Statement by SEC Chair Mary Jo White at the SEC Open Meeting on Credit Risk Retention

Chair Mary Jo White

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Good morning. This is an open meeting of the Securities and Exchange Commission on October 22, 2014 under the Government in the Sunshine Act.

Today, the Commission will consider the recommendation of the staff to adopt, jointly with five other federal agencies, final rules for the asset-backed securities market that will require securitizers to keep "skin in the game." Specifically, we will consider rules to require certain securitizers to retain no less than five percent of the credit risk of the assets they securitize. These rules, which are mandated by Section 941 of the Dodd-Frank Act, are part of a strong and comprehensive package of reforms that will address some of the most serious issues exposed in the asset-backed securities market that contributed to the financial crisis.

The importance of the securitization market to the overall financial and economic health of the country is profound. When properly structured and regulated, securitization can expand the availability of credit crucial to a growing business or a robust housing market, lower the cost of providing that credit, and enhance liquidity.

The financial crisis, however, revealed how the securitization process can be misused by parties who have incentives that are misaligned with those of investors and of a healthy, functioning economy. Many lenders loosened their underwriting standards and extended low quality loans, knowing that the loans would be sold through a securitization by a sponsor. Sponsors of asset-backed securities frequently did not exercise an appropriate level of due diligence when selecting assets from lenders because they knew that once securitized, the true quality of the underlying assets would not be known by investors. Investors, unlike the sponsors and originators in the securitization chain, did not have access to the kind of information they needed to understand the quality of the assets collateralizing the asset-backed securities they were buying. This pattern was repeated over and over again by lenders and sponsors who retained little or no exposure to these loans. Investors, consumers, and the overall financial system all suffered as a result.

Two months ago, to address these serious deficiencies, the Commission unanimously adopted important new disclosure requirements for asset-backed securities offerings. As I said then, those rules formed a critical foundation for the recommendation requiring risk retention which is before us today. The rules adopted by the Commission in August require securitizers to give investors the information and time they need to properly evaluate the quality of assets collateralizing asset-backed securities. On the same day, we also adopted a wide-ranging set of reforms for credit rating agencies, which failed in the last decade to adequately assess the quality of asset-backed securities and the assets they comprised.

Today, we take another significant step to reform the asset-backed securities market. The credit risk retention requirements mandated by the Dodd-Frank Act are designed to realign the incentives of securitizers and investors by requiring securitizers to retain an economic interest in the credit risk of the assets they securitize. At the same time, the Dodd-Frank Act provided exemptions for assets that meet underwriting and other standards designed to help ensure that these assets are a low credit risk — and therefore do not require risk retention measures.

Today's recommendation implements these mandates and exemptions. It does so through a careful consideration of the different types of assets that are securitized, the structures used in securitizations, the manner in which securitizers have retained exposure to the credit risk of the assets they securitize, and the extensive public feedback from two proposals.

These rules will provide sponsors with a number of options as to how they can meet the risk retention requirements — an approach that will offer flexibility without sacrificing the strength of the new incentives. Disclosure — a central tool of this agency — is also an important part of each of the options, with sponsors required to disclose to investors important information about the required risk retention, such as the interest retained in the transaction, the fair value amount, and, under certain options, the identity of the legal entity involved.

As provided by the statute, the rules provide an exemption from the risk retention requirements for asset-backed securities that are collateralized solely by "qualified residential mortgages," or QRM. Last year, the agencies proposed two alternatives for defining QRM. The preferred alternative was to equate the definition of a QRM with the definition of "qualified mortgage" (QM) adopted by the Consumer Financial Protection Bureau ("CFPB") under the Truth in Lending Act. That is the alternative recommended for the final rule, reflecting the judgment of the six agencies of the right balance between two of the central purposes of the statutory mandate — protecting investors and not unnecessarily inhibiting the residential mortgage market.

While this approach is appropriate today, it is important that we closely monitor the implementation of this exemption to assess its impact. Mortgage and securitization market conditions change and underwriting practices and product offerings evolve. Responses to these changes may be reflected in modifications to the CFPB's definition of QM from time-to-time, which could then, under our rule, be reflected in the definition of QRM. But we cannot rely solely on this tool as a means to monitor the effectiveness of the QRM definition.

It is therefore essential, in my view, that the rules we are considering today now include a commitment by the agencies to review the QRM definition at regular intervals, or at the request of any agency. This requirement will provide the agencies the opportunity to consider changed circumstances, including any changes to the structure and framework of the GSEs and these markets and whether additional regulatory changes affecting securitization should be made. And I have directed the SEC staff to monitor for the Commission changes in this market, including changes made by the CFPB to the qualified mortgage standard, developments in underwriting practices, delinquency rates, and trends in the securitization market generally.

These rules are a very important Dodd-Frank Act mandate and I am pleased to support the recommendation of the six agencies charged with jointly implementing it.

Before I ask Keith Higgins, Director of the Division of Corporation Finance, to discuss the rules in greater detail, I would like to thank, in addition to my fellow Commissioners and their counsels, the staffs of all of the other federal agencies for their collaboration on this rulemaking effort.

Most importantly, I would like to thank the Commission staff members for their tireless and dedicated efforts on this rulemaking: Keith Higgins, Karen Garnett, Katherine Hsu, Arthur Sandel, David Beaning, Lulu Cheng, Raquel Fox, Paul Dudek, and Amy Starr from the Division of Corporation Finance; Dr. Mark Flannery, our new Chief Economist and Director of the Division of Economic and Risk Analysis, Scott Bauguess, Sean Wilkoff, Igor Kozhanov, and Vanessa Countryman, also from the Division of Economic and Risk Analysis; Anne Small, Rich Levine, and Bryant Morris from the Office of the General Counsel; Dan Murdock, Rachel Mincin, Chris Rogers, Jeff Minton, and Blair Petrillo from the Office of the Chief Accountant; David Grim, Sarah ten Siethoff and Thoreau Bartman from the Division of Investment Management; Catherine Moore and Elizabeth Sandoe from the Division of Trading and Markets; Joe Brenner and Ryan VanGrack from the Division of Enforcement; Carlos Portugal from the Office of International Affairs; and John Cross and Rebecca Olsen from the Office of Municipal Securities.