency ("FHFA") on the proposals presented in the FHFA's October 4, 2012 White Paper entitled "Building a New Infrastructure for the Secondary Mortgage Market" (the "White Paper").

Active securitization markets must play a role in both the near-term recovery of housing markets, and the longer-term future U.S. housing policy. While the future of U.S. housing policy will be an issue ultimately decided by Congress, the actions of the FHFA in its role as Conservator of Fannie Mae and Freddie Mac (the "Enterprises") may have a significant impact on housing markets. The restoration of the housing markets requires that the Enterprises remain viable sources of funding for mortgage credit until such time as mortgage markets are able to operate in a prudential and accessible manner with reduced levels of government support. Accordingly, SIFMA strongly supports efforts of FHFA to preserve and modernize the infrastructure of the Enterprises. As detailed in our letter of June 12, 2012[2], we believe that the FHFA should follow a phased approach to implementing its Strategic Plan[3], and give priority to the alignment of the operations of the Enterprises. Such alignment, we believe, is important to preserve and enhance the liquidity of the TBA market.[4] The FHFA proposals outlined in the White Paper are steps in that direction in that

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[1] The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit www.sifma.org.

[2] SIFMA letter, dated June 12, 2012, to Toni Harris, Manager, Strategic Planning and Performance Management, Federal Housing Finance Agency: "Comments on Draft Strategic Plan". http://www.sifma.org/issues/item.aspx?id=8589939012

[3] FHFA Strategic Plan for Fiscal Years 2013-2017, October 9, 2012: http://www.fhfa.gov/webfiles/24577/FHFAStrategicPlan10912Final.pdf

[4] "SIFMA believes that the liquidity of the 'to be announced' (TBA) market developed over the past 30 years is critical to our nation's housing finance system and should be preserved. This over $6 trillion market, which is one of the largest and most liquid of all fixed-income markets globally, attracts vast amounts of private

they will further the unification of the Enterprises' policies and procedures, and we are hopeful that the FHFA will continue to move aggressively in this regard. We applaud the FHFA for the path for the future of the housing finance market it has proposed in the White Paper, which, over time, will reduce taxpayer risk.

We will limit our detailed input on the proposals at this time to those issues most directly pertinent to our membership; i.e., the provisions of the proposed model Pooling and Servicing Agreement ("PSA") related to securities issued by the Enterprises where private capital assumes the first loss credit risk.

As discussed below, we believe that the FHFA needs to be more specific about its intentions with regard to a number of the issues to be considered for a model PSA, and that specific credit investor feedback is then required before such proposals are codified in a model PSA to be used for transactions. We are available to assist in organizing such specific feedback and otherwise to assist the FHFA in any way possible to meet its goals.

Introduction and Overview of Comments

Since the inception of their respective MBS programs, the Enterprises have provided support for the housing markets by, among other things, providing full credit guarantees for the mortgage securities they have issued to finance their purchases of residential mortgage loans from originators.

As indicated in the White Paper, one of the goals of the proposed new infrastructure is to "establish a framework that is consistent with multiple states of housing finance reform, including greater participation of private capital in assuming credit risk."[5] It is the participation of private capital in assuming credit risk that is the focus of our comments. Specifically, we will comment on the provisions that we believe will matter to credit investors in a model PSA for Enterprise securitizations that contemplate participation of private capital in assuming credit risk.[6]

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capital, which ultimately flow directly to mortgage borrowers and reduce the cost of mortgage lending. The TBA market is also an essential tool for lenders to hedge risk. If the future housing finance system fails to take this into account, it could severely decrease the liquidity of the secondary mortgage market, and dramatically impact its ability to channel these huge sums of private capital to mortgage borrowers. The TBA market is one of the components of a successful, liquid, affordable, and national mortgage market, and SIFMA believes it is of critical importance that it be preserved." SIFMA Statement on Administration's Housing Finance Reform White Paper, February 11, 2011: http://www.sifma.org/news/news.aspx?id=23305

[5] White Paper, page 2. The White Paper also contemplates that the proposed single securitization platform will be able to "serve both Enterprises and a post-conservatorship market with multiple future issuers." White Paper, page 15.

[6] We note that there may be separate model PSAs for each of the routes that may be contemplated by the White Paper, depending on whether credit risk is sold to investors, and in what form, and whether issuers other than the Enterprises are permitted to use the platform.

Our comments contemplate that the transactions to be engaged in are securitizations by an Enterprise, off of a platform controlled by FHFA or the Enterprises, in which the risk of the underlying assets is sold to third party credit investors. Additional issues may present themselves when issuers other than the Enterprises use the platform through which an Enterprise guarantee is provided for the senior portion of the risk.

Private Label Securities ("PLS") Market

The PLS market is wholly dependent on the assumption of credit risk by private capital. The White Paper identifies several issues that are critical to credit investors in the PLS market.[7] These are also among the critical issues that will need to be addressed in order to attract private capital to assume credit risk in connection with mortgage securities issued by the Enterprises.

We observe that the decisions with regard to these critical issues made by private issuers in PLS transactions will be wholly commercial decisions, while the decisions made by the FHFA may also reflect public policy decisions. In addition, whatever decisions may be made by the FHFA, and as important as standardization may be to investors, unless otherwise mandated by law, individual PLS issuers may choose to make different decisions, either for substantive commercial reasons, competitive reasons or otherwise. The decisions made by the FHFA with regard to these critical issues may be one of many alternatives considered by private issuers but may not be determinative.

Model PSA Provisions

Investors in credit risk must have certainty and transparency, and must be able to exercise some measure of control, to a large extent as if they were equity investors in an operating company. Credit investors will want there to be mechanisms in place to assure that the provisions of the PSA intended to protect their interests are in fact effective. Credit investors will also want to be assured that the contractual obligations of transaction parties (e.g. the servicer, the trustee, etc.) are being met and will want to be able to replace transaction parties if such parties do not fulfill their contractual obligations. Model PSA provisions must provide such certainty and transparency and such protections.

We believe that the critical issues to attract private capital to assume credit risk in connection with mortgage securities issued by the Enterprises, including those identified in the White Paper, are the following:[8]

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[7] White Paper, pages 12-13 and 31.

[8] Our views on certain of these issues were included in our comment letters of August 10, 2010 and October 4, 2011 (the "2010 Comment Letter" and the "2011 Comment Letter", respectively) to the Securities Exchange Commission on the Commission's Release Nos. 33-9117, 34-61858, Asset Backed Securities; Proposed Rules, regarding registration and transaction requirements for shelf registration of asset backed securities ("Proposed Reg ABII").

- Conflicts between transaction parties
- Representations and warranties
    - Content
    - Breach enforcement
    - Claim resolution
- Credit risk management
- Transaction oversight
- Servicing
    - Loss mitigation alternatives
    - NPL special servicing
    - NPL buy outs
    - Servicer compensation
- Investors
    - Communications
    - Voting
    - Reporting

Our detailed comments with regard to each of these issues are set forth below.

Detailed Comments

1. TBA Considerations – To the extent that the provisions in the model PSA change the structure or performance of Enterprise guaranteed securities, as compared to Enterprise guaranteed securities issued prior to the implementation of such changes, questions will be raised as to the TBA eligibility of the newly issued securities.

TBA securities benefit from greater liquidity and reduced costs to the Enterprises, resulting in reduced costs to homeowners. A decision to maintain TBA eligibility for newly issued securities may limit the ability of the Enterprises to make all of the changes that it and credit investors may desire to make. This is among the choices to be made by the FHFA as it develops the model PSA.

2. Conflicts – The White Paper notes the possibility of potential conflicts in PLS transactions between "sellers, borrowers, servicers, trustees, senior investors and subordinate investors"[9].

Our focus is on whether there could be potential conflicts that would adversely impact private capital that has assumed the credit risk, as a subordinated investor or otherwise, in an Enterprise securitization. Any such material conflict that is known to an issuer should be disclosed.

3. Representations and Warranties and Enforcement Mechanisms – The White Paper asserts that "[PLS] investors were affected by non-standardized loan representations and warranties and ineffective mechanisms for enforcing remedies for breaches . . .."[10]

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[9] "[L]ack of standardization in . . . Private Label PSAs produced divergent business practices that led to ambiguity in interpretation and placed different market participants . . . at direct odds with each other." White Paper, page 12.

[10] White Paper, page 12-13.

a. Representations and Warranties

Credit investors will, of course, want a robust set of representations and warranties in the Enterprise PSAs regarding the characteristics of the mortgage loans, the mortgagors and the mortgaged properties.

Investors in Enterprise guaranteed securities at this time do not rely on representations and warranties. However, credit risk investors will rely on such provisions and the nature and content of the representations and warranties will be important to such investors. We propose that the Enterprises prepare a comprehensive list of the representations and warranties they currently provide, and solicit specific investor input on whether such representations and warranties are adequate or whether additional or different provisions are required.

b. Enforcement and Resolution Mechanisms

The most significant concern of investors in PLS transactions is the absence in most transactions of a party that is specifically charged with enforcement of representations and warranties, and an effective mechanism for requiring repurchase of (or substitution for) a defective pool asset when a material breach has been identified.[11] This concern will be equally applicable for credit investors in Enterprise securitizations.

The model PSA must provide for an independent process that would provide credit investors with assurance that representations and warranties will be enforced. This process should involve appointment at the outset of a transaction of an independent party, a credit risk manager that would be responsible for identifying and pursuing representation and warranty breaches and pursuing claims, and would also provide that if a claim could not otherwise be resolved, the dispute would be submitted to binding arbitration.[12] It is essential that the credit risk manager have access to loan level files in order for it to fulfill these responsibilities. Details regarding the recommendation we have previously made in this regard may be found in the excerpt to our 2010 Comment Letter attached hereto in the Appendix.

We note that the FHFA recently announced that Fannie Mae and Freddie Mac will implement a new representation and warranty framework for conventional loans acquired

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[11] We note that in its post-crisis PLS transactions, Redwood Trust has revised its PSAs to provide for the holder of the subordinated interests or the trustee to identify and pursue breach claims and for mandatory arbitration to resolve disputes. In addition, the requisite percentage of certificateholders can direct the trustee to take these actions.

[12] We objected, in both our 2010 Comment Letter and our 2011 Comment Letter, to certain of the enforcement process provisions of Proposed Reg ABII that would defer the intervention of a credit risk manager until the occurrence of certain minimum triggering events, subject to the satisfaction of the trustee that such events have occurred. Investors have expressed concerns about inherent conflicts of interest for servicers and trustees, and feel strongly that an independent credit manager and not other parties to the transaction will best serve as the advocate and protector of the investors' interests.

on or after January 1, 2013, which will provide originators with a higher degree of certainty and clarity around their repurchase exposure, but which will also cut off recourse by the Enterprises. The new framework will also include changes to the quality control process, with loan reviews that occur earlier in the acquisition process rather than at the time of loan default.

Under the new framework, lenders will not be required to repurchase certain conventional mortgage loans with 36 months of consecutive, on-time payments or, in the case of HARP loans, only 12 months of consecutive, on-time payments after the acquisition date. In addition, no repurchase will be required if the borrower (i) had no more than two 30-day delinquencies and no 60-day or greater delinquencies during the 36 months following the acquisition date; and (ii) was current as of the 60th month following the acquisition date.

Significantly, the change does not apply to certain "life of loan" representations and warranties, such as those that relate to Fannie Mae or Freddie Mac charter matters[13]; misstatements, misrepresentations, omissions and data inaccuracies; clear title or first lien enforceability; compliance with laws and responsible lending practices; and product eligibility.[14]

Some of the most common reasons for loan put backs have been based on allegations of borrower fraud, misrepresentations about income or debt, misstatements and misrepresentations about owner occupancy, and inaccuracy of appraisals.

Investors will, of course, want to conduct due diligence on the mortgage loans included in a securitization. However, and notwithstanding the new representation and warranty framework for the Enterprises, investors also feel strongly that if there is a default on a loan and there was a material misrepresentation that caused the default, the Enterprise should be required to repurchase the loan, without regard to when the misrepresentation was discovered.

c. Due Diligence

As indicated above, prior to making an investment decision, credit investors will want to conduct due diligence on the mortgage loans included in a securitization. In order to conduct such due diligence, credit investors will need to have made available to them detailed loan by loan data.

Such due diligence may be conducted by an independent third party selected by the Enterprises and acceptable to credit investors or by the credit investors themselves. The scope of such due diligence would be determined by the credit investors in each transaction, based on, among other things, the size and structure of the transaction.

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[13] Mortgaged properties must be secured by residential properties located in the United States with four or fewer units, and the initial principal amount must not exceed the applicable maximum loan limit.

[14] No balloons, borrower must be a United States citizen or permanent resident, no reverse mortgages.

It is also important that the representations and warranties to be made by the Enterprises and on which credit investors will rely specifically confirm the accuracy of the data on which due diligence is conducted.

In a transaction in which a TBA security will be issued and first loss credit risk will be transferred to private capital investors, we anticipate that due diligence required to be performed by investors or by an independent third party acceptable to investors would be performed after the TBA securities are sold.

4. Servicing – The White Paper asserts that "borrowers [whose loans were in PLS] in similar circumstances were treated very differently depending on whether their respective [PLS] PSAs permitted a broad or narrow range of loss mitigation alternatives to foreclosure."[15]

a. Loss Mitigation Alternatives

Our 2010 Comment Letter proposed the following disclosures to PLS investors regarding servicing practices. This is also a good outline of what credit investors in Enterprise securitizations will care about.

- Loan modification criteria and practices
- Loss mitigation policies
- Methodologies and standards used to qualify borrowers for modification programs (including the servicer's practices for determining whether default is reasonably foreseeable)
- A description of the types of inputs used in net present value ("NPV") models used by servicers to weigh loss mitigation alternatives against foreclosure proceedings
- Formulas or other calculations for rate decreases or other term modifications
- How forbearance and other partial reductions of principal are treated
- Details of methodologies used by servicers to advance interest and principal on delinquent loans and to reimburse those advances.

We propose that the model PSA include provisions to address the factors outlined above.[16] In order to assure that credit investor concerns are addressed by these model PSA provisions relating to servicing, we propose that the Enterprises prepare a description of what they propose to include in such provisions and solicit specific investor input on whether such provisions are adequate or whether additional or different provisions will be required.

In addition, our investor members believe that servicing will be better understood if investors have access to information regarding not only the basic servicing standards but

[15] White Paper, page 12.

[16] All in accordance with the rules to be adopted by the Consumer Financial Protection Bureau (CFPB). See proposed rules at 12 CFR Part 1024.

also servicers' actual practices. Accordingly, investor distribution reports should include information regarding actual servicing practices during the term of a transaction, especially if such actual servicing practices deviate from what has been agreed.

b. Repurchase of Non-Performing Loans

The FHFA specifically asked in the White Paper whether the model PSA should define when a non-performing loan is required to be purchased out of the trust.

Fannie Mae Non-performing Loan Repurchases The Master Trust Agreement through which Fannie Mae issues MBS provides for mandatory repurchase after a payment is 24 months past due, unless the borrower is complying with a loss mitigation alternative, the servicer is pursuing a foreclosure, the property is being sold or similar circumstances exist.

The Master Trust Agreement also provides for optional purchase "at any time after that Mortgage Loan has been in a state of continuous delinquency . . . during the period from the first missed payment date through the fourth consecutive payment date (or eighth consecutive payment date, in the case of a bi-weekly Mortgage Loan) . . ."[17]

In order to provide for cash flows to Enterprise guaranteed securitization investors under the model PSA identical to the cash flows to Enterprise guaranteed securitization investors at this time, we propose that the model PSA provide for the Enterprises to repurchase loans in the same manner as is currently provided in the Fannie Mae Master Trust Agreement.

In any event, however, so long as the credit investors will remain exposed to credit losses on loans that are repurchased, such loans must be assigned to a special servicer as described below.

c. Special Servicing

The FHFA also specifically asked in the White Paper whether the model PSA should define when a non-performing loan is required to be transferred to a specialty servicer.

Credit investors will want the model PSA to provide for a special servicer to be named to take over servicing for severely delinquent loans and will want a process to be in place by which the special servicer is named, either from a list acceptable to the credit investors, pursuant to guidelines acceptable to credit investors, or in some other acceptable fashion.

[17] Note that the Freddie Mac Master Trust Agreement only provides for optional purchase if a "Mortgage is 120 or more days delinquent." Further note that there is a distinction between when an Enterprise buys a loan out of a trust and when the originator may be required to buy the loan back from the Enterprise.

<u>d. Servicer Compensation</u>

The FHFA, in its Alternative Mortgage Servicing Compensation Discussion Paper dated September 27, 2011, proposed for comment two alternative servicing compensation structures, a Reserve Fund model and a fee for services model.

- <u>Reserve Fund Model</u> – Servicers would retain a reduced master servicing fee strip (ranging from 12.5 to 20 basis points), rather than the current 25 basis points for most RMBS, with an additional reserve account (ranging from 3 to 5 basis points) to cover non-performing loan servicing costs. The reserve fund could be refunded to servicers at the end of the deal if not used for nonperforming loan servicing costs.

- <u>Fee for Service Model</u> – Servicers would simply be paid fixed dollar amount fees per month per loan, irrespective of principal balance.

The SIFMA comment letter, dated December 21, 2011, rejects both models for reasons explained in the letter, saying that neither accomplishes the stated goals of servicing compensation reform (improving service to borrowers, reducing financial risk to servicers, promoting liquidity of the TBA markets and promoting competition in servicing).

The issue of servicer compensation and how to provide appropriate incentives for servicers to perform at the highest levels when credit issues emerge, remains a critical issue. This issue will be even more important as third party credit investors are exposed to such credit issues.

In any case, and especially to the extent that FHFA intends to implement changes to the Enterprises' policies in the market for TBA-eligible securities, FHFA should re-engage with the industry on this topic to develop a solution that creates appropriate incentives while preserving market liquidity and competition.

5. Transaction Oversight – The FHFA also specifically asks for comment on how compliance with the PSA should be monitored in the future.

It will be important for the confidence of credit investors that the PSA provisions agreed to by servicers, trustees and any other transaction parties are, in fact, observed, and also that there are consequences and remedies if such provisions are breached.

We propose that a transaction oversight manager be appointed to evaluate whether transaction parties are fulfilling their obligations and to report its findings to credit investors on a monthly basis. Transaction parties who are not fulfilling their obligations would be subject to removal by a vote of a majority of the credit investors.

The transaction oversight manager should be chosen either from a list acceptable to credit investors, pursuant to guidelines acceptable to credit investors, or in some other acceptable fashion.

The most critical transaction party is the servicer of the underlying loans. The transaction oversight manager may be a master servicer for a transaction overseeing compliance by the servicer and others with their obligations.

6. Role of the Trustee **–** Regarding the role of the trustee, the FHFA asks "[w]hat enhancements to the role of the trustee should be considered in order to attract private capital"?

The basic role of the trustee should be to act in the interests of the investors. We propose that the trustee be required to enforce the rights of each class of security holders at the direction of a majority of the investors in such class, subject to an agreement by such investors to pay for the fees, costs and expenses incurred by the trustee and to provide the required indemnification. Historically, security holders were required by many PLS PSAs to provide "any reasonably requested" indemnification. We propose that the model PSA include the specific indemnification provisions to be required by the trustee so that action taken by the trustee on behalf of security holders is not held up by negotiation of those provisions.

The Enterprises act as issuers, master servicers, trustees and as guarantors of their own securitizations. In the case of a structure in which credit risk is assumed by third party credit investors, there appears to be an inherent conflict of interest for the Enterprises to act in so many roles, particularly as issuer, with loan repurchase and other obligations, and guarantor, which is a senior credit position, while also serving as trustee with responsibilities to the credit investors whose interest may well be at odds with the interests of the issuer and the senior credit position.

7. Investor Communications and Voting – The White Paper observes that non-standard PLS PSAs "included vague and ambiguous mechanisms for exercising voting rights,"[18] and that there was an "inability to identify and communicate with other investors when securities were held through intermediaries."

a. Investor Communications

The SEC's proposed revisions to Regulation AB ("Reg ABII")[19] would require that the PSA or other transaction documents provide for a securitization issuer to include in its monthly filing after a distribution date any request received from an investor to communicate with other investors related to investors exercising their rights under the terms of the securitization.[20] The request to communicate would be required to include the name of the investor making the request, the date the request was received and a description of the method by which other investors may use to contact the requesting investor.

[18] White Paper, page 13.

[19] 17 CFR Parts 200, 229, 230 et al.

[20] 17 CFR 229.1121 (Item 1121) (g)

We propose that the model PSA include investor communication provisions consistent with the requirements of Reg ABII when adopted. If Reg ABII is not adopted or does not include such provisions, the model PSA should include a provision substantially the same as described above.[21]

b. Investor Voting

Currently, investors in Enterprise securitizations have voting rights only in the event of a Guarantor default.

As indicated above, if the transaction oversight manager determines that a transaction party is not fulfilling its obligations, such party would be subject to removal by a vote of a majority of the credit investors. In addition, a majority of the credit investors should have the authority to direct the trustee to take actions on its behalf, subject to the indemnification and other provisions of the PSA, also as discussed above.

8. Investor Reporting – The White Paper observes that another issue with PLS PSAs was that there was a "lack of information about the performance of mortgage loans in the securitization."[22]

The SEC's proposed Reg ABII requires that detailed asset level performance information be included in the Form 10-D that is required to be filed by an issuer in connection with each distribution date.[23]

We propose that the model PSA incorporate investor reporting provisions consistent with the investor reporting provisions of Reg ABII when adopted. If Reg ABII is not adopted or does not include such provisions, the model PSA should include a provision substantially the same as set forth in proposed Reg ABII.

9. Form of Credit Instrument – We note that credit investors will want essentially the same protections notwithstanding the form of the credit instrument; i.e., a subordinated interest in a pool of loans on which one of the Enterprises guarantees the senior interests, a credit-linked note ("CLN") that transfers credit risk on one or more pools of loans underlying Enterprise guaranteed securities, or otherwise. These protections might be

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[21] Section 8.02 of the Redwood Trust PSA provides that if three or more holders apply in writing to the certificate registrar for the purpose of communicating with other holders with respect to their rights under the PSA, the registrar must afford access to the most recent list of certificateholders or, at the applicants' expense, will send the written communication proffered by the applicants to all certificateholders.

[22] White Paper, page 13.

[23] See 17 CFR 229.1121(d) as proposed and published in the Federal Register on May 3, 2010. See page 104 of this PDF (23430 of the Federal Register): http://www.gpo.gov/fdsys/pkg/FR-2010-05-03/pdf/2010-8282.pdf. Under proposed Reg ABII, the SEC proposed a new Rule 192 of the Securities Act, which, if adopted, will "require an issuer of privately-issued structured finance products to provide, upon the investors' request, information as would be required if the transaction were registered."

provided for in the applicable PSA, in the case of subordinated interests, or in the PSA as well as in other agreements in the case of CLNs or other instruments.

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We greatly appreciate your consideration of the views set forth in this letter, and we would be pleased to have the opportunity to discuss these matters further with you or with any member of the FHFA staff. Please do not hesitate to contact Richard Dorfman at 212-313-1359 or Chris Killian at 212-313-1126 with any questions or comments, or to further discuss these important issues.

Sincerely,

Richard A. Dorfman
Managing Director, Head of Securitization

Chris Killian
Managing Director

Appendix – Credit Risk Manager Recommendation

SIFMA Reg ABII comment letter to the U.S. Securities and Exchange Commission August 2, 2010

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4. Third-Party Verification Regarding Repurchase Obligations

The mechanisms for enforcement of asset-level representations and warranties in asset-backed transactions – particularly RMBS transactions – have been a source of great frustration for SIFMA's investor members. In many existing transactions, these mechanisms have not functioned effectively. In some cases, the standard for determining whether a material breach of a representation and warranty has occurred, and whether repurchase of or substitution for the affected pool asset is therefore required, is unclear. In others, investor members believe that claims for repurchase or replacement of defective pool assets have not been made when appropriate. At the same time, our dealer and sponsor members have been subject in many cases to claims for material breaches of representations and warranties that they believe are without basis in fact, and that have sometimes been asserted without any specific grounds other than delinquency in payment.

We believe that reform of the enforcement provisions for material breaches of asset-level representations and warranties, particularly in RMBS transactions, is an important element of the recovery of the ABS markets.[21]

As a partial replacement of the current condition to ABS shelf eligibility requiring an investment grade credit rating by at least one NRSRO, the Commission has proposed that the transaction documents be required to provide that the party that is obligated to repurchase (or substitute for) pool assets that are in material breach of a representation or warranty[22] must provide to the securitization trustee, on at least a quarterly basis, a certificate or opinion of an unaffiliated third party regarding pool assets not repurchased or substituted for[23] after a demand for such was made. This certificate or opinion would state that the affected pool asset was not in material breach of a representation or warranty. Although we appreciate the Commission's proposal and applaud it as a step in the right direction, we believe that the proposed requirement for a third-party opinion or certificate as a condition to shelf registration does not adequately address our members' concerns – which we believe are widely shared in the ABS markets – regarding enforcement of representations and warranties.

In addition, the proposed requirement for a third party opinion or certificate would not address the most significant concerns of investors – the absence in most transactions of a party that is specifically charged with enforcement of representations and warranties, and an effective mechanism for requiring repurchase of (or substitution for) a defective pool asset when a material breach has been identified.

As an alternative, our dealer and sponsor members have developed a more practical mechanism that would be genuinely beneficial to investors. We recommend an

independent enforcement process that would be feasible for issuers to undergo while at the same time providing investors with an effective mechanism to ensure that representations and warranties would be enforceable. This process would involve appointment of an independent party that would be responsible for enforcing representations and warranties, and requiring that if a claim could not otherwise be resolved the dispute would be submitted to binding arbitration. We ask that the Commission condition shelf eligibility under Form SF-3 on the transaction documents implementing the process described below for repurchase claims for material breaches of representations and warranties.[25] We outline this recommendation in significant detail; SIFMA's dealer and sponsor members and our investor members share the view that in order for this process to operate effectively, the criteria described below should be satisfied. We recognize that the Commission may not wish to include this amount of detail in the General Instructions to Form SF-3. If the Commission chooses to adopt but abbreviate the requirement by, for example, providing that the transaction documents must specify detailed procedures sufficient to implement the requirement, we ask that the Commission cite the procedures described in this letter as procedures that, if included in the transaction documents, would satisfy this shelf eligibility criterion.[26]

For each transaction in which ABS are to be offered pursuant to a shelf registration statement,[27] the transaction documents should provide that an independent credit risk manager ("CRM")[28] would be appointed to represent the interests of the securityholders. The CRM would be provided by the custodian or other party that maintains the physical loan files or electronic credit underwriting files with electronic access to all loan and credit underwriting files. The CRM would have access to all underwriting guidelines and any other documents necessary to reunderwrite the loans, whether on the basis of asset performance or otherwise. A risk management fee would be paid to the CRM alongside other service providers, before investors are paid, through the cash flow waterfall. A simple majority vote of investors, by interest, could terminate the CRM and appoint a successor.

It would be the responsibility of the CRM to determine whether it is appropriate to assert against the sponsor or other obligated party (each a "seller") a claim of a material breach of a representation or warranty with respect to any pool asset, and if so, to assert that claim on behalf of the securitization trust. The transaction documents would provide that claims may be made by the CRM either on its own initiative in the interests of all investors in the aggregate, or as directed by an investor, subject to the following standards:[29]

- A claim may be initiated by the CRM if it has a good faith reasonable belief that:
    - On the basis of documented and verifiable evidence (other than the performance of the pool asset alone, except in the case of a violation of an early payment default condition), a representation or warranty has been breached,
    - The breach has materially and adversely affected the interests of investors with respect to the affected pool asset,[30] and

- Seeking repurchase or replacement of the pool asset or a cure of the breached representation or warranty is in the best interests of all investors in the transaction, in the aggregate.

- A claim may be initiated by the CRM on behalf of the trust upon the direction of an investor or group of investors if those investors' interests represent at least 25 percent (by principal balance) of the total interest in the entire pool of securitized assets. This criterion is designed to reduce the likelihood of claims brought by investors that may acquire small interests in ABS in the secondary market in order to assert claims for the purpose of securing settlement payments outside of the trust that do not benefit other investors. As in the case of claims brought by the CRM on its own initiative on behalf of the trust, investor claims for material breaches of representations and warranties must be based on a good faith reasonable belief that:

    - On the basis of documented and verifiable evidence (other than the performance of the pool asset alone, except in the case of a violation of an early payment default condition), a representation or warranty has been breached, and

    - The breach has materially and adversely affected the interests of investors with respect to the affected pool asset.[31]

- Investors representing at least five percent of the total interest in the pool may ask the CRM to initiate a claim. The CRM must then poll investors to determine whether investors representing a total of 25 percent of the interest in the pool assets agree.

    - In order to enable investors to determine whether five percent or more of securityholders want to make such a request, the transaction documents would provide a mechanism for securityholders, acting through the CRM and/or the trustee, to determine whether other securityholders share their view.

- Investors whose interests in the ABS do not represent at least 25 percent of the interest in the entire pool of securitized assets would be entitled to direct the CRM to pursue a claim for material breach of a representation or warranty only if they agree to pay directly any costs associated with pursuit of the claim, including arbitration costs and reunderwriting costs incurred after the date of the request.

The transaction documents would provide that the seller must either comply with the applicable remedy provisions of the transaction documents or respond with specificity as to the reasons why a material breach has not occurred. Remedies would include cure of the breach, repurchase of the affected pool asset for the purchase price specified in the transaction documents, or, if applicable and if provided in the transaction

documents, substitution of a pool asset having substantially similar characteristics as the defective pool asset (exclusive of any defects). If after review the seller and the CRM agree that no material breach has occurred, the claim would be withdrawn with prejudice.

If the parties could not agree within 180 days following the date of notice of a claim for repurchase of a pool asset (or another remedy) due to an alleged material breach of a representation or warranty as to whether a material breach has occurred, the dispute could, at the option of either the CRM or the obligated party, be referred to a binding arbitration proceeding before an independent arbitrator (or panel of arbitrators).[32] In order to avoid excessive costs, arbitration proceedings would take place semiannually. The arbitrators would either require performance of a remedy available under the transaction documents or determine that no material breach occurred. All arbitration decisions would be final and non-appealable.

Costs of arbitration would be borne by the losing party. If the arbitrators rule against the seller, the seller must reimburse all costs of the arbitrators as well as reasonable costs, expenses and legal fees of the CRM or the asserting investor(s), as applicable, related to the arbitration proceedings. If the arbitrators rule in favor of the seller, then (i) if the claim was brought by the CRM on behalf of the trust, the arbitration costs and the seller's reasonable costs, expenses and legal fees would be reimbursed by the trust, and (ii) if the claim was brought by the CRM on behalf of an investor or group of investors whose interests do not comprise 25 percent of the interests in the entire pool of securitized assets, the reasonable costs, expenses and legal fees of the seller would be paid by that investor or group of investors. This method of cost allocation would permit the CRM or individual investors to pursue valid claims through binding arbitration, but would discourage baseless or frivolous claims made for the purpose of forcing settlements outside of the trust.

The status of all requests for repurchase of a pool asset (or other remedy) on the basis of an asserted breach of a representation or warranty, including cures, repurchases, failures to repurchase, arbitration proceedings, and associated costs and expenses, should be required to be reported in distribution reports on Form 10-D.

<u>Footnotes</u>

[21] Requests for repurchase of or, where permitted, substitution of new pool assets for, assets as to which a material breach of a representation or warranty is alleged to have been identified, are primarily a phenomenon associated with RMBS transactions. The Commission may therefore wish to consider whether the recommendation that we have outlined below should be applicable in all respects to ABS other than RMBS, and whether for some types of ABS these recommendations may be inapplicable. It would be rare for repurchase of pool assets due to a material breach of a representation or warranty to be requested in, for example, motor vehicle loan or lease transactions. In credit card securitizations, receivables that are required to be removed are reassigned to the seller's interest in the pool of receivables. Although it probably would not be practical to establish

completely different representation and warranty enforcement mechanisms for every asset class, it may, for example, be unnecessary to appoint (and pay a fee to) an independent credit risk manager in transactions in which ABS are backed by assets other than residential mortgage loans.

[22] Or, of course, the obligated party may cure the breach, if the breach is of a type that is susceptible to cure.

[23] In some transactions, the party that is obligated on the asset-level representations and warranties may, at its option, if it is determined that a material breach of a representation or warranty has occurred as provided in the transaction documents, either repurchase the affected pool asset for the specified purchase price or substitute for the Our dealer and sponsor members are concerned that the proposed requirement may not be workable in practice, and that the opinions or certificates of third parties would be of minimal value to investors. The party responsible for providing the opinion or certificate would need to make not only a technical determination as to whether a breach has occurred but also a determination that the breach is material and adverse. It is not clear who would be qualified to provide the opinion or certificate, or who would be willing to undertake the responsibility to do so. As noted by the Commission in the Proposing Release, this would not be an appropriate responsibility for accountants.[24] We believe that it would also be an inappropriate subject for a legal opinion, as the conclusions as to which the third party would be required to opine would generally be matters of fact, not law.

[24] 75 Fed. Reg. at 23345.

[25] As discussed below, our investor members believe that additional disclosure should be required in the prospectus regarding asset-level representations and warranties and the remedies for material breach, so that investors would be able to more easily enforce repurchase or substitution obligations for material breaches.

[26] We believe that if the Commission chooses to adopt our recommendation for enforcement of representations and warranties in shelf offerings of ABS, it is likely that this mechanism will be adopted as a model for other ABS transactions.

[27] Or at least, for each RMBS shelf offering. As noted above, the Commission may wish to consider whether all of these requirements would need to be satisfied for transactions in which ABS are backed by assets other than residential mortgage loans.

[28] The CRM should not be affiliated with the issuer or sponsor, and should not be the same institution hired by the sponsor or underwriter to perform pre-closing due diligence work on the pool assets.

[29] In order to facilitate the assertion of appropriate claims for material breaches of representations and warranties, the transaction documents should require that the securitization sponsor or any other party obligated on representations and warranties notify the CRM after any public disclosure of a settlement between such obligated party

and any governmental body or regulatory agency regarding violations of predatory lending or other laws specifically relating to the pool assets.

[30] The breach of certain representations and warranties specified in the transaction documents, such as representations related to predatory lending and compliance with law, would be deemed to be material.

[31] The CRM would provide access to loan documentation, underwriting guidelines and other relevant documents to investors upon request, consistent with applicable privacy laws and the securities laws, for the purpose of investigating potential claims for material breaches of representations and warranties. Investors seeking this information would be required to sign standard confidentiality agreements in the form prescribed for each transaction. Any associated costs would be borne by the requesting investors.

[32] For a standard three-arbitrator panel, each of the CRM and the seller would appoint one arbitrator, with the third appointed by mutual agreement or, if the parties cannot agree, by the arbitration forum specified in the transaction documents. For a single arbitrator, the CRM and the seller would appoint the arbitrator by mutual agreement (or, if they cannot agree, the arbitration proceeding would default to a standard three-arbitrator panel).