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ASSOCIATION OF FINANCIAL GUARANTY INSURERS

Unconditional, Irrevocable Guaranty ®

August 3, 2012

Mr. Tim Pinkowski
General Secretariat
International Organization of Securities Commissions (IOSCO)
Calle Oquendo 12
28006 Madrid
Spain

Re: Public Comment on Global Developments in Securitization Regulation

Dear Mr. Pinkowski:

The Association of Financial Guaranty Insurers ("AFGI") appreciates the opportunity to provide the International Organization of Securities Commissions ("IOSCO") with comments regarding its Consultation Report on *Global Developments in Securitization Regulation* ("Consultation Report").[1]

AFGI is supportive of the efforts of IOSCO's Task Force on Unregulated Markets and Products ("TFUMP") to examine material differences in regulatory approaches and initiatives on risk retention, transparency, and disclosure standardization. In particular, AFGI supports TFUMP's specific proposals to: standardize product disclosure and develop best practice templates; improve transparency and consult with investors regarding the potential benefit of stress test information disclosure; standardize the definitions of securitization terminology; and monitor the differences in approaches to risk retention. As such, this letter focuses on AFGI's suggested clarifications to the proposed policy recommendations, including the importance of (1) the disclosure of loan-level representation and warranty obligations in best practice templates, and (2) the exclusion of financial guaranty insurance transactions from the definition of the term "securitization."

[1] International Organization of Securities Commissions ("IOSCO"), *Global Developments in Securitization Regulation*, Consultation Report (June 2012).

I. Overview of the Financial Guaranty Insurance Industry

AFGI is a trade association of insurers and reinsurers of municipal bonds, asset-backed securities ("ABS"), and other financial obligations. Financial markets employ financial guaranty insurance in order to help securitization sponsors and municipal issuers reduce their borrowing costs and provide investors with payment default protection, risk management, and improved liquidity for their investments. Financial guaranty insurance provided by AFGI members generally guarantees the timely payment of scheduled payments of interest and principal due on insured securities. Investors in insured securities may also benefit from the due diligence, surveillance, and remediation activities performed by financial guaranty insurers. Unlike a trustee or a credit rating agency, a financial guaranty insurer has capital at risk, more closely aligning its interests with those of the holders of the insured securities.

In ABS markets, insurance reduces borrowing costs for securitization sponsors and offers wider market access and improved transaction execution. Similarly, in the public finance market, municipal issuers and their taxpayers benefit from lower financing costs when financial guaranty insurance is employed. AFGI estimates that, since the industry's inception in 1971, U.S. municipalities and their taxpayers have saved more than $40 billion in interest costs as a result of financial guaranty insurance.

II. Improvements to Disclosure and Transparency Approaches

Industry Best Practice Templates Should Include the Disclosure of Representation and Warranty Obligations

AFGI agrees that standard disclosure templates may enable investors to perform more in-depth due diligence and risk analysis on their securitization positions.[2] For this reason, it supports TFUMP's proposal to encourage industry to develop best practice disclosure templates and to adopt standard disclosure approaches in various jurisdictions. Further, AFGI recommends that such industry best practice templates include comprehensive disclosure of the performance of loan-level representation and warranty obligations ("Reps and Warranties") supporting ABS, including disclosure of fulfilled and unfulfilled repurchase requests.

In the context of residential mortgage-backed securities ("RMBS"), for example, Reps and Warranties relate to the quality, characteristics, enforceability, and legal

[2] *See* Consultation Report at 27.

compliance of the residential mortgage loans and related real property.[3] Reps and Warranties are usually provided or assigned to the securitization trust that holds the loans in a pool for the benefit of the RMBS holders. When a financial guaranty insurer provides insurance to the RMBS trustee for the benefit of the RMBS holders, the insurer usually receives the benefit of—and relies upon—the Reps and Warranties.

Reps and Warranties are breached when a mortgage loan or related real property deviates from stated criteria, which may differ by seller or originator, loan type, vintage, or other attribute. Typically, a pooling and servicing agreement or other operative agreement requires that, upon discovery of a Rep and Warranty breach as to a residential mortgage loan that materially and adversely impacts a security holder's interests in the loan, notice should be given to the Rep and Warranty provider and others. In turn, the Rep and Warranty provider should repurchase the loan at a defined purchase price or replace the loan with an eligible substitute loan.[4]

The inclusion of Reps and Warranties disclosure in a standard disclosure template would serve the interests of ABS investors and financial guaranty insurers and increase transparency in the ABS market. Reps and Warranties disclosure would enable investors, insurers, and other market participants to: (1) monitor compliance with such obligations, (2) enforce available rights and remedies with respect to such obligations, and (3) distinguish among originators and other Reps and Warranties providers on the basis of repurchase requests and their responses to such requests. If such Reps and Warranties disclosure were to reveal that certain originators or other Reps and Warranties providers are subject to frequent repurchase demands, such information would be material to insurers in making underwriting decisions, as well as to investors in making investment decisions with respect to ABS associated with those originators or providers.

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[3] AFGI believes that the same principles and arguments for the disclosure of the performance of loan-level representation and warranty obligations ("Reps and Warranties") are also applicable to other types of asset-backed securities ("ABS"), including commercial mortgage-backed securities.

[4] A typical RMBS pooling and servicing agreement provides as follows: "Upon discovery by any of the parties hereto of a breach of a representation or warranty . . . that materially and adversely affects the interest of the Certificateholders or the Certificate Insurer in any Mortgage Loan, the party discovering such breach shall give prompt notice thereof to the other parties and the Certificate Insurer. The Seller hereby covenants that within 90 days of the earlier of its discovery or its receipt of written notice from any party of a breach of any representation or warranty . . . which materially and adversely affects the interests of the Certificateholders or the Certificate Insurer in any Mortgage Loan sold by the Seller to the Trust, it shall cure such breach in all material respects, and if such breach is not so cured, shall, (i) if such 90-day period expires prior to the second anniversary of the Closing Date, remove such Mortgage Loan (a "Deleted Mortgage Loan") from the Trust Fund and substitute in its place a Qualified Substitute Mortgage Loan . . . ; or (ii) repurchase the affected Mortgage Loan or Mortgage Loans at the Purchase Price . . . ."

In order to increase market participants' access to information regarding the features and risks associated with investments in securitizations, AFGI supports TFUMP's proposal to encourage the development of standard disclosure templates, and recommends that such best practice templates include disclosure of the Reps and Warranties supporting ABS.

The Disclosure of Stress Testing Information May Benefit Investor Analysis and Comprehension of ABS

In terms of improving transparency in the securitization market, AFGI supports TFUMP's proposal to consult with investors regarding the potential benefit of disclosing stress testing information and scenario analysis on underlying assets.[5] Prior to the 2007-2008 subprime lending crisis, many investors of securitized products relied heavily on credit rating agencies to assess the default probability of securities and the expected default loss. AFGI believes that providing stress test information that illuminates the risk profile of the securitization structure and the underlying assets may reduce investor overreliance on credit rating agency determinations, increase transparency, and facilitate greater investor protection in the marketplace.

III. <u>Standard Definitions for Securitization Products</u>

The Consultation Report notes that IOSCO members have a diverse understanding of the definitions of relevant securitization terminology, making it difficult to compare products.[6] To prevent miscommunication in the marketplace resulting from the various definitions of relevant terminology, AFGI believes that TFUMP should consider developing standard definitions for the different types of securitization products. Moreover, AFGI submits that the financial guaranty insurance transactions described below should be excluded from the definition of "securitization" because they are undertaken solely to manage financial guaranty insurance related to the underlying obligations.

Secondary Market Financial Guaranty Insurance Transactions Should Be Excluded from the Definition of "Securitization"

In secondary market transactions, financial guaranty insurers insure securities originally issued without insurance, typically covering a portion of an original bond issuance. To implement secondary market insurance, a custodian, trust, escrow, or special purpose entity receives a deposit of the securities to be insured and the insurance

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[5] *See* Consultation Report at 27.

[6] *See* Consultation Report at 30.

policy for such securities. The custodian, in turn, issues a "custody receipt" representing ownership of the security and the insurance policy. In a secondary market transaction, therefore, an investor is merely seeking credit protection on a bond it already owns.

Synthetic Terminations of Financial Guaranty Insurance Do Not Result in "Securitizations"

Financial guaranty insurers employ trusts or similar arrangements to synthetically remove insurance coverage on securities insured in the primary market in which the insurance cannot, as a practical matter, be terminated prior to maturity of the insured securities. Financial guaranty insurance policies by their terms are unconditional and irrevocable. Individual insured security holders, however, may agree with an insurer to forego the benefits of their insurance policies, while retaining their interest in the underlying securities. In such circumstances, the insured securities are generally placed in a trust, and the trustee issues: (1) a certificate to participating investors representing an interest in the underlying securities, and (2) a certificate to the insurer representing an interest in any payments under the insurance policy. As a result, all insurance payments related to the deposited securities are returned to the insurer and the insurance is nullified as an economic matter.

Distressed Debt Refinancing Transactions Should Be Excluded from the Definition of "Securitization"

If an insured security defaults, the financial guaranty insurer may seek to refinance the defaulted insured securities by: (1) paying the unpaid principal and interest on the defaulted insured securities under its insurance policy, and (2) contributing its rights for reimbursement from the original bond issuer to a special purpose vehicle ("SPV") that issues insured refinancing securities. The SPV issues insured securities and pays the proceeds to the insurer to compensate the insurer for payments made under the original insurance policy. In other words, the insurer may refinance the defaulted insured securities by, for example, extending the maturity or reducing the coupon, while it retains the credit risk related to the SPV's securities by virtue of its new financial guaranty insurance policy.

As the transactions discussed above are undertaken solely to manage financial guaranty insurance related to the underlying obligations, AFGI recommends that such transactions be excluded from the definition of the term "securitization."

IV. Different Approaches to Risk Retention

In the Consultation Report, TFUMP discusses the differences in approach to exemption provisions, and notes that compliance with the different retention requirements among the jurisdictions may increase the cost of cross border issuance.[7] AFGI commends IOSCO for recognizing that regulatory approaches to risk retention requirements and exemptions in various jurisdictions do not exist in isolation. As AFGI members issue and reinsure financial guaranty insurance for both U.S. and international structured finance transactions, AFGI supports TFUMP's efforts to monitor industry feedback and, if necessary, develop appropriate regulatory responses and mechanisms in order to minimize any adverse impact resulting from differences in approaches to retention requirements.

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We thank IOSCO for the opportunity to comment on its Consultation Report on *Global Developments in Securitization Regulation* and appreciate its attention to the recommendations highlighted by AFGI in this letter. If you have any questions, please do not hesitate to contact the undersigned at bstern@assuredguaranty.com or (212) 339-3482.

Sincerely,

Bruce E. Stern, Chairman

[7] Consultation Report at 26.