NAVY FEDERAL Credit Union

Office of the President

August 20, 2014

Mr. Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: Notices of Proposed Rulemaking
Asset Securitization and Safe Harbor,
Document Nos. 2014-14926; 2014-14919

Dear Mr. Poliquin:

Navy Federal Credit Union is pleased to provide comments on the National Credit Union Administration's Notices of Proposed Rulemaking (NPRs) concerning asset securitization and the related safe harbor, of June 26, 2014.

In general, Navy Federal supports this proposal. It is an important step toward ensuring Federal Credit Unions (FCUs) have the ability to access the capital markets so we can continue to serve our members. Equally important, this authority will enhance a FCU's ability to manage its financial risks.

NCUA has proposed two restrictions that should be amended. First, NCUA has limited securitization authority to loans originated by the FCU itself. We believe it is important for a FCU to have the authority to purchase loans and put them in a securitization, particularly if these loans are needed to complete a pool. We recommend NCUA eliminate this restriction. Second, NCUA has proposed limiting retained interests to 25% of net worth. Instead of relying on an arbitrary fixed net worth limit, we believe FCUs should hold capital commensurate with the risk of these retained interests. This approach is consistent with the requirements of federal banking regulators and we recommend NCUA adopt this framework. Lastly, we have provided additional comments on the Asset Securitization rule and the accompanying Safe Harbor rule in Attachment I.

In summary, Navy Federal supports this rule and we look forward to its implementation. If you have any questions, please feel free to contact Vince Pennisi, Chief Investment & Risk Officer at (703) 255-8740.

Sincerely,

Cutler Dawson

Cutler Dawson
President/CEO

Attachment

Attachment I

1. **Asset Securitization Rule**
These comments pertain to 12 CFR Part 721 and 741, NCUA's proposed Asset Securitization rule:

a. **Origination Requirements**
The Board has proposed to limit securitization authority to those assets that were originated by the Federal Credit Union (FCU) itself. The Board states allowing FCUs to "purchase loans for the purpose of issuing asset-backed securities would add an additional layer of risk, in an area that is uncharted for both FCUs and NCUA". We disagree with this restriction and request the NCUA Board eliminate it.

Currently, a FCU can purchase loans to hold in portfolio under 17 CFR 701.23(b)(2). Restricting a FCU's ability to use securitization as a funding source limits its ability to engage in a substantively similar and already permissible activity. For example, a FCU can purchase mortgage loans, execute a pass-through securitization and record the transaction as a secured borrowing on the balance sheet. In this case the FCU will likely take on the first-loss position via the retained interests; however, if the FCU had financed the loan purchase though deposits or borrowings, it would be in the same first-loss position. Allowing a credit union to purchase loans for the purpose of aggregating them is merely another way to finance the purchase of loans. In the increasingly rare cases where off-balance sheet treatment is achieved, NCUA can control the risk to the FCU by requiring capital commensurate with the risk of the retained pieces.

This limitation can also reduce the ability of FCUs to access the market. This is particularly true for FCUs that do not have enough organic originations to create pools and regularly access the securitization market. Under 17 CFR 701.23 (b)(1), a FCU can purchase loans to complete a secondary market transaction; however, under the proposed rule, a FCU will not be able to purchase loans if it's secondary market outlet is securitization. Effectively, this closes the securitization market to mid-sized credit unions that might otherwise benefit from direct market access, and, it prevents larger FCUs from providing liquidity to the industry. We recommend NCUA set a threshold by which a FCU can purchase loans to make-up the balance necessary to complete a securitization. We recommend NCUA consider a 50% threshold.

b. **Policy Limits**
NCUA has proposed exempting pass-through structures from the proposed net worth limits. We agree with this approach.

For all other types of structures, NCUA has proposed limiting a FCU's cumulative residual interest to 25% of net worth. Instead of using a limit based on net worth, we recommend NCUA establish a risk-based capital requirement for these residual interests. This would allow FCUs to more freely engage in securitization while also ensuring FCUs retain capital commensurate with the risks of securitizations. We recommend NCUA adopt the risk weights commensurate with other financial institutions. These risk weights should be incorporated into NCUA's proposed

Risk Based Capital framework. In the interim, these risk weights can be added to the existing Risk Based Net Worth Requirement.

c. **Derivatives**

Depending on the type of loan collateral, it may be necessary for the issuing entity to use a derivative (e.g., interest rate swap) to align the interest rate risk between the assets held in the SPV and the securities issued to investors. The derivative authorities in 12 CFR 703 do not allow FCUs to execute transactions in a SPV. We recommend NCUA provide explicit authorization to use otherwise permissible derivatives in conjunction with a securitization. We recognize this may require a FCU to apply for derivative authority under Part 703; we support this requirement.

d. **Originating Entity**

The proposed rule limits the securitization of assets to only those originated by the FCU. The proposed rule does not address whether loans originated by a FCU's CUSO are acceptable. We believe the intent of NCUA's proposed language is to prevent FCUs from purchasing 3rd party loans for the sole purpose of creating a securitization. We do not believe NCUA intended to limit a FCU from using its CUSO to securitize bona fide originations to its members. We recommend NCUA specifically authorize FCUs to securitize loans originated by either the FCU or its CUSO.

e. **Implicit Recourse**

NCUA restricts FCUs from engaging in securitizations where the FCU provides post-sale credit support to poorly performing assets, commonly referred to as "implicit" recourse. Banking regulators have expressed concerns that some originators have provided implicit recourse in situations where the originating entity believed failure to provide this support, even though not contractually required, would damage its future access to the market. In May, 2002 an Interagency Guidance Memo was issued on this topic. In this memo, banking regulators listed ways originators could provide implicit recourse, for example; selling assets to a securitization trust or other special purpose entity (SPE) at a discount; purchasing assets from a trust or other SPE at an amount greater than fair value; exchanging performing assets for nonperforming assets; and funding credit enhancements beyond contractual requirements. We interpret NCUA's prohibition on implicit recourse to be consistent with this guidance memo. We request NCUA confirm their prohibition aligns with the Interagency Guidance Memo.

Additionally, there are other provisions that protect investors that we believe fall outside of the scope of NCUA's implicit recourse prohibition. For example; Early Payment Default (EPD) clauses can require originators to buy back loans that become delinquent within 90 days of securitization. We believe this would not fall under the implicit recourse prohibition. We request NCUA explicitly state these types of agreements are permitted as internal credit enhancements and do not fall within the scope of the implicit recourse prohibition.

f. **Risk-Based Capital Implications**

There will be risk-based capital (RBC) implications, particularly for those securitizations that are classified as on-balance sheet. We anticipate the risk weights will be addressed in NCUA's RBC rule. We recommend NCUA provide regulatory capital relief for pass-through securitizations.

Additionally, if NCUA continues with its concentration risk thresholds for mortgages (e.g., 50%, 75%, 100%), we recommend NCUA eliminate securitized mortgages from the calculation of concentration risk thresholds.

g. <u>GSE Securitizations</u>

The proposed rule does not explicitly state that securitizations via a GSE's program are exempt from the rule. We recommend NCUA clarify the proposed rule only applies to those securitizations issued directly by the sponsoring FCU (i.e., "Private-Label" securitizations).

h. <u>Retained Interest</u>

Securitizations create residual interests that are typically held on the balance sheet of the sponsoring institution. Under current guidelines in 12 CFR 703, FCUs are not authorized to invest in these types of securities. The proposed rule grants FCUs the authority to hold these securities provided they are the outcome of sponsoring a securitization transaction. The proposed rule does not specifically grant the FCU the authority to sell these securities either concurrent with the securitization issuance or subsequently out of a FCU's investment portfolio. We believe NCUA did not intend to limit a FCU's ability to sell these residual interests. We recommend NCUA explicitly grant the FCU this authority.

i. <u>Clean-up Calls</u>

The proposed rule does not provide the necessary flexibility for FCUs to exercise the clean-up call rights in the securitizations they sponsor. These rights are customary in private-label securitizations and typically give the sponsor the right to purchase all (but not less than all) the remaining securities, and related assets, when the aggregate balance falls below a specified threshold (e.g., commonly 10% of the securitized balance).

Clean-up call rights are necessary to avoid the costs of administering legacy securitizations whose outstanding balances no longer justify the costs. Additionally, NCUA should grant FCUs the authority to purchase these obligations, and related assets, upon exercise of the clean-up call rights regardless of whether they are, at the time, obligations eligible for purchase in light of statutory powers and existing regulations. For example, these obligations and assets might not be eligible for purchase because they are no longer obligations of a valid member. NCUA should grant FCUs the authority to repurchase these obligations and assets because they were eligible obligations at the time they were securitized. We recommend NCUA include an explicit statement providing the authority for clean-up calls.

j. <u>Forward Hedging</u>

The proposed rule does not expand NCUA's regulation *12. C.F.R. 701.21(i), put option purchases in managing increased interest-rate risk for real estate loans produced for sale on the secondary market*. The regulation limits the securities a FCU may use as forward hedges to agency securities. This regulation also limits hedge counterparties to primary dealers in government securities. Lastly, the regulation limits forward hedges for real estate loans to be sold in the secondary market within ninety (90) days of closing; it does not include loans to be securitized by a FCU at a later date.

Securitizations often require more than ninety (90) days for a sponsor to plan and organize. During this time, it is necessary for a sponsor to hedge the interest rate risk of the loans to be securitized by entering into forward hedges with the underwriters of the securities, some of which, may not be primary dealers in government securities. In addition, the hedges often relate to the type of securities to be issued rather than agency securities (e.g., jumbo loans vs. GSE conforming loans). To enable FCU's to effectively hedge their risks, it is necessary to expand the NCUA's regulation at 12 C.F.R. 701.21(i) to permit FCUs to enter into effective forward hedges for the loans they plan to include in securitizations they sponsor.

k. <u>Multiple Sponsors</u>

In certain situations there may be multiple sponsors for a securitization; for example, in certain types of CMBS transactions. In the proposed rule it is unclear whether multiple sponsor securitizations are permissible, whether all sponsors must be FCUs, and if there are any related origination requirements. We recommend NCUA clarify the rule to allow multiple sponsors.

l. <u>Miscellaneous Clarifications</u>

Under (2) *Definitions*, the definition of Financial Asset, the sentence ends with "entity". This could be inadvertently construed to prevent securitized assets from having natural person obligors. We do not believe this was NCUA's intent and request the wording be clarified.

Under (5) *Other minimum requirements*, clause (i), the word "comply" seems to have been omitted from the space between the words "must" and "with."

2. Safe Harbor Rule

These comments pertain to 12 CFR Part 709, NCUA's proposed Safe Harbor rule:

a. <u>Scope of Rule</u>

In order to maintain investor confidence, and not create any impediments when accessing the markets, we believe it is imperative for NCUA to create a safe harbor rule that mirrors the investor protections put in place by the FDIC. We believe NCUA's proposed safe harbor rule is substantially equivalent to the current FDIC safe harbor rule. Going forward, the securitization market remains in flux which may impact the FDIC's safe harbor rule. We strongly recommend NCUA ensure its safe harbor rule remains consistent with other financial regulators.

b. <u>Tranche Limitations</u>

The proposed safe harbor rule establishes a limit of six tranches in a securitization. NCUA states this limit is designed to discourage complex or opaque structures. We believe codifying this requirement in regulation may have the unintended consequence of limiting a FCUs ability to access the market or issuing a securitization at the best possible price. Since there is no empirical evidence that structures with more than six tranches create materially more risk than those with less than six, we recommend NCUA eliminate this requirement from the safe harbor rule.