February 5, 2019
Submitted via e-mail to the ARRC Secretariat at: arrc@ny.frb.org

Re: ARRC Consultation Response – Securitizations

Dear Secretariat:

We appreciate the opportunity to comment on the consultation on USD LIBOR fallback contract language for securitizations ("Consultation") on an anonymous basis and we respectfully submit this feedback letter to the Alternative Reference Rates Committee ("ARRC") in response to the questions raised in the Consultation. Our intention in providing these comments is to contribute to increased market adoption of SOFR.

The opinions included in this letter are unique to our company and are not necessarily representative of the securitization industry at large. We are members of the Structured Finance Industry Group ("SFIG") and we support the views expressed in SFIG's response to the Consultation.

Responses to Questions

Question 1: *Which securitization asset classes are you referring to in your response to this consultation if limited to only certain asset classes? If there are particular features of these asset classes that shape your responses to the questions in this survey, please describe them to the extent possible.*

Response to Question 1:
The securitization asset class to which we will refer in our response is student loans.

Our responses to the Consultation questions are influenced by the consumer-facing nature of the student loan asset and are shaped by the structural features of the securitizations we issue.

In general, securitization transactions have a different nature than derivatives contracts. Securitization transaction documents are more challenging to amend due to factors such as the number of transaction parties involved and the fact that many investors hold their positions through clearing agencies like DTCC in the name of the broker. While we certainly prefer that securitization and derivative triggers be aligned, we place a higher priority on the alignment of securitization and loan triggers, as derivative contracts are more easily amended than securitization transactions or loan agreements.

Commonly, our securitization transactions are structured such that the securitization trust will purchase a pool of student loans on the closing date of a transaction and the trust will be entitled to receive all collections and proceeds made on those loans on or after the closing date. The investors holding the securitization notes will receive payments primarily from collections on the trust's student loans.

The maturity of student loan-backed securities varies. The student loan asset and the securitization of that asset can be rather long dated. For example, in a recent transaction securitizing private education loans, the securitization notes have a scheduled maturity date in 2059. The actual final payment date of any class of notes could occur earlier if, for example, there are higher than anticipated prepayment rates on the trust's student loans or if certain parties to the transaction choose to exercise certain options.

Question 2: *The ISDA triggers contemplate a permanent cessation of LIBOR as of a date certain which may be announced in advance (the "Cessation Date"), at which point the transition from LIBOR to SOFR would occur. As there may be operational challenges for securitizations as both assets and liabilities will have to be transitioned, some have asked for the ability to transition in advance of the Cessation Date in order to address any operational issues that may arise. Specifically, the Designated Transaction Representative (as defined in Appendix I) will have the ability to pick one date within a 30-day period prior to the Cessation Date to facilitate an orderly transition. Do you feel the inclusion of this ability to transfer prior to the Cessation Date is needed? If so, please explain the specific, critical and tangible needs that support its inclusion?*

Response to Question 2:
No. Although we understand that other market participants are requesting this ability for various reasons, an ability to transition prior to the Cessation Date is not a critical need for us.

Question 3(a): *Should fallback language for Securitizations include any of the pre-cessation triggers (clauses (3), (4), (5) and (6) of the Benchmark Discontinuance Event definition)? If so, which ones? Also, please identify any pre-cessation triggers that you do not believe should be utilized for a particular securitization product and explain why.*

Response to Question 3(a):
We support the inclusion of clause (3).

As written, clause (4) does not contemplate development possibilities to the calculation of LIBOR in which reliance on panel bank submissions is reduced.

Clause (6) serves no functional purpose for the securitizations we currently issue.

Question 3(b): *Please indicate whether any concerns you have about these pre-cessation triggers relate to the differences between these securitization triggers and those for standard derivatives or whether your concerns relate specifically to the pre-cessation triggers themselves.*

Response to Question 3(b):
The concerns we have about the pre-cessation triggers relate specifically to the pre-cessation triggers themselves.

Question 3(c): *If you believe that the pre-cessation trigger in clause (6) (Asset Replacement Percentage) should not be retained, please note any specific concerns leading to this conclusion. If you believe that it should be retained, are there any changes you believe should be made to this trigger? Please explain.*

Response to Question 3(c):
It is not common for consumer term loans to provide the lender with a right to change the underlying index rate when the original underlying index rate remains available. Clause (6) sets a trigger that will cause an automatic conversion of a note's base rate to a replacement rate that is appropriate only for securitizations with certain characteristics. A provision with such an impact is deserving of prudent vetting to understand the unintended consequences that may result from recommending this clause as a best practice for securitizations in general.

Question 3(e): *If pre-cessation triggers are not included, are there options available to market participants to manage the potential risks involved in continuing to reference a Benchmark in the circumstances contemplated by each of these pre-cessation triggers?*

Response to Question 3(e):
Yes.

Question 4: *Should the proposed securitization fallback language permit the Designated Transaction Representative to transition the securities after a trigger has occurred but before the Benchmark Replacement Date? Should any limitations be placed on its use? Should there be a limited date range (e.g., 60 days) prior to the Benchmark Replacement Date in which this could be used? Should the Designated Transaction Representative be limited in the circumstances under which it could elect to utilize the additional time? If so, what standard should be utilized to assess whether the additional time is necessary? In each case, please explain why.*

Response to Question 4:
It is our opinion that such an ability would not be necessary if a minimal grace period is provided.

Question 5(a): *If the ARRC has recommended a forward-looking term rate, should that rate be the primary fallback for the securities referencing LIBOR even though derivatives are expected to reference overnight versions of SOFR? Please explain why.*

Response to Question 5(a):
Yes, if the ARRC has recommended a forward-looking term rate then that rate should be the primary fallback for the securities referencing LIBOR even though derivatives are expected to reference overnight versions of SOFR. Participants who encounter new basis risk between their position with the securitization and their derivative can amend the derivative or enter into a new derivative to minimize the new basis risk.

We think a forward-looking term SOFR will alleviate many of the foreseeable operational challenges from using overnight SOFR, or the alternative adjustment methodologies proposed (such as compounding). Further, we expect that the existence of term SOFRs with 1-week, 1-month, 3-month, 6-month, and 12-month tenors will create a symmetry in tenors of SOFR and USD LIBOR, resulting in SOFR being a more viable alternative to USD LIBOR.

Question 5(b): *Is there a specific reason that the securitization market should first fall back to forward-looking term SOFR instead of another rate? Please explain why.*

Response to Question 5(b):
Yes, the securitization market should first fall back to forward-looking term SOFR in order to reduce operational burden, to parallel the efficiency of LIBOR, and to more closely align with underlying assets (as it is uncertain whether Compounded SOFR will be deemed appropriate for consumer loan products). In addition, the purpose for including Compounded SOFR is to achieve a rate that mimics a forward-looking term SOFR. In the event a forward-looking term SOFR exists, it should be used instead of using Compounded SOFR.

Question 5(c): *Is the use of an Interpolated Period appropriate in the securitization markets? Please explain any limitations that should be applied to the use of an Interpolated Period.*

Response to Question 5(c):
Yes. If an Interpolated Period is used we recommend the calculation formula be included in the transaction documents to ensure consistent interpretation among the securitization parties.

Question 5(d): *In the event a Replacement Benchmark is determined other than under Step 1 of the waterfall, should the waterfall provide that the Replacement Benchmark be changed in the future as soon as a rate can be established under Step 1 of the waterfall?*

Response to Question 5(d):
Yes, and we continue to contemplate the practical impacts of such a decision. The ARRC's Phase-In plan gives guidance that a forward-looking term SOFR is expected to be produced before 2022. If this expectation diminishes, we request the ARRC to release revised guidance in order for organizations to adapt preparations accordingly. The waterfall should allow the Replacement Benchmark to be determined under Step 1 of the waterfall when possible. It is our understanding that the purpose of Step 2 of the waterfall is to synthetically create the Step 1 rate when it is unavailable. If the rate in Step 1 is available, then that rate should be used.

Question 6(a): *Should Compounded SOFR be the second step in the waterfall? Would this preference be influenced by whether ISDA implements fallbacks referencing Compounded SOFR or overnight SOFR?*

Response to Question 6(a):
While we understand that certain market participants support Compounded SOFR, our perspective is that Compounded SOFR causes complex operational hurdles in securitizations. We are not certain how to handle the operational complexity of transitioning deal structures in ways that will impact the structure mid-deal. In addition to the index rate, payment variables such as reset dates, day count, and the time between accrual end-date and payment date will need to be evaluated and likely changed to retro-fit Compounded SOFR into an existing LIBOR-linked securitization. These types of changes are not currently contemplated within securitization transaction documents, and we recommend including guidance for necessary additional changes, as relevant, when promoting Compounded SOFR as a fallback.

The operational hurdles will not be influenced by whether ISDA implements fallbacks referencing Compounded SOFR or overnight SOFR.

Question 6(b): *If you believe that Compounded SOFR should be included, which compounding period is preferable ("in arrears" or "in advance")? Please explain why. Would this preference be influenced by whether ISDA implements fallbacks referencing Compounded SOFR "in arrears" or "in advance?" Please explain whether your preference is based on operational concerns in implementing a particular approach or on economic concerns.*

Response to Question 6(b):
The "in arrears" method presents operational obstacles which may be partially alleviated through the inclusion of additional language.

The "in arrears" method creates a situation in which the payment amount is unknown until the day following the end of the accrual period (it is common for trade book systems to require an overnight cycle to conduct payment calculations). Knowing the payment amount at the beginning of the accrual period enables timely communication with trustees, swap counterparties, DTCC, and external reporting systems weeks before the payment date. This enables these parties to proactively address calculation disputes before payments are made. Adopting the "in arrears" method will require this communication process to occur after the payment date, likely leading to an increase in the volume of disorderly post-settlement disputes.

Knowing the payment amount at the beginning of an accrual period aids in the ability to more accurately forecast liquidity needs, an ability which will be lost if adopting the "in arrears" method.

In practice, we would not be able to use the "in arrears" method unless there is a rate setting lock-out period prior to the payment date. Although the "in advance" method would not present the same operational obstacles, it would present economic concerns expressed by some of the investors of our securitization notes.

Question 6(c): *If it was necessary to calculate Compounded SOFR and a third party was not available to perform those calculations, are there parties to the Securitization transactions with sufficient resources to perform those calculations accurately and efficiently? Are there other considerations relating to the calculation of Compound SOFR that would make it an undesirable Replacement Benchmark without the availability of a third-party provider?*

Response to Question 6(c):
No, we are not aware of a transaction party that could perform the calculations both accurately and efficiently. If it was necessary to calculate Compounded SOFR and a third party was not available to perform those calculations, we believe there are parties to the securitization with sufficient resources to perform the calculation accurately, but not efficiently. Without a third party to publish the compounded rate in a way that is easily retrievable, like LIBOR is today, there will be increased disputes, making the process less efficient than the current process for LIBOR. We believe the market will be more likely to adopt alternative rates that provide the same level of efficiency as LIBOR.

We are interested in better understanding how a third-party will be used to conduct compounding calculations on an affordable basis in a way that will eliminate the increased potential for disputes. It is our understanding that the formula under consideration compounds overnight-SOFR during the current, or previous, accrual period. The calculation relies on the accrual start and end dates unique to a transaction, preventing the ease of a single screen look-up.

Question 7: *As noted, this consultation does not include Spot SOFR as a third step in the waterfall. Do you believe that Spot SOFR is an appropriate fallback reference rate for Securitization contracts or should the second step in the replacement rate waterfall be Compounded SOFR, after which the replacement rate would be, first, recommended by the Relevant Governmental Body, second, default to then-current ISDA Definitions, and third, proposed by the Designated Transaction Representative?*

Response to Question 7:
No, we do not believe spot overnight SOFR is appropriate for securitization contracts because spot overnight SOFR is susceptible to month- and quarter-end volatility presenting the potential to lock-in one day of market disruption for the term. We are hesitant to adopt the step in the waterfall that defaults to then-current ISDA Definitions because of the uncertainty of the rate and its appropriateness for products other than derivatives.

Question 8: *In the future circumstance where there is no SOFR-based fallback rate, is the replacement rate determined by the Relevant Governmental Body the best alternative at this level of the waterfall? Please explain why.*

Response to Question 8:
Yes, if in the future there is no SOFR-based fallback rate, a replacement rate determined by the Relevant Government Body is the best alternative at this level of the

waterfall. We believe it is reasonable to expect a Relevant Government Body will recommend a replacement rate if SOFR is no longer published to avoid financial instability.

Question 9: *In the future circumstance where there is no SOFR-based fallback rate and the Relevant Governmental Body has not recommended a replacement rate for Securitizations, is the fallback for SOFR-linked derivatives set forth in the ISDA definitions at the time of cessation the best alternative at this level of the waterfall? Is this fallback appropriate if ISDA Definitions only include overnight fallback rates? Please explain why.*

Response to Question 9:
No, if in the future there is no SOFR-based fallback rate and the Relevant Government Body has not recommended a replacement rate, the fallback for SOFR-linked derivatives set forth in the ISDA definitions at the time of cessation is not the best alternative at this level of the waterfall. Based on the by-laws of ISDA, we expect the rate selected by ISDA will promote efficient conduct of the business of its membership in swaps and other derivatives and may not consider the appropriateness of the rate for use in other vehicles such as securitizations. While we understand some market participants strongly support relying on the ISDA definitions, we believe our structures would be better prepared without such reliance.

Question 10(a): *Since it is unlikely that there will be no ISDA fallback (clause (a) above), this provision is more likely to occur (if at all) when the ISDA fallback is deemed not appropriate for securitization securities (clause (b) above). In that scenario, is this provision appropriate as the final step in the Replacement Benchmark waterfall? Please explain why.*

Response to Question 10(a):
Yes, we believe this provision is appropriate as the final step in the Replacement Benchmark waterfall. Due to the myriad of securitization structures, we believe it is prudent to provide a mechanism for a Designated Transaction Representative to effectively intervene to best serve the securitization instead of ending the waterfall on a prescribed rate. It is highly unlikely the traditional process required to materially amend a securitization's structure (which requires 100% of investors to consent to the amendments through a voting process) will be an effective tool in replacing the index rate for most securitizations.

We support this provision because it is limited in use, and in the event of worst-case circumstances, it provides a more agile solution than the traditional voting process.

Question 10(b): *Should the provision allow for "re-testing" the waterfall to determine whether another Replacement Benchmark has become available in the scenario where investors have rejected the Proposed Replacement Benchmark? Should the waterfall be re-tested in any other circumstances (e.g., any time the Replacement Benchmark has been determined under a "less-desirable" clause)? How often? Please explain why.*

Response to Question 10(b):
Yes, and we continue to contemplate the impacts of such a decision. We comprehend the order of rates in the waterfall to reflect the rank of preference for each rate (i.e. the rate in Step 1 is the most desirable rate, the rate in the final Step is the least desirable rate). We believe that the waterfall should provide the ability for the Replacement Benchmark to be changed in the future when a more desirable rate in the waterfall becomes available, and we recognize the importance of specifying parameters on how frequently the re-testing occurs.

Question 11: *Are there any concerns if a spread adjustment was utilized with cash products that was calculated by a spot rate comparison of the difference between LIBOR and the Replacement Base Rate at the time of conversion? Should this option be included in the spread waterfall? If so, where?*

Response to Question 11:
Yes, there are concerns related to using this method of calculating a spread adjustment because it is reasonable to anticipate market dislocation on the day a Replacement Benchmark Trigger is met. We would support variations of this option such as taking a historical look-back.

Question 12: *Do you believe that the ARRC should consider recommending a spread adjustment that could apply to cash products, including Securitizations?*

Response to Question 12:
Yes, the ARRC recommending a spread adjustment that could apply to cash products would be a key component to achieve a smooth transition and inspire organic market adoption.

Question 13(a): *Is a spread adjustment applicable to fallbacks for derivatives under the ISDA definitions appropriate as the second priority in the spread waterfall? Please explain why.*

Response to Question 13(a):
No, however, a spread adjustment applicable to fallbacks for derivatives under the ISDA definitions would be appropriate to be used when the ISDA Replacement Rate is in effect.

Question 13(b): *If the ARRC has recommended a forward-looking term SOFR but has not recommended a corresponding spread adjustment under Step 1 above, do you believe that the ISDA spread adjustment described in Step 2 (which may be intended to apply to a different Replacement Base Rate) should apply to Securitizations? Please explain why.*

Response to Question 13(b):
No, because the ISDA spread adjustment described in Step 2 will be crafted specifically to serve in conjunction with the ISDA Replacement Rate.

Question 13(c): *Given that ISDA has not yet decided upon the spread calculation methodology, should Step 2 be excluded from the waterfall? Please explain why.*

Response to Question 13(c):
No, if the waterfall includes the ISDA Replacement Rate, then the ISDA spread can be included to be used during periods when the ISDA Replacement Rate is used.

Question 14(a): *What type of institution can and should take on the responsibility to (i) determine whether the proposed triggers have occurred, (ii) select screens where reference rates or spreads are to be found, (iii) make calculations of a rate or spread in the absence of published screen rates, (iv) interpolate term SOFR if there is a missing middle maturity and/or (v) elect to cause an early transition under the proviso to the definition of Benchmark Replacement Date?*

Response to Question 14(a):
It would be most efficient for a highly reputed large organization to act as an authority and take on responsibilities (i), (ii), (iii), and (iv).

Question 14(b): *Whether as issuer, sponsor, servicer or calculation agent, would your institution be willing to (i) determine whether the proposed triggers have occurred, (ii) select screens where reference rates or spreads are to be found, (iii) make calculations of a rate or spread in the absence of published screen rates, (iv) interpolate term SOFR if there is a missing middle maturity and/or (v) elect to cause an early transition under the proviso to the definition of Benchmark Replacement Date?*

Response to Question 14(b):
We presume, in some securitizations, the trust administrator could likely take on most of the responsibilities detailed above so long as (i) triggers are observable facts, (ii) there is ample time to conduct the calculation with proper due diligence, and (iii) trustees are able to provide oversight within the time-period between accrual end dates and payment dates.

Question 15: *Is there any provision in the proposal that would significantly impede Securitization issuances? If so, please provide a specific and detailed explanation.*

Response to Question 15:
We do not expect to be able to transact using the “in arrears” method without a lock-out period of at least three days for the reasons we outlined in our responses to Question 6(b).

Question 16: *Given the fallback language for the Securitization and the underlying assets may operate independently, please identify any sources of misalignment between those components that are not addressed in the consultation.*

Response to Question 16:
There is misalignment between the fallback language in securitizations outlined in the Consultation and what would be appropriate to include as fallback language in consumer loans. It is important to use easily understandable terms, rates, and calculations when lending to consumers. In the absence of regulatory guidance, we are concerned that the inclusion of pre-cessation triggers or a compounding calculation may not be appropriate for a consumer loan.

Question 17: *Are there specific operational challenges that implementing the proposed fallback language might create for securitizations? If so, what are those challenges and under what circumstances might they occur? How might they be mitigated?*

Response to Question 17:
Yes, as we have discussed in this letter there are specific operational challenges that implementing the proposed fallback language might create for securitizations. An effective solution for these foreseeable operational challenges would be to use a forward-looking term SOFR. In the absence of a forward-looking term SOFR, there will be operational challenges that may not be able to be mitigated. The operational challenges can be partially alleviated by the inclusion of grace periods for “in arrears” calculations and by a third-party providing the compounding calculations in a way that does not require manipulation or user intervention.

Question 18: *Please provide any additional feedback on any aspect of the proposal.*

Response to Question 18:
As the ARRC is aware, there are a number of regulatory hurdles to address prior to transitioning to a new rate. Securitization participants have discussed a potential solution of entering into a derivative within a securitization structure to offset basis risk arising from misaligned fallbacks and underlying index rates between the trust assets and its payment obligations on the notes. In order for this to be a practicable solution, relief will be needed from certain U.S. swap regulations due to the inability of a securitization vehicle to post daily margin[1].

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[1] The Dodd-Frank Act required the Commodity Futures Trading Commission and the Prudential Regulators (“Swap Regulators”) to jointly adopt rules for swap dealers and major swap participants imposing margin requirements on swaps that are not cleared through a clearing house (“uncleared swaps”). The Swap Regulators adopted margin rules under which U.S. swap providers are required to collect and post margin when entering into swap contracts with a “financial end user”, a legal category that includes securitization vehicles. Under these new rules, the swap provider will be obligated to collect or post margin no later than the day following the execution of an uncleared swap contract with a securitization vehicle and on a daily basis thereafter. The swap provider will be required to hold margin against the market value of the swap when it is “in-the-money” and to post margin against the market value of the swap when it is “out-of-the-money”. The securitization vehicle is required to do the same. Securitization vehicles commonly do not have the contractual authority to allocate assets to post margin in compliance with the margin rules, causing a low likelihood that a securitization would be able to enter in to a new swap or amend or novate a legacy swap to adopt new ISDA definitions.

We are grateful for the opportunity to contribute to the creation of viable solutions that will drive natural market adoption of SOFR. The calculation methodologies presented in the Consultation are less efficient than LIBOR is today, and we are concerned that markets will not naturally transition to a less efficient rate. A forward-looking term SOFR will be able to rival the efficiency of LIBOR in its simplicity of a single rate, its ease of being retrievable on a single screen, and its benefits of calculating payment obligations sufficiently ahead of the payment date.

Concluding Remarks

Thank you for considering our comments. Please do not hesitate to contact us through the submitter of this letter if you have questions or desire clarification concerning any of the matters discussed in this letter.