DEPARTMENT OF LABOR

Pension and Welfare Benefits Administration

Proposed Amendment to Prohibited Transaction Exemption (PTE) 97–34 Involving Bear, Stearns & Co. Inc., Prudential Securities Incorporated, et al., (D–10829)

AGENCY: Pension and Welfare Benefits Administration, Department of Labor.

ACTION: Notice of a proposed amendment to the Underwriter Exemptions.[1]

SUMMARY: This document contains a notice of pendency before the Department of Labor (the Department) of a proposed amendment to the Underwriter Exemptions. The Underwriter Exemptions are individual exemptions that provide relief for the origination and operation of certain asset pool investment trusts and the acquisition, holding and disposition of certain asset-backed pass-through certificates representing undivided interests in those investment trusts. The proposed amendment, if granted, would: (1) Permit, for certain categories of transactions, the offering of ''investment grade'' mortgage-backed securities and asset-backed securities which are either senior or subordinated; (2) permit the use of eligible interest rate swaps (both ratings dependent and non-ratings dependent) under circumstances described in this proposal; (3) permit the use of yield supplement agreements which involve notional principal amounts; and (4) make certain changes to the Underwriter Exemptions that would reflect the Department's current interpretation of the Underwriter Exemptions.

Finally, the proposed amendment, if granted, would provide exemptive relief for transactions involving: (1) an Issuer of mortgage-backed securities or asset-backed securities which is a trust (including a grantor or owner trust), REMIC, FASIT, special purpose corporation, limited liability company or partnership and (2) mortgage-backed securities or asset-backed securities issued which are either debt or equity investments.

DATES: Written comments and/or requests for a public hearing should be received by October 10, 2000.

Effective Date: If granted, the proposed amendment to the Underwriter Exemptions would be effective for transactions occurring on or after the date of publication of this notice in the **Federal Register**, except as otherwise provided in sections I.C., II.A.(4)(b), and III.JJ. of the proposed amendment to the Underwriter Exemptions.

ADDRESSES: All written comments and requests for a hearing (preferably at least three copies) should be sent to: Office of Exemption Determinations, Pension and Welfare Benefits Administration, Room N–5649, Department of Labor, 200 Constitution Avenue, N.W., Washington, D.C. 20210, Attn: Proposed Amendment to the Underwriter Exemptions. The application pertaining to the amendment proposed herein and the comments received will be available for public inspection in the Public Documents Room of the Pension and Welfare Administration, U.S. Department of Labor, Room N–5638, 200 Constitution Avenue, N.W., Washington, D.C. 20210.

FOR FURTHER INFORMATION CONTACT: Wendy McColough of the Department, telephone (202) 219–8971. (This is not a toll-free number).

SUPPLEMENTARY INFORMATION: Notice is hereby given of the pendency before the Department of a proposed exemption to amend PTE 97–34, 62 FR 39021 (July 21, 1997) (the 1997 Amendment). PTE 97–34 amended over forty individual Underwriter Exemptions. The Underwriter Exemptions provide substantially identical relief for the operation of certain asset pool investment trusts and the acquisition and holding by plans of certain asset-backed pass-through certificates representing interests in those trusts. These exemptions provide relief from certain of the restrictions of sections 406(a), 406(b) and 407(a) of the Act and from the taxes imposed by section 4975(a) and (b) of the Code, by reason of certain provisions of section 4975(c)(1) of the Code.

I. Introduction

The proposed amendment was requested by application dated October 22, 1999, and as restated in later submissions on behalf of Morgan Stanley & Co. Incorporated.[2] (the Applicant). In preparing the application, the Applicant received input from members of The Bond Market Association (TBMA).

The Department is proposing the amendment to this individual exemption pursuant to section 408(a) of the Act and section 4975(c)(2) of the Code, and in accordance with the procedures set forth in 29 CFR Part 2570 (Subpart B) 55 FR 32836, 32847(August 10, 1990).[3] In addition, the Department

[1] The term ''Underwriter Exemptions'' refers to the following individual Prohibited Transaction Exemptions (PTEs): PTE 89–88, 54 FR 42582 (October 17, 1989); PTE 89–89, 54 FR 42569 (October 17, 1989); PTE 89–90, 54 FR 42597 (October 17, 1989); PTE 90–22, 55 FR 20542 (May 17, 1990); PTE 90–23, 55 FR 20545 (May 17, 1990); PTE 90–24, 55 FR 20548 (May 17, 1990); PTE 90–28, 55 FR 21456 (May 24, 1990); PTE 90–29, 55 FR 21459 (May 24, 1990); PTE 90–30, 55 FR 21461 (May 24, 1990); PTE 90–31, 55 FR 23144 (June 6, 1990); PTE 90–32, 55 FR 23147 (June 6, 1990); PTE 90–33, 55 FR 23151 (June 6, 1990); PTE 90–36, 55 FR 25903 (June 25, 1990); PTE 90–39, 55 FR 27713 (July 5, 1990); PTE 90–59, 55 FR 36724 (September 6, 1990); PTE 90–83, 55 FR 50250 (December 5, 1990); PTE 90–84, 55 FR 50252 (December 5, 1990); PTE 90–88, 55 FR 52899 (December 24, 1990); PTE 91–14, 55 FR 48178 (February 22, 1991); PTE 91–22, 56 FR 03277 (April 18, 1991); PTE 91–23, 56 FR 15936 (April 18, 1991); PTE 91–30, 56 FR 22452 (May 15, 1991); PTE 91-62, 56 FR 51406 (October 11, 1991); PTE 93–31, 58 FR 28620 (May 5, 1993); PTE 93–32, 58 FR 28623 (May 14, 1993); PTE 94–29, 59 FR 14675 (March 29, 1994); PTE 94–64, 59 FR 42312 (August 17, 1994); PTE 94–70, 59 FR 50014 (September 30, 1994); PTE 94–73, 59 FR 51213 (October 7, 1994); PTE 94–84, 59 FR 65400 (December 19, 1994); PTE 95–26, 60 FR 17586 (April 6, 1995); PTE 95–59, 60 FR 35938 (July 12, 1995); PTE 95–89, 60 FR 49011 (September 21, 1995); PTE 96–22, 61 FR 14828 (April 3, 1996); PTE 96–84, 61 FR 58234 (November 13, 1996); PTE 96–92, 61 FR 66334 (December 17, 1996); PTE 96–94, 61 FR 68787 (December 30, 1996); PTE 97–05, 62 FR 1926 (January 14, 1997); PTE 97–28, 62 FR 28515 (May 23, 1997); PTE 97–34, 62 FR 39021 (July 21, 1997); PTE 98–08, 63 FR 8498 (February 19, 1998); PTE 99–11, 64 FR 11046 (March 8, 1999); PTE 2000–19, 65 FR 25950 (May 4, 2000); PTE 2000–33, 65 FR 37171 (June 13, 2000); and PTE 2000–41, First Tennessee National Corporation (August, 2000).

In addition, the Department notes that it is also proposing individual exemptive relief for: Deutsche Bank AG, New York Branch and Deutsche Morgan Grenfell/C.J. Lawrence Inc., Final Authorization Number (FAN) 97–03E (December 9, 1996); Credit Lyonnais Securities (USA) Inc., FAN 97–21E (September 10, 1997); ABN AMRO Inc., FAN 98–08E (April 27, 1998); and Ironwood Capital Partners Ltd., FAN 99–31E (December 20, 1999), which received the approval of the Department to engage in transactions substantially similar to the transactions described in the Underwriter Exemptions pursuant to PTE 96–62. Finally, the Department notes that it is proposing relief for Countrywide Securities Corporation (Application No. D–10863).

[2] PTE 90–24, 55 FR 20548 (May 17, 1990). Morgan Stanley & Co. Incorporated (Morgan Stanley) is an international securities firm providing through its affiliates a wide range of financial and securities services on a global basis to a large and diversified group of clients and customers, including corporations, governments, financial institutions and individuals. The businesses of Morgan Stanley and its affiliates include securities underwriting, distribution and trading; merger, acquisition, restructuring, real estate, project finance and other corporate finance advisory activities; asset management; private equity and other principal investment activities; brokerage and research services; and the trading of foreign exchange and commodities as well as derivatives on a broad range of asset categories, rates and indices. Affiliates of Morgan Stanley also provide credit and transaction services, including the operation of the Discover/Novus (trademark symbol) Network, a proprietary network of merchant and cash access locations, and the issuance of proprietary general purpose credit cards.

[3] Section 102 of Reorganization Plan No. 4 of 1978 (43 FR 47713, October 17, 1978, 5 U.S.C. App. 1 [1995]) generally transferred the authority of the

is proposing to provide the same relief on its own motion pursuant to the authority described above for many of the other Underwriter Exemptions which have substantially similar terms and conditions.[4] The Department notes that it is also proposing individual exemptive relief for: Deutsche Bank AG, New York Branch and Deutsche Morgan Grenfell/C.J. Lawrence Inc., FAN 97–03E (December 9, 1996); Credit Lyonnais Securities (USA) Inc., FAN 97–21E (September 10, 1997); ABN AMRO Inc., FAN 98–08E (April 27, 1998); and Ironwood Capital Partners Ltd., FAN 99–31E (December 20, 1999), which received the approval of the Department to engage in transactions substantially similar to the transactions described in the Underwriter Exemptions pursuant to PTE 96–62. Finally, the Department notes that it is proposing relief for Countrywide Securities Corporation (Application No. D–10863).

A. The Underwriter Exemptions

The original Underwriter Exemptions permit plans to invest in pass-through certificates representing undivided interests in the following categories of trusts: [5] (1) Single and multi-family residential or commercial mortgage investment trusts; [6] (2) motor vehicle receivables investment trusts; (3) consumer or commercial receivables investment trusts; and (4) guaranteed governmental mortgage pool certificate investment trusts.[7] Residential and commercial mortgage investment trusts may include mortgages on ground leases of real property. The terms of the ground leases pledged to secure leasehold mortgages will in all cases be at least ten years longer than the terms of such mortgages.[8]

Each trust is established under a pooling and servicing agreement or an equivalent agreement among a sponsor, a servicer, and a trustee. Prior to the closing date under the pooling and servicing agreement, the sponsor and/or the servicer selects receivables from the classes of assets described in section III.B.(1)(a)–(f) of the original Underwriter Exemptions to be included in a trust, establishes the trust and designates an independent entity as trustee for the trust. Typically, on or prior to the closing date, the sponsor acquires legal title to all assets selected for the trust. In some cases, legal title to some or all of such assets continues to be held by the originator of the receivables until the closing date. On the closing date, the sponsor and/or the originator conveys to the trust legal title to the assets, and the trustee issued certificates representing fractional undivided interests in the trust assets.

Since the receivables to be held in the trust were all transferred as of the Closing Date, no exemptive relief was requested under the Underwriter Exemptions for the trust to hold any cash, or temporary investments made therewith, other than cash representing undistributed proceeds from payments of principal and interest by obligors under the receivables. However, over time, the transactions relating to the funding of the trust changed. The 1997 Amendment to the Underwriter Exemptions: (1) Modified the definition of ''Trust'' to include a ''pre-funding account'' (PFA) and a ''capitalized interest account'' (CIA) as part of the corpus of the trust; (2) provided retroactive relief for transactions involving asset pool investment trusts containing PFAs which have occurred on or after January 1, 1992; (3) included in the definition of ''Certificate'' a debt instrument that represents an interest in a Financial Asset Securitization Investment Trust (FASIT); and (4) made certain changes to the Underwriter Exemptions that reflected the Department's current interpretation of the Underwriter Exemptions.

Under the Underwriter Exemptions as amended in 1997: (1) The rights and interests evidenced by certificates acquired by plans may not be subordinated to the rights and interests evidenced by other certificates of the same trust; (2) the certificates acquired by the plan must have received a rating from a Rating Agency at the time of such acquisition that is in one of the three highest generic rating categories; (3) the assets held by the trust must consist solely of receivables, obligations or credit instruments which are ''secured,'' (4) no interest rate swaps and no yield supplement agreements or similar yield maintenance agreements involving swap agreements or other notional principal contracts may be held by the trust and (5) the certificates must represent a beneficial ownership interest in the assets of a trust or a debt instrument issued by a REMIC or a FASIT which is a trust.

B. Proposed Amendment to the Exemptions

The proposed amendment to the Underwriter Exemptions (the Proposed Amendment) is requested in order to permit plans to invest in investment-grade [9] mortgage-backed securities (MBS) and asset-backed securities (ABS) (collectively, Securities) involving categories of transactions which are either senior or subordinated, and/or in certain cases, permit the entity issuing such Securities (Issuer) to hold receivables with loan-to-value property ratios (HLTV ratios) in excess of 100%. Specifically, the requested amendment would exempt transactions involving senior or subordinated Securities rated ''AAA,'' ''AA,'' ''A'' or ''BBB'' issued by Issuers whose assets are comprised of the following categories of receivables: (1) Automobile and other motor vehicle loans, (2) residential and home equity loans which may have HLTV ratios in excess of 100%, (3) manufactured housing loans and (4) commercial

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Secretary of the Treasury to issue exemptions under section 4975(c)(2) of the Code to the Secretary of Labor. In the discussion of the exemption, references to sections 406 and 408 of the Act should be read to refer as well to the corresponding provisions of section 4975 of the Code.

[4] In this regard, the entities who received the other Underwriter Exemptions were contacted concerning their participation in this amendment process.

[5] The Department stated in the 1997 Proposed Amendment to the Underwriter Exemptions, 62 FR 28502 (May 23, 1997), that a given trust may include receivables of the type described in one or more of the categories under the definition of Trust.

[6] The Department noted that PTE 83–1, 48 FR 895 (January 7, 1983), a class exemption for mortgage pool investment trusts, would generally apply to trusts containing single-family residential mortgages, provided that the applicable conditions of PTE 83–1 are met. The Underwriter Exemptions provide relief for single-family residential mortgages because the applicants preferred one exemption for all trusts of similar structure. However, the applicants have stated that they may still avail themselves of the exemptive relief provided by PTE 83–1.

[7] Guaranteed governmental mortgage pool certificates are mortgage-backed securities with respect to which interest and principal payable is guaranteed by the Government National Mortgage Association (GNMA), the Federal Home Loan Mortgage Corporation (FHLMC), or the Federal National Mortgage Association (FNMA). The Department's regulation relating to the definition of plan assets (29 CFR 2510.3–101(i)) provides that where a plan acquires a guaranteed governmental mortgage pool certificate, the plan's assets include the certificate and all of its rights with respect to such certificate under applicable law, but do not, solely by reason of the plan's holding of such certificate, include any of the mortgages underlying such certificate. Exemptive relief for trusts containing guaranteed governmental mortgage pool certificates was provided previously because the certificates in the trusts may be plan assets.

[8] The Department previously noted that Trust assets may also include obligations that are secured by leasehold interests on residential real property. See PTE 90–32 (involving Prudential-Bache Securities, Inc.) 55 FR 23147, at 23150 (June 6, 1990).

[9] The term ''investment grade'' refers to Securities which are rated at the time of issuance in one of the four highest generic rating categories by at least one Rating Agency. The designations ''AAA,'' ''AA,'' ''A'' and ''BBB'' are used herein to refer to the generic rating categories used by Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies Inc., Fitch ICBA, Inc., and Duff & Phelps Credit Rating Co. and are deemed to include the equivalent generic category rating designations ''Aaa'' ''Aa,'' ''A'' and ''Baa'' used by Moody's Investors Service, Inc.

mortgages (the Designated Transactions).

The Applicant requests that the relief the Department granted to MBNA America Bank National Association (MBNA) in Prohibited Transaction Exemption 98–13, 63 FR 4038 (April 7, 1998) (PTE 98–13) and to Citibank South Dakota, N.A., Citibank (Nevada), N.A. and affiliates (Citibank) in Prohibited Transaction Exemption 98–14, 63 FR 4052 (April 7, 1998) (PTE 98–14) with respect to the use of Eligible Swaps (both Ratings Dependent and Non-Ratings Dependent) be extended to all securitizations which otherwise meet the conditions of the Underwriter Exemptions, provided that the swap transaction meets the requirements set forth in the requested amendment. As a corollary to such request, the Applicant also requests that yield supplement agreements which involve notional principal amounts be permitted.

Finally, the Applicant is requesting that exemptive relief also be extended to all securitization transactions which otherwise meet the conditions of the Underwriter Exemptions notwithstanding that: (1) The Issuer of the Securities is a trust (including a grantor or owner trust), REMIC, FASIT, special purpose corporation, limited liability company or partnership or that (2) the Securities issued are either debt or equity investments.[10]

The proposed amendment to the Underwriter Exemptions specifically will modify the relief previously provided in the following respects:

(i) The rights and interests evidenced by securities acquired by plans in the Designated Transactions (*i.e.*, motor vehicle, residential/home equity, manufactured housing and commercial mortgage ABS/MBS transactions) described in this application may be subordinated to the rights and interests evidenced by other securities of the same Issuer.

(ii) Securities acquired by a plan in a Designated Transaction may receive a rating from a Rating Agency at the time of such acquisition that is in one of the four highest generic rating categories.

(iii) The corpus of the Issuer in residential and home equity Designated Transactions may include mortgage loans with HLTV ratios in excess of 100%.

(iv) Eligible interest rate swaps (both ratings dependent and non-ratings dependent) and yield supplement arrangements with notional principal amounts may be included.

(v) The securitization vehicle can also be an owner trust, special purpose corporation, limited partnership or limited liability company.

(vi) The security may be either an equity or debt interest issued by any permissible type of Issuer.

The Applicant represents that the transactions associated with subordinated and/or ''BBB'' rated debt and equity ABS/MBS, issued by a variety of special purpose vehicles which may be funded with collateral with HLTV ratios in excess of 100% and may use interest rate swaps or yield supplement agreements with notional principal amounts, have been customary in the financial marketplace for many years, and all of these features and security types are taken into consideration by the Rating Agencies when they rate the securities issued by such entities. If these securities can not be sold to plans, investing plans will lose an opportunity to achieve a current market return through investment in securities that have received a rating from a Rating Agency which is as high or higher than that of comparable instruments in which such plans are clearly permitted to invest. In addition, thesetransactions are backed by diverse varieties of individual assets that a plan would be reluctant to purchase on its own, if for no other reason than the necessity to perform its own asset-by-asset credit analysis and servicing functions.

The Applicant notes that the requested relief is administratively feasible since it substantially incorporates the provisions of the Underwriter Exemptions which have already proven in practice to be administratively feasible. To the extent that the requested amendment permits additional types of securitization vehicles and the use of yield supplement arrangements with notional principal balances and interest rate swaps, the additional safeguards the Department has required can be accommodated by market practices and do not require any further action by the Department. The Applicant states that all of the features included in the amendment request are also acceptable to the Rating Agencies. The Applicant believes that the amendment is in the interest of plan participants and beneficiaries because it provides greater opportunities for plans to invest in a more diverse range of liquid, extremely creditworthy securities. Lastly, the Applicant notes that the requested amendment is protective of the rights of participants and beneficiaries of affected plans because securities with the features proposed in the request for amended relief have experienced almost no defaults in their entire market history.

II. Request for Additional Types of Issuers

A. The Applicant's Request

The Applicant is requesting that the Underwriter Exemptions be amended to expand the permissible types of securitization vehicles that may be used to offer securities to include special purpose corporations, limited partnerships and limited liability companies and owner trusts, in addition to grantor trusts, REMICs and FASITs. It is also requesting that the securities eligible for relief include those issued by all such entities whether they are debt or equity.

When the original Underwriter Exemptions were granted, relief was only requested for ABS/MBS issued by grantor trusts and REMICs since, at that time, these were the principal securitization vehicles used for asset-backed transactions. FASITs were included under PTE 97–34 in response to legislation that had been enacted during the time period when the relief requested under PTE 97–34 was being considered by the Department. Currently, ABS/MBS securitizations are structured with a variety of types of special purpose vehicles which issue both debt and equity securities. The permissible types of Issuers used to offer Securities include trusts (including grantor and owner trusts), special purpose corporations, limited partnerships and limited liability companies and may also be REMICs or FASITs. The Applicant asserts that each of these different types of securitization entities provides virtually the same legal protections to investors. At the request of the Department, the Applicant provided the following discussion that describes the legal structure, bankruptcy status and taxation of each securitization vehicle. It also explains why debt is issued in certain transactions instead of equity and the relative rights of both types of securities.

The principal factors in the choice of securitization vehicle and whether equity or debt securities are issued by the securitization vehicle are not economic but involve a combination of tax, accounting and ERISA considerations. In this regard, the Applicant notes that where the Issuer is not a Trust, equity will not be sold to plans pursuant to this exemption, if granted. In the final analysis, the choice of securitization entity or type of security does not significantly affect plan investors either from a legal rights,

[10] The Department notes that this exemption request will not preclude the Applicant (or any other parties which have previously, or may in the future, request an Underwriter Exemption) from requesting additional exemptive relief from the Department in future applications with respect to other issues relating to the Underwriter Exemptions.

credit risk or tax perspective, but it significantly affects ERISA eligibility. Accordingly, transactions are restructured solely because of ERISA considerations which have no relationship to the safety of the securities for plan investors.

Securitizations transactions are structured with a variety of types of Issuers which are special purpose vehicles which issue both debt [11] and equity Securities. Each of the different types of securitization entities provides virtually the same legal protections to investors.

B. Legal Protections and Structure of Issuers

A goal in every structured finance transaction is to remove the assets being securitized from the estate of the Sponsor so that in the event of a bankruptcy or insolvency of such Sponsor, its creditors (or regulators in the case of entities such as banks that are not eligible to be debtors under the Bankruptcy Code (11 U.S.C.)) will be unable to claim those assets or delay payments therefrom. This allows potential buyers of Securities to base their purchasing decisions solely on the creditworthiness of the assets and not the Sponsor. This transfer of assets is referred to as a ''true sale.''

The Applicant asserts that if the transfer of assets by the Sponsor is not treated as a ''true sale,'' the transaction would be deemed a borrowing by the Sponsor, with the assets serving as collateral for the financing. In a typical financing transaction, if the Sponsor were to become the subject of a proceeding under the Bankruptcy Code (or comparable regulatory provisions for entities that are not eligible to be debtors under the Bankruptcy Code), the assets may be deemed property of the Sponsor's estate. Although a secured creditor should eventually realize the benefits of its pledged collateral, several provisions of the Bankruptcy Code or comparable regulatory provisions may operate to delay payments, and such creditor may in some cases receive less than the full value of the pledged collateral. First, immediately upon filing of a bankruptcy petition, Section 362(a) of the Bankruptcy Code imposes an automatic stay on the ability of all secured creditors to exercise their rights against pledged collateral. Other sections of the Bankruptcy Code allow a bankruptcy court to permit the use of pledged collateral to aid in the debtor's reorganization (Section 363), to provide ''super priority'' liens on such assets (Section 364), or to require a secured creditor in possession of the collateral to return it to the debtor (Section 542). Thus, in a loan financing transaction, the creditworthiness of the Sponsor is a prime factor in determining whether to extend credit, as well as the value of the collateral.

Accordingly, the goal in a structured finance transaction is to insulate the collateral from the Sponsor. The usual mechanism to accomplish this goal is through the creation and use of a bankruptcy remote Issuer which issues the Securities. The assets to be securitized are transferred to the Issuer in a ''true sale'' transaction. The Issuer either issues Securities backed by those assets or transfers the Securities (in a second transaction) to a second Issuer, which then issues the Securities backed by those assets. These are known as ''one-tier'' or ''two-tier'' transactions, respectively.

An Issuer can be formed as a corporation, limited partnership, limited liability corporation or trust. Regardless of legal structure, many restrictions are placed on the Issuer's operations, including its ability to file for bankruptcy protection (either voluntarily or involuntarily). Examples of such prohibitions are severe restrictions on the Issuer's ability to borrow money or issue debt, as well as prohibitions on the Issuer's merging with another entity, reorganizing, liquidating or selling assets (outside of the permitted securitization transactions). In this regard, the Issuer can only borrow money or issue debt in connection with the securitization.

The documents which create the Issuer (articles/certificates of incorporation for corporations, deeds of partnership/partnership agreements for limited partnerships, articles of organization for limited liability corporations or deeds of trust/trust agreements for trusts) contain restrictive clauses significantly limiting the activities of the Issuer (usually to just activities relating to the securitization transactions). They also provide for the election of one or more independent directors/partners/members whose affirmative consent is required before a voluntary bankruptcy petition can be filed by the Issuer. Independent directors are generally individuals not having significant interests in, or other relationships with, the related Sponsor or any of its affiliates. The legal documentation evidencing the securitization often contains covenants prohibiting all parties thereto from filing an involuntary bankruptcy petition against the Issuer or initiating any other form of insolvency proceeding. In this way, the Issuer, Sponsor, Servicer, trustees and others are contractually prohibited from seeking such actions against the Issuer.

Once the Issuer is formed, the Sponsor will transfer the assets to the Issuer, typically in exchange for the cash (and possibly some Securities) received from the securitization transaction. This transaction will be evidenced by appropriate legal documentation. Also, a ''true sale'' opinion from counsel is obtained for Issuers subject to the Bankruptcy Code. For those Issuers not subject to the Bankruptcy Code, an opinion is obtained from counsel to the effect that in the event of insolvency or receivership of the Sponsor, the assets transferred to the Issuer will not be part of the estate of the Sponsor.

The Applicant explains that the above procedures are generally perceived as effective in removing the assets from the Sponsor's bankruptcy estate. However, if the Sponsor were to file for bankruptcy protection, a bankruptcy court, under the provisions of Section 105 of the Bankruptcy Code, could still gain jurisdiction over the securitized assets if the Issuer could be ''substantively consolidated'' with the Sponsor. Substantive consolidation permits the bankruptcy court to treat separate but related legal entities as one and merge the assets and liabilities of two or more entities as if they belonged to one debtor. If a court determines that the Issuer has not acted as a separate legal entity but merely exists as an ''alter-ego'' of another entity, then the court may utilize the principles of ''piercing the corporate veil'' or substantive consolidation to gain control of the underlying assets even if a ''true sale'' of such assets from the Issuer to the Sponsor exists.

To prevent a court from ordering a substantive consolidation, the applicable Rating Agencies require that the organizing documents of the Issuer

[11] The Department notes that PTE 84–14, 49 FR 9494 (March 13, 1984) (as corrected at 50 FR 41430 (Oct. 10, 1985), relating to transactions determined by independent qualified professional asset managers; PTE 90–1, 55 FR 2891 (Jan. 29, 1990), relating to certain transactions involving insurance company pooled separate accounts; PTE 91–38, 56 FR 31966 (July 12, 1991) (as corrected at 56 FR 59299 (Nov. 25, 1991), relating to certain transactions involving bank collective trust funds; PTE 95–60, 60 FR 35925 (July 12, 1995), relating to certain transactions involving insurance company general accounts and PTE 96–23, 61 FR 15975 (Apr. 10, 1996), relating to transactions determined by in-house asset managers collectively (Investor-Based Exemptions), may apply to the acquisition or disposition of debt securities by plans. The Applicant requests relief for transactions meeting the conditions of the Underwriter Exemptions because it would prefer one Exemption for all Issuers of similar structures. However, the Applicant has stated that Issuers may still issue debt securities pursuant to the Investor-Based Exemptions.

contain a variety of ''separateness'' covenants. These include, among other things, requirements that the Issuer: Maintain fully separate books and records, not commingle assets with any other entity, maintain separate accounts, conduct business in its own name, prepare separate financial statements, engage only in arm's-length transactions with affiliates, pay its liabilities only from its own funds, observe all trust, corporate or partnership formalities (as applicable), not guarantee the debts or pledge its assets in support of another entity, hold itself out to be a separate legal entity and maintain adequate capital for its business operations. In certain transactions, legal opinions are delivered to the effect that adherence to these covenants would be sufficient to prevent a court from ordering the substantive consolidation of the Issuer into a debtor-parent or affiliate. The Applicant has suggested similar restrictions relating to the activities of the Issuer and the parties to an ABS/MBS transaction that would serve as conditions of the exemptive relief requested with respect to non-Trust Issuers (see section II.A.(8) of the Proposed Amendment).

The Applicant states that whether an Issuer is structured as a corporation, limited partnership, limited liability corporation or trust will have little impact on the relevant bankruptcy or insolvency protection features. They are merely different legal entities with differing structures but will produce, in the aggregate, similar types of protections for investors. A corporation will have shareholders (who benefit from limited liability protections) and debt holders (who enjoy a superior claim on assets to that of shareholders and are taxed differently). A limited partnership will have general partners (who operate the entity and are ultimately responsible for its debts) and limited partners (who will receive investment earnings but are only liable to the extent of their actual investment in the event of losses). In a limited liability corporation, ''members'' (also the holders of equity Securities) are given the limited liability protections of a corporation's equity holders (much like limited partners but with a greater degree of permitted active management abilities). In an owner trust (which is also referred to as a business trust), the trust itself is a separately existing entity that is under the day-to-day control of its trustee but whose profits are distributable to the beneficial owners. According to the Applicant, an owner trust is essentially a Delaware business trust or similar entity as organized under other local law. An owner trust may also issue debt instruments. It can also declare bankruptcy (unlike a common law trust which does not exist as a legal entity distinct and separate from its creator). As previously indicated, the specific entity chosen for a structured finance transaction is often motivated by tax considerations and less so by any legal advantage of one structural form over another.

C. Rights of Equity and Debt Holders

Equity holders have an undivided beneficial ownership interest in the issuer's assets. Debt holders do not beneficially own such assets but have a security interest in such assets which has preference over the rights of the equity holders to such collateral. The Applicant believes that, since the Underwriter Exemptions currently allow equity investments by plans, it is entirely appropriate for the Department to also provide relief for debt instruments which give their holders preferential rights to the collateral.

The equity holders, limited partners or other beneficial owners of all types of Issuers are liable on the obligations of the entity only to the extent of such holders' investment and are not personally liable on any obligations in excess thereof. In general, each type of Issuer may issue debt, and while debt holders (or note holders) of any of these entities do not own an ownership interest in the assets of the Issuer, they are entitled to preferential treatment over equity holders (*e.g.*, certificateholders) or limited partners with respect to rights to collateral. To protect equity and debt holders further, the pooled assets of any specific transaction will be placed under the control of a trustee who is independent from the Sponsor and the Servicers. This can be accomplished in different ways depending on the type of Issuer. If the Issuer is a trust and only equity Securities are issued, then the trustee of the trust would have control over the pooled assets. If instead, debt Securities are issued by any type of Issuer (trust or non-trust), then the Indenture Trustee would have control of the pooled assets. Accordingly, any requirements under the Proposed Exemption applying to the ''trustee'' will apply to both the trustee of any Issuer which is a trust and to any Indenture Trustee (each a ''Trustee'' and any Issuer which is a trust, a ''Trust''). In any transaction where debt Securities are issued, possession of the assets by the Trustee or filing a security interest would serve to perfect the debt holders' security interest in the pooled assets. In transactions involving debt Securities, the Rating Agencies require perfected security interest opinions. The Applicant agrees to make perfected security interest opinions a condition of exemptive relief for those securities issued which are debt instruments.

D. Choice of Issuer and Choice of Debt Versus Equity Securities

The principal determining factors for the choice of securitization vehicle and whether equity or debt Securities are issued are tax and accounting considerations which have no affect on plan investors as they are tax exempt.[12]

Although the decision as to whether debt or equity Securities are issued does not significantly affect the interests of the securityholders, it does affect the Sponsor of an Issuer. A Sponsor may want to be able to recognize the gain from the sale of the receivables to the Issuer for accounting purposes but not have the sale trigger gain for tax purposes. Under Statement of Financial Accounting Standards No. 125 (FASB 125) issued by the Financial Accounting Standards Board, generally a transfer of assets to an Issuer which results in the Sponsor surrendering control of the transferred assets will allow the Sponsor to book the gain for accounting purposes. However, the tax treatment to a Sponsor can be greatly affected by whether the Issuer issues debt or equity Securities. For example, if an Issuer other than a REMIC or a FASIT issues debt, the Sponsor is generally not taxed on the sale of the assets into the Trust (which is treated instead as a financing) but will be taxed on the same percentage of the economic gain on such sale as the proportion of equity interest in the Issuer which is sold by the Sponsor. By way of illustration, if an Issuer issues $100 of Securities, $6 of which are equity and $94 are debt, and the Sponsor keeps 100% of the equity and sells all of the debt, it will not be taxed on the gain from selling the assets to the Trust. However, if the Sponsor issues $100 of equity Securities and sells 94% of them, it will recognize gain of $94 on the sale of the Securities. Accordingly, if a transaction does not qualify under the REMIC or FASIT rules, the transaction may be structured to issue debt instruments.

E. Effect of Tax Rules on Choice of Issuer and Securities

The Applicant notes that the choice of Issuer and whether the Securities

[12] Although plans are subject to tax on their unrelated business taxable income under sections 511–514 of the Internal Revenue Code of 1986, as amended (UBTI), the kind of income produced in securitization transactions does not generally trigger UBTI if the plan investor holds a Security which is treated as a debt instrument for tax purposes.

offered are debt or equity is also greatly affected by the tax rules governing each type of Issuer. The tax characterization of Issuers is not necessarily the same as their characterization under local law. For example, a Trust can be taxed as a trust, a partnership, a corporation or be completely ignored for tax purposes. Conversely, any form of Issuer can be treated as a REMIC or FASIT for tax purposes if it meets the applicable requirements and so elects. However, regardless of the tax characterizations, the transaction will be structured to avoid double taxation; *i.e.*, taxation at both the Issuer level and the investor level (for investors who are tax-paying entities). The tax treatment of each type of Issuer with respect to which exemptive relief is requested is as follows.

1. Grantor Trust

Under the Federal tax rules which govern grantor trusts as set forth in Treas. Reg. section 301.7701–4(c), a grantor Trust is disregarded for tax purposes and the securityholders are generally taxed on their ratable share of the income of the Trust. There is no specific prohibition on a grantor Trust's ability to issue debt under the tax rules. However, this is usually not done because if the debt securities were ever recharacterized as equity for tax purposes, the trust could be viewed as violating Treas. Reg. section 301.7701–4(c) which generally prohibits multiple classes of equity from being issued. Although a grantor Trust is not permitted to issue multiple classes of equity with disproportionate payments or fast-pay/slow-pay structures, it may issue a senior class and a subordinated class, provided that they each receive normal distributions pro rata. Because a grantor Trust may not issue Securities with different maturity dates, real estate related securitization transactions which are intended to have these features are often structured as REMICs.

2. REMICs

REMICs can be formed as any type of Issuer; *i.e.*, Trust, corporation, partnership, limited liability company or even a segregated pool of assets. A REMIC is permitted to issue both equity and debt Securities but usually is set up as a Trust which issues equity Securities. The REMIC itself does not pay tax, but the residual equity holder instead is taxed on the REMIC's taxable income. REMIC ''regular'' interests are treated as debt instruments for tax purposes. One of the principal advantages to using a REMIC structure is that the transaction can use a fast-pay/slow-pay structure.

3. FASITs

FASITs can also be formed as any type of Issuer and can be a segregated pool of assets. FASITs are a type of statutory entity created by the Small Business Job Protection Act of 1996 (SBA) through amendments to the Code effective on September 1, 1997.[13] FASITs are designed to facilitate the securitization [14] of debt obligations, such as credit card receivables, home equity loans and auto loans, and thus allows certain features such as revolving pools of assets, Issuers containing unsecured receivables and certain hedging types of investments. A FASIT is permitted to issue both equity and debt Securities. A FASIT is not a taxable entity and debt instruments issued by such Issuers, which might otherwise be recharacterized as equity, will be treated as debt in the hands of the holder for tax purposes. The holder of the ownership interest (which may not be a pension plan) is taxed on the FASIT income. FASIT ''regular interests'' are treated as debt instruments.

Although FASITs are permitted to have revolving pools of permitted assets, exemptive relief is only currently available for FASITs that are, in fact, passive in nature which would preclude (in the absence of other exemptive relief) revolving asset pools. Thus, only FASITs with assets which were comprised of secured debt and which did not allow revolving pools of assets or hedging investments not otherwise specifically authorized by the Underwriter Exemptions would be permissible.

4. Owner Trusts

There are many situations where a securitization transaction wishes to use a Trust as the Issuer but cannot qualify as a REMIC or a grantor Trust. These include transactions that do not qualify as REMICs because they either do not involve real estate assets (*e.g.*, motor vehicle transactions) or are real estate transactions where the REMIC rules are not satisfied (*e.g.*, the LTV ratios exceed the REMIC limits or the Pre-Funding Period exceeds three months). If the parties wish to use the type of tranching which uses a fast-pay/slow-pay structure, they also cannot qualify as a grantor Trust. In such cases, the Issuer will be set up as an owner Trust which is a business Trust. State statutory and common law governs the formation and operation of owner trusts. An owner Trust with more than one equity holder is treated as a partnership with the same tax effects as the other types of Issuers described above. The ''partnership'' is not taxed; its income is taxed to its equity holders and any debt holders are taxed on the interest income they receive. If the owner Trust is wholly owned, it is disregarded for tax purposes.[15] Whoever holds the equity in the owner Trust is the beneficial owner of the trust assets. Therefore, if the equity is sold to more than one entity it could have multiple beneficial owners. The debt holder(s) would have a security interest in the owner Trust assets.

5. Limited Liability Companies, Partnerships and Special Purpose Corporations

Entities which are limited liability companies with more than one equity holder or are partnerships under local law are taxed as partnerships. If the limited liability company is wholly owned, it is also disregarded for tax purposes.[16] A special purpose corporation is taxed on its income, but it receives a deduction for interest paid to debt holders, so the tax result is similar to that of a partnership.

While the permissible types of Issuers under the requested exemption include Issuers which are not required under the tax rules to be passive entities,[17] in order for a transaction to qualify for exemptive relief, each of the applicable requirements of the Underwriter Exemptions as modified must be met. This would mean, for example, that only transactions involving Issuers holding assets which are comprised of secured debt (unless the assets are residential and home equity loans in a Designated Transaction) and which do not allow revolving pools of assets or hedging investments (unless specifically authorized) are permissible under the requested relief. Specifically, the Issuer must be maintained as an essentially passive entity, and, therefore, both the Sponsor's discretion and the Servicer's discretion with respect to assets included in an Issuer must be severely limited both as to those assets transferred on the Closing Date and

[13] Section 1621 of the SBA added sections 860H, 860I, 860J, 860K and 860L to the Internal Revenue Code of 1986, as amended.

[14] Securitization is the process of converting one type of asset into another and generally involves the use of an entity separate from the underlying assets. In the case of securitization of debt instruments, the instruments created in the securitization typically have different maturities and characteristics than the debt instruments that are securitized.

[15] Whether an entity is wholly owned or owned by more than one equity holder is determined under the tax rules.

[16] *Id.*

[17] Grantor trusts and REMICs are required under the tax rules to be passive entities with limited asset substitution rights, but other types of Issuers are not so restricted.

those acquired during any Pre-Funding Period. Pooling and Servicing Agreements provide for the substitution of Issuer receivables by the Sponsor only in the event of breaches of representations and warranties or defects in documentation discovered within a short time after the issuance of Securities (within 120 days, except in the case of obligations having an original term of 30 years, in which case the period will not exceed two years). Any receivable so substituted is required to have characteristics substantially similar to the replaced receivable and will be at least as creditworthy as the replaced receivable. In some cases, the affected receivable would be repurchased, with the purchase price applied as a payment on the affected receivable and passed through to securityholders.

F. The Applicant's Arguments for Exemptive Relief for Different Types of Issuers and Securities

Although, as previously noted, the choice of Issuer does not significantly affect the rights of securityholders or the safety of the investments, ERISA's prohibited transaction rules affect whether plan investors can purchase these different forms of ABS/MBS. The plan asset regulation set forth at 29 CFR § 2510–3.101 (the Plan Asset Regulation) was intended to prevent an employee benefit plan subject to ERISA from retaining an asset manager indirectly through an equity investment by the plan in an investment fund in order to avoid the fiduciary responsibility and prohibited transaction provisions of ERISA. The Department made a determination that debt instruments should not be subject to the Plan Asset Regulations as they were not likely to be vehicles for the indirect provision of investment management services.[18] As a consequence of this regulation, the treatment of debt and the treatment of equity is very different under ERISA. Equity investments in ABS/MBS not only can result in the purchase and sale of the securities triggering prohibited transactions, but if the underlying assets of the Trust are deemed to include plan assets, the operation of the Trust and the servicing of its assets can also trigger prohibited transactions.

In contrast, investments in ABS/MBS which are debt securities avoid any plan asset issues with respect to the operation of the Trust. However, they can still result in one or more prohibited transactions. This is because the acquisition or disposition of the debt security itself may be a sale or exchange of property between a plan and a party in interest and also an extension of credit between such entities. The acquisition or disposition of the debt securities may be covered under PTE 75–1. However, in many ABS/MBS transactions, the conditions of PTE 75–1 may not be met, *i.e.*, where a broker-dealer is not selling the securities but is instead acting as the placement agent for securities which are being offered pursuant to a private placement exempt from registration under the Securities Act of 1933. Similarly, if a plan sold the ABS/MBS to a party in interest in the secondary market, Part V of PTE 75–1 would not apply since it is limited to extensions of credit to a plan in connection with the purchase or sale of securities (*e.g.*, extensions of credits during the three-day settlement period).

When a plan purchases an ABS/MBS which is a debt security, it is effectively viewed as an extension of credit to the Issuer for ERISA purposes. While the Issuer, as a newly formed, special purpose entity, would not be a party in interest with respect to such plan, if the Issuer is deemed to be an affiliate of an existing party in interest, this could create a prohibited extension of credit. Whenever ABS/MBS are issued as debt, some other entity will own the equity of the Issuer, either as a residual equity interest held by the Sponsor or all or part of the equity could be sold to the public. If any equity holder which owns a 50% or more interest in the Issuer is a party in interest with respect to a plan holding the debt security, the Issuer will be deemed a party in interest under 3(14)(G) of ERISA. This problem is compounded by the fact that most publicly-offered securities are held by the Depository Trust Company and Clearing Corporation so that the identity of the public equity holders may not be known either at the initial issuance of the securities or when a security is sold in the secondary market. Accordingly, there is a need for the Underwriter Exemptions to cover the acquisition, disposition and holding of debt securities which is not met by PTE 75–1.

As debt securities generally are not eligible for relief under the Underwriter Exemptions, an ABS/MBS which is a debt security may not be purchased by a plan investor from a party in interest unless another exemption is available. This is an anomalous result since the rights of debt holders in ABS/MBS transactions are senior to those of Certificateholders, and the decision to issue debt or equity ABS/MBS is not dictated by the relative rights of the investor but is made based on tax and accounting considerations which are not relevant to plan investors. In fact, purchasers make the decision to invest in ABS/MBS based on the projected return on the securities and the quality and sufficiency of the underlying obligations in the pool without regard to the characterization as debt or equity. According to the Applicant, either type of security issued in an ABS/MBS transaction is viewed by plan investment managers as a fixed income alternative to corporate bonds. The fact that ABS/MBS pass-through Certificates are equity interests under local law is completely disregarded by plan investors except to the extent that the equity characterization negatively impacts ERISA eligibility of those securities in the absence of an exemption. Thus, the Applicant asserts that allowing debt securities issued in ABS/MBS transactions to be eligible securities under the Underwriter Exemptions is beneficial to such investors in their efforts to diversify plan assets.

In this regard, the Applicant has submitted letters from the Rating Agencies which state that the legal form of the issuer does not affect the ratings given to comparable securities and that the Rating Agencies' analysis takes into account the legal and structural risks of each type of Issuer. Accordingly, the Applicant believes that, if a particular transaction has sufficient substantive safeguards to protect the interests of plan investors, the choice of Issuer or whether the particular security is debt or equity should not be determinative of whether they are eligible investments for ERISA plans.

Although the Applicant is requesting that the definition of securitization vehicle be expanded to include special purpose corporations, partnerships and limited liability companies, none of which is a Trust, the Applicant believes that any and all requirements under the Underwriter Exemptions which currently are applicable to the ''Trustee'' will continue to be applicable and are appropriate no matter what type of Issuer is used. This is because, even in transactions where the Issuer is not a Trust, ABS/MBS which are debt securities will be issued pursuant to a Trust indenture, and there will be an Indenture Trustee representing the interests of debt holders which will be independent of the Sponsor and other members of the Restricted Group. The Indenture Trustee is the trustee appointed pursuant to an indenture which provides for the pledge of collateral to secure the debt securities issued by the issuer pursuant to the

[18] See the preamble to the final Plan Asset Regulation, 51 FR 41280 (Nov. 13, 1986).

indenture and sets forth the rights of the debt holders. Accordingly, the fact that an Issuer which is not a Trust does not have a Trustee will not affect the existing requirement under the Underwriter Exemptions relating to an independent Trustee that is not an affiliate of any other member of the Restricted Group (see section III.M. of the Proposed Amendment). Thus, there will always be an Independent Trustee in transactions entered into pursuant to the requested exemption. The Applicant notes that where the Issuer is not a Trust, equity will not be sold to plans.

G. Classes of Securities

The Applicant notes that some of the Securities will be multi-class Securities. The Applicant requests exemptive relief for two types of multi-class Securities: ''strip'' Securities and ''fast-pay/slow-pay'' Securities. Strip Securities are a type of Security in which the stream of interest payments on receivables is split from the flow of principal payments and separate classes of Securities are established, each representing rights to disproportionate payments of principal and interest.[19]

''Fast-pay/slow-pay'' Securities involve the issuance of classes of Securities having different stated maturities or the same maturities with different payment schedules. Interest and/or principal payments received on the underlying Issuer's assets are distributed first to the class of Securities having the earliest stated maturity of principal and/or earlier payment schedule, and only when that class of Securities has been paid in full (or has received a specified amount) will distributions be made with respect to the second class of Securities. Distributions on Securities having later stated maturities will proceed in like manner until all the securityholders have been paid in full. The only difference between this multi-class arrangement and a single-class arrangement is the order in which distributions are made to securityholders. In each case, securityholders will have a beneficial ownership interest in the underlying Issuer's assets or a security interest in the collateral securing such assets. Except as permitted in a Designated Transaction, the rights of a plan purchasing Securities will not be subordinated to the rights of another securityholder in the event of default on any of the underlying obligations. In particular, unless the Securities are issued in a Designated Transaction, if the amount available for distribution to securityholders is less than the amount required to be so distributed, all senior securityholders will share in the amount distributed on a pro rata basis.[20]

III. Requested Modifications for Interest Rate Swap Agreements

A. Interest Rate Swaps

PTE 98–13 and PTE 98–14 provide exemptive relief for securitizations featuring revolving pools of secured and unsecured credit card receivables held in Trusts sponsored by MBNA and Citibank, respectively, which Trusts may also hold simple interest rate swaps as an asset. The granting of these exemptions involved extensive discussions between the Department and representatives of MBNA and Citibank as to the structure and operation of credit card securitizations, including the use of interest rate swaps, and the approach used by the Rating Agencies in rating these types of securities where the rating given by the Rating Agency is dependent upon the existence of an interest rate swap agreement.

Interest rate swaps are used in non-credit card securitization transactions in the same manner that they are used in credit card transactions; *i.e.,* where the index used to calculate interest payments on the receivables is different than the index used to calculate interest payments on the securities issued by the Trust. For example, many securities bear interest based upon the London Interbank Offered Rate for dollar deposits of a specified maturity (LIBOR). However, the assets being securitized often bear interest at fixed rates or rates based upon U.S. Treasury securities, the prime rate or other indices that may not move in tandem with LIBOR. The swap helps assure that the Trust will have sufficient funds to make full payments of interest on the securities.

The Applicant states that a class of Securities in a non-credit card securitization may have the benefit of an interest rate swap agreement entered into between the Issuer and a bank or other financial institution acting as a swap counterparty. Pursuant to the swap agreement, the swap counterparty would pay a certain rate of interest to the Issuer in return for a payment of a rate of interest by the Issuer, from collections allocable to the relevant class of Securities, to the swap counterparty. The Applicant represents that the credit rating provided to a particular class of Securities by the relevant Rating Agency may or may not be dependent upon the existence of a swap agreement. Thus, in some instances, the terms and conditions of the swap agreements will not affect the credit rating of the class of Securities to which the swap relates (*i.e.,* a Non-Ratings Dependent Swap).

The Applicant requests that the same exemptive relief which has been provided to MBNA and Citibank with respect to interest rate swaps be extended to all securitization transactions, otherwise meeting the conditions of the requested amendment. Thus, the Applicant is requesting relief for both ratings dependent and non-ratings dependent swaps as described in PTE 98–13 and PTE 98–14 (the Credit Card Exemptions), subject to the same terms and conditions regarding interest rate swaps contained in those exemptions. Consistent with the conditions of the Credit Card Exemptions, the Applicant has included the swap counterparty as a member of the Restricted Group. However, two revisions regarding interest rate swaps are necessary in order to make the swap provisions compatible with fixed asset pool transactions.

First, the Credit Card Exemptions require that a ratings dependent swap include as an early payout event the withdrawal or reduction by a Rating Agency of the swap counterparty's credit rating where the Servicer has failed to meet its obligations under the Pooling and Servicing Agreement relating to obtaining a replacement swap agreement or causing the swap counterparty to post collateral. The early payout causes principal to be paid out for the benefit of securityholders instead of being used to purchase additional credit card receivables. In contrast, all principal and interest payments received by the Issuer in non-revolving pool transactions are used to make payments to either the securityholders, the swap counterparty or to pay servicing fees or other expenses; none are used to purchase additional obligations for deposit into the Issuer. Accordingly, the concept of an early payout event is not relevant for

[19] It is the Department's understanding that where a plan invests in REMIC ''residual'' interest Certificates to which this Exemption applies, some of the income received by the plan as a result of such investment may be considered unrelated business taxable income to the plan, which is subject to income tax under the Code. The Department emphasizes that the prudence requirement of section 404(a)(1)(B) of the Act would require plan fiduciaries to carefully consider this and other tax consequences prior to causing plan assets to be invested in Certificates pursuant to this Proposed Exemption.

[20] If an Issuer issues subordinated Securities, holders of such subordinated Securities may not share in the amount distributed on a pro rata basis. The Department notes that the Proposed Exemption does not provide relief for plan investment in such subordinated Securities, unless the Securities are issued in a Designated Transaction.

the non-revolving pools of assets which are covered under the Underwriter Exemptions. Instead, the Applicant is proposing that if the swap counterparty's rating is downgraded, and the Servicer fails to obtain an acceptable replacement swap or to cause the swap counterparty to post collateral or make other arrangements satisfactory to the Rating Agency, the plan certificateholders would be notified in the immediately following Trustee's periodic report and would have sixty days thereafter to dispose of the Certificates before the exemptive relief under section I.C. of the Underwriter Exemptions with respect to the servicing, management and operation of the Issuer would prospectively cease to be available. The party responsible for such notification may be the Sponsor, the Trustee, a third-party administrator or any other party designated in the pooling and servicing agreement and/or servicing agreement to give periodic reports to the securityholders.

Second, the Credit Card Exemptions use the term ''Excess Finance Charge Collections'' which is not relevant to non-credit card ABS/MBS transactions. Accordingly, the Applicant has substituted the term ''Excess Spread'' which is the functionally equivalent term and best suited to the types of transactions covered by the Underwriter Exemptions. The term ''excess spread'' applies to both ratings dependent and non-ratings dependent swaps and is defined as the amount, as of any given day funds are distributed from the issuer, by which the interest allocated to the securities exceeds the amount necessary to pay interest to the securityholders, servicing fees and issuer expenses. This term is defined in section III.II. of the Proposed Amendment.

The Applicant believes that allowing the use of interest rate swaps is beneficial to plan investors as it helps to protect them from the risk of interest rate fluctuations. The conditions the Department has imposed in PTE 98–13 and PTE 98–14, which will be met with respect to any interest rate swap used in transactions covered by the requested exemption, will further protect the interest of plans. Accordingly, the Applicant represents that whether or not the credit rating of a particular class of Securities is dependent upon the terms and conditions of one or more interest rate swap agreements entered into by the Issuer (*i.e.*, a ''Ratings Dependent Swap'' or a ''Non-Ratings Dependent Swap''), each particular swap transaction will be an ''Eligible Swap'' as defined in the Proposed Amendment.

B. Conditions

In this regard, an Eligible Swap will be a swap transaction:

1. Which is denominated in U.S. Dollars;

2. Pursuant to which the Issuer pays or receives, on or immediately prior to the respective payment or distribution date for the applicable class of Securities, a fixed rate of interest or a floating rate of interest based on a publicly available index (*e.g.* LIBOR or the U.S. Federal Reserve's Cost of Funds Index (COFI)), with the Issuer receiving such payments on at least a quarterly basis and being obligated to make separate payments no more frequently than the counterparty, with all simultaneous payments being netted;

3. Which has a notional amount that does not exceed either: (i) The principal balance of the class of Securities to which the swap relates, or (ii) the portion of the principal balance of such class represented solely by those types of corpus or assets of the Issuer referred to in subsections III.B. (1), (2) and (3) of the Proposed Amendment;

4. Which is not leveraged (i.e., payments are based on the applicable notional amount, the day count fractions, the fixed or floating rates designated in item (b) above and the difference between the products thereof, calculated on a one-to-one ratio and not on a multiplier of such difference);

5. Which has a final termination date that is the earlier of the date on which the Issuer terminates or the related class of Securities is fully repaid; and

6. Which does not incorporate any provision which could cause a unilateral alteration in any provision described in items (1) through (5) above without the consent of the Trustee.

In addition, any Eligible Swap entered into by the Issuer will be with an ''Eligible Swap Counterparty,'' which will be a bank or other financial institution with a rating at the date of issuance of the Securities by the Issuer which is in one of the three highest long-term credit rating categories, or one of the two highest short-term credit rating categories, utilized by at least one of the Rating Agencies rating the Securities; provided that, if a swap counterparty is relying on its short-term rating to establish its eligibility, such counterparty must either have a long-term rating in one of the three highest long-term rating categories or not have a long-term rating from the applicable Rating Agency, and provided further that if the class of Securities with which the swap is associated has a final maturity date of more than one year from the date of issuance of the Securities, and such swap is a Ratings Dependent Swap, the swap counterparty is required by the terms of the swap agreement to establish any collateralization or other arrangement satisfactory to the Rating Agencies in the event of a ratings downgrade of the swap counterparty.

Under any termination of a swap, the Issuer will not be required to make any termination payments to the swap counterparty (other than a currently scheduled payment under the swap agreement) except from Excess Spread or other amounts that would otherwise be payable to the Servicer or the Sponsor.

With respect to a Rating Dependent Swap, the Servicer shall either cause the Eligible Counterparty to establish certain collateralization or other arrangements satisfactory to the Rating Agencies in the event of a rating downgrade of such swap counterparty below a level specified by the Rating Agency (which will be no lower than the level which would make such counterparty an Eligible Counterparty), or the Servicer shall obtain a replacement swap with an Eligible Swap Counterparty acceptable to the Rating Agencies with substantially similar terms. If the Servicer fails to do so, the plan securityholders will be notified in the immediately following Trustee's periodic report to securityholders and will have a 60-day period thereafter to dispose of the Securities, at the end of which period the exemptive relief provided under section I.C. of the Underwriter Exemption (relating to the servicing, management and operation of the Issuer) would prospectively cease to be available. With respect to Non-Ratings Dependent Swaps, each Rating Agency rating the Securities must confirm, as of the date of issuance of the Securities by the Issuer, that entering into the swap transactions with the Eligible Counterparty will not affect the rating of the Securities, even if such counterparty is no longer an Eligible Counterparty and the swap is terminated.[21]

[21] In the course of considering applications for exemptive relief under PTE 98–13 and PTE 98–14, the Department received representations from the Rating Agencies that certain classes of Securities issued by an Issuer holding receivables will have Securities ratings that are not dependent on the existence of a swap transaction entered into by the Issuer. Therefore, a downgrade in the swap counterparty's credit rating would not cause a downgrade in the rating established by the Rating Agency for the Securities. These Rating Agency representations stated that in such instances, there will be more credit enhancements (*e.g.*, ''excess spread,'' letters of credit, cash collateral accounts) for the class to protect the securityholders than there would be in a comparable class where the Issuer enters into a so-called Ratings Dependent

Any class of Securities to which one or more swap agreements entered into by the Issuer applies will be acquired or held only by Qualified Plan Investors. Qualified Plan Investors will be plan investors represented by an appropriate independent fiduciary that is qualified to analyze and understand the terms and conditions of any swap transaction relating to the class of Securities to be purchased and the effect such swap would have upon the credit rating of the Securities to which the swap relates.

For purposes of the Underwriter Exemptions, such a qualified independent fiduciary will be either:

(a) A ''qualified professional asset manager'' (*i.e.*, QPAM), as defined under Part V(a) of PTE 84–14;

(b) An ''in-house asset manager'' (*i.e.*, INHAM), as defined under Part IV(a) of PTE 96–23; or

(c) A plan fiduciary with total assets under management of at least $100 million at the time of the acquisition of such Securities.

C. Yield Supplement Agreements

A yield supplement agreement is a contract under which the issuer makes a single cash payment to the contract provider in return for the contract provider promising to make certain payments to the issuer in the event of market fluctuations in interest rates. For example, if a class of securities promises an interest rate which is the greater of 7% or LIBOR and LIBOR increases significantly, the yield supplement agreement might obligate the contract provider pay to the issuer the excess of LIBOR over 7%. In some circumstances, the contract provider's obligation may be capped at a certain aggregate maximum dollar liability under the contract. Alternatively, a cap could be placed on the supplemental interest that would be paid to a securityholder from monies paid under the yield supplement agreement. For example, the yield supplement agreement would provide the difference between LIBOR and 7% but only to the extent that the securityholder would be paid a total of 9%. The interest to be paid by the contract provider to the issuer under the yield supplement agreement is usually calculated based on a notional principal balance which may mirror the principal balances of those classes of securities to which the yield supplement agreement relates or some other fixed amount. This notional amount will not exceed either: (i) The principal balance of the class of Securities to which such agreement or arrangement relates, or (ii) the portion of the principal balance of such class represented solely by those types of corpus or assets of the Issuer referred to in subsections III.B. (1), (2) and (3) of the Proposed Amendment. In all cases, the issuer makes no payments other than the fixed purchase price for the yield supplement agreement and may, therefore, be distinguished from an interest rate swap agreement, notwithstanding that both types of agreements may use an ISDA form of contract. The 1997 Amendment includes within the definition of ''Trust'' cash or investments made therewith which are credited to an account to provide payments to certificateholders pursuant to any yield supplement agreement or similar yield maintenance arrangement provided that such arrangements do not involve swap agreements or other notional principal contracts. However, the Applicant notes that the Credit Card Exemptions (PTE 98–13 and PTE 98–14) permit interest rate swaps which clearly feature notional principal amounts. In addition to requesting exemptive relief for ''plain vanilla'' interest rate swaps, the Applicant also requests relief for yield supplement arrangements that do not involve interest rate payments by the Trustee, even if they have a notional principal amount.

Accordingly, the Applicant is requesting that yield supplement agreements with notional principal amounts be permitted retroactively to April 7, 1998, which is the date that PTE 98–13 and PTE 98–14 were issued as final exemptions. The Applicant's request for relief covers only the type of interest rate cap agreements which are currently covered under the Underwriter Exemptions. The only change being requested is to clarify that agreements which have a notional principal balance and/or are set forth on International Swaps and Derivatives Association, Inc. (''ISDA'') forms will be permitted.

The Applicant notes that no ''plan assets'' within the meaning of the Plan Asset Regulation (under 29 CFR 2510–3–101) are utilized in the purchase of the cap agreement, as the Sponsor or some other third party funds such arrangement with an up-front single-sum payment. The Issuer's only obligation is to receive payments from the counterparty if interest rate fluctuations require them under the terms of the contract and to pass them through to securityholders. The Rating Agencies examine the creditworthiness of the counterparty in a ratings dependent yield supplement agreement. The Applicant suggests that the relief for yield supplement agreements should be subject to the same conditions as for interest rate swaps found in the Credit Card Exemptions (PTE 98–13 and PTE 98–14), to the extent relevant. These conditions would include that the yield supplement agreement must be denominated in U.S. dollars, the agreement must not be leveraged, any changes in these conditions must be subject to the consent of the Trustee, and the counterparty must be subject to the same eligibility requirements as an interest rate swap counterparty.

IV. Other Features of Securitizations

A. Formation of the Issuer

Each Issuer is established under a Pooling and Servicing Agreement or equivalent agreement between a Sponsor, a Servicer and a Trustee. Prior to the Closing Date under the Pooling and Servicing Agreement, the Sponsor and/or Servicer selects receivables from the classes of assets described in section III.B.(1)(a)–(f) of the Underwriter Exemptions to be included in the Issuer, establishes the Issuer and designates an independent entity as Trustee. Typically, on or prior to the Closing Date, the Sponsor acquires legal title to all assets selected for the Issuer. In some cases, legal title to some or all of such assets continue to be held by the originator until the Closing Date. On the Closing Date, the Sponsor and/or the originator conveys to the Issuer legal title to the assets, and the Issuer issues Securities representing fractional undivided interests in the Issuer's assets and/or debt obligations of the Issuer.

B. Pre-Funding Accounts

While in many cases all of the receivables to be held in the Issuer are transferred to the Issuer on or prior to the Closing Date,[22] it is also common for other transactions to be structured using a Pre-Funding Account and/or a Capitalized Interest Account as described below. If pre-funding is used, some portion of the receivables will be transferred after the Closing Date during an interim Pre-Funding Period. The Pre-Funding Period for any Issuer will be

Swap. Non-Ratings Dependent Swaps are generally used as a convenience to enable the Issuer to pay certain fixed interest rates on a class of Securities. However, the receipt of such fixed rates by the Issuer from the counterparty is not a necessity for the Issuer to be able to make its fixed rate payments to the securityholders.

[22] The Department is of the view that the term ''Issuer'' under the Underwriter Exemptions would include an Issuer: (a) The assets of which, although all specifically identified by the Sponsor or originator as of the Closing Date, are not all transferred to the Issuer on the Closing Date for administrative or other reasons but will be transferred to the Issuer shortly after the Closing Date, or (b) with respect to which Securities are not purchased by plans until after the end of the Pre-Funding Period at which time all receivables are contained in the Issuer.

defined as the period beginning on the Closing Date and ending on the earliest to occur of: (i) The date on which the amount on deposit in the Pre-Funding Account is less than a specified dollar amount, (ii) the date on which an event of default occurs under the related Pooling and Servicing Agreement [23] or (iii) the date which is the later of three months or ninety days after the Closing Date. If pre-funding is used, cash sufficient to purchase the receivables to be transferred after the Closing Date will be transferred to the Issuer by the Sponsor or originator on the Closing Date. During the Pre-Funding Period, such cash and temporary investments, if any, made therewith will be held in a Pre-Funding Account and used to purchase the additional receivables, the characteristics of which will be substantially similar to the characteristics of the receivables transferred to the Issuer on the Closing Date. Certain specificity and monitoring requirements described below will be met which will be disclosed in the Pooling and Servicing Agreement and/or the prospectus [24] or private placement memorandum.

For a transaction involving an Issuer using pre-funding, on the Closing Date, a portion of the offering proceeds will be allocated to the Pre-Funding Account generally in an amount equal to the excess of: (i) The principal amount of Securities being issued over (ii) the principal balance of the receivables being transferred to the Issuer on such Closing Date. In certain transactions, the aggregate principal balance of the receivables intended to be transferred to the Issuer may be larger than the total principal balance of the Securities being issued. In these cases, the cash deposited in the Pre-Funding Account will equal the excess of the principal balance of the total receivables intended to be transferred to the Issuer over the principal balance of the receivables being transferred on the Closing Date.

On the Closing Date, the Sponsor transfers the receivables to the Issuer in exchange for the Securities. The Securities are then sold to an Underwriter for cash or to the securityholders directly if the Securities are sold through a placement agent. The cash received by the Sponsor from the securityholders (or the Underwriter) from the sale of the Securities issued by the Issuer in excess of the purchase price for the receivables and certain other Issuer expenses, such as underwriting or placement agent fees and legal and accounting fees, constitutes the cash to be deposited in the Pre-Funding Account. Such funds are either held in the Issuer and accounted for separately, or are held in a sub-account or sub-trust. In either event, these funds are not part of assets of the Sponsor.

Generally, the receivables are transferred at par value, unless the interest rate payable on the receivables is not sufficient to service both the interest rates to be paid on the Securities and the transaction fees (*i.e.*, servicing fees, Trustee fees and fees to credit support providers). In such cases, the receivables are sold to the Issuer at a discount, based on an objective, written, mechanical formula which is set forth in the Pooling and Servicing Agreement and agreed upon in advance between the Sponsor, the Rating Agency and any credit support provider or other Insurer. The proceeds payable to the Sponsor from the sale of the receivables transferred to the Issuer may also be reduced to the extent they are used to pay transaction costs. In addition, in certain cases, the Sponsor may be required by the Rating Agencies or credit support providers to set up Issuer reserve accounts to protect the securityholders against credit losses.

The exemptive relief provided under the 1997 Amendment for pre-funding is limited so that the percentage or ratio of the amount allocated to the Pre-Funding Account, as compared to the total principal amount of the Securities being offered (the Pre-Funding Limit), does not exceed 25% effective for transactions occurring on or after May 23, 1997 and did not exceed 40% effective for transactions occurring on or after January 1, 1992, but prior to May 23, 1997. The Pre-Funding Limit (which may be expressed as a ratio or as a stated percentage or as a combination thereof) will be specified in the prospectus or the private placement memorandum.

Any amounts paid out of the Pre-Funding Account are used solely to purchase receivables and to support the interest rate payable on the Securities (as explained below). Amounts used to support the interest rate are payable only from investment earnings and are not payable from principal. However, in the event that, after all of the requisite receivables have been transferred into the Issuer, any funds remain in the Pre-Funding Account, such funds will be paid to the securityholders as principal prepayments. Upon termination of the Issuer, if no receivables remain in the Issuer and all amounts payable to the securityholders have been distributed, any amounts remaining in the Issuer would be returned to the Sponsor.

A dramatic change in interest rates on the receivables held in an Issuer using a Pre-Funding Account would be handled as follows. If the receivables (other than those with adjustable or variable rates) had already been originated prior to the Closing Date, no action would be required as the fluctuations in market interest rates would not affect the receivables transferred to the Issuer after the Closing Date. In contrast, if interest rates fall after the Closing Date, receivables originated after the Closing Date will tend to be originated at lower rates, with the possible result that the receivables will not support the interest rate payable on the Securities. In such situations, the Sponsor could sell the receivables into the Issuer at a discount and more receivables will be used to fund the Issuer in order to support the interest rate. In a situation where interest rates drop dramatically and the Sponsor is unable to provide sufficient loans at the requisite interest rates, the pool of receivables would be closed. In this latter event, under the terms of the Pooling and Servicing Agreement, the securityholders would receive a repayment of principal from the unused cash held in the Pre-Funding Account. In transactions where the interest rates payable on the Securities are variable or adjustable, the effects of market interest rate fluctuations are mitigated. In no event will fluctuations in interest rates payable on the receivables affect the interest rate payable on fixed rate Securities.

The cash deposited into the Issuer and allocated to the Pre-Funding Account is invested in certain permitted investments (see below), which may be commingled with other accounts of the Issuer. The allocation of investment earnings to each Issuer account is made periodically as earned in proportion to each account's allocable share of the investment returns. As Pre-Funding Account investment earnings are required to be used to support (to the extent authorized in the particular transaction) the amounts of interest payable to the securityholders with respect to a periodic distribution date, the Trustee is necessarily required to make periodic, separate allocations of

[23] The minimum dollar amount is generally the dollar amount below which it becomes too uneconomical to administer the Pre-Funding Account. An event of default under the Pooling and Servicing Agreement generally occurs when: (i) A breach of a covenant or a breach of a representation and warranty concerning the Sponsor, the Servicer or certain other parties occurs which is not cured, (ii) there occurs a failure to make required payments to securityholders or (iii) the Servicer becomes insolvent.

[24] References to the term ''prospectus'' herein shall include any related prospectus supplement thereto, pursuant to which Securities are offered to investors.

the Issuer's earnings to each Issuer account, thus ensuring that all allocable commingled investment earnings are properly credited to the Pre-Funding Account on a timely basis.

C. The Capitalized Interest Account

In certain transactions where a Pre-Funding Account is used, the Sponsor and/or originator may also transfer to the Issuer additional cash on the Closing Date, which is deposited in a Capitalized Interest Account and used during the Pre-Funding Period to compensate the securityholders for any shortfall between the investment earnings on the Pre-Funding Account and the interest rate payable on the Securities.

The Capitalized Interest Account is needed in certain transactions since the Securities are supported by the receivables and the earnings on the Pre-Funding Account, and it is unlikely that the investment earnings on the Pre-Funding Account will equal the interest rates payable on the Securities (although such investment earnings will be available to pay interest on the Securities). The Capitalized Interest Account funds are paid out periodically to the securityholders as needed on distribution dates to support the interest rate. In addition, a portion of such funds may be returned to the Sponsor from time to time as the receivables are transferred into the Issuer and the need for the Capitalized Interest Account diminishes. Any amounts held in the Capitalized Interest Account generally will be returned to the Sponsor and/or originator either at the end of the Pre-Funding Period or periodically as receivables are transferred and the proportionate amount of funds in the Capitalized Interest Account can be reduced. Generally, the Capitalized Interest Account terminates no later than the end of the Pre-Funding Period. However, there may be some cases where the Capitalized Interest Account remains open until the first date distributions are made to securityholders following the end of the Pre-Funding Period.

In other transactions, a Capitalized Interest Account is not necessary because the interest paid on the receivables exceeds the interest payable on the Securities at the applicable interest rate and the fees payable by the Issuer. Such excess is sufficient to make up any shortfall resulting from the Pre-Funding Account earning less than the interest rate payable on the Securities. In certain of these transactions, this occurs because the aggregate principal amount of receivables exceeds the aggregate principal amount of Securities.

D. Pre-Funding Account and Capitalized Interest Account Payments and Investments

Pending the acquisition of additional receivables during the Pre-Funding Period, it is expected that amounts in the Pre-Funding Account and the Capitalized Interest Account will be invested in certain permitted investments or will be held uninvested. Pursuant to the Pooling and Servicing Agreement, all permitted investments must mature prior to the date the actual funds are needed. The permitted types of investments in the Pre-Funding Account and Capitalized Interest Account are investments which are either: (i) Direct obligations of, or obligations fully guaranteed as to timely payment of principal and interest by, the United States or any agency or instrumentality thereof, provided that such obligations are backed by the full faith and credit of the United States or (ii) have been rated (or the Obligor on the investment has been rated) in one of the three highest generic rating categories by Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies Inc., (S&P's), Moody's Investors Service, Inc. (Moody's), Duff & Phelps Credit Rating Co. (D&P), Fitch ICBA, Inc. (Fitch) or any successors thereto (each a Rating Agency or collectively, the Rating Agencies) as set forth in the Pooling and Servicing Agreement and as required by the Rating Agencies. The credit grade quality of the permitted investments is generally no lower than that of the Securities. The types of permitted investments will be described in the Pooling and Servicing Agreement.

The ordering of interest payments to be made from the Pre-Funding Account and Capitalized Interest Accounts is pre-established and set forth in the Pooling and Servicing Agreement. The only principal payments which will be made from the Pre-Funding Account are those made to acquire the receivables during the Pre-Funding Period and those distributed to the securityholders in the event that the entire amount in the Pre-Funding Account is not used to acquire receivables. The only principal payments which will be made from the Capitalized Interest Account are those made to securityholders if necessary to support the Security interest rate or those made to the Sponsor either periodically as they are no longer needed or at the end of the Pre-Funding Period when the Capitalized Interest Account is no longer necessary.

E. The Characteristics of the Receivables Transferred During the Pre-Funding Period

In order to ensure that there is sufficient specificity as to the representations and warranties of the Sponsor regarding the characteristics of the receivables to be transferred after the Closing Date during the Pre-Funding Period:

1. All such receivables will meet the same terms and conditions for eligibility as those of the original receivables used to create the Issuer (as described in the prospectus or private placement memorandum and/or Pooling and Servicing Agreement for such Securities), which terms and conditions have been approved by a Rating Agency. However, the terms and conditions for determining the eligibility of a receivable may be changed if such changes receive prior approval either by a majority vote of the outstanding securityholders or by a Rating Agency; [25]

2. The transfer of the receivables acquired during the Pre-Funding Period will not result in the Securities receiving a lower credit rating from the Rating Agency upon termination of the Pre-Funding Period than the rating that was obtained at the time of the initial issuance of the Securities by the Issuer;

3. The weighted average annual percentage interest rate (the average interest rate) for all of the receivables in the Issuer at the end of the Pre-Funding Period will not be more than 100 basis points (''bps'') lower than the average interest rate for the receivables which were transferred to the Issuer on the Closing Date;

4. The Trustee of the Trust (or any agent with which the Trustee contracts to provide trust services) will be a substantial financial institution or trust company experienced in Issuer activities and familiar with its duties, responsibilities and liabilities as a fiduciary under the Act. The Trustee, as the legal owner of the receivables in the Issuer or the holder of a security interest in the receivables, will enforce all the

[25] In some transactions, the Insurer and/or credit support provider may have the right to veto the inclusion of receivables, even if such receivables otherwise satisfy the underwriting criteria. This right usually takes the form of a requirement that the Sponsor obtain the consent of these parties before the receivables can be included in the Issuer. The Insurer and/or credit support provider may, therefore, reject certain receivables or require that the Sponsor establish certain Issuer reserve accounts as a condition of including these receivables. Virtually all Issuers which have Insurers or other credit support providers are structured to give such veto rights to these parties. The percentage of Issuers that have Insurers and/or credit support providers, and accordingly feature such veto rights, varies.

rights created in favor of securityholders of the Issuer, including employee benefit plans subject to the Act.

In order to ensure that the characteristics of the receivables actually acquired during the Pre-Funding Period are substantially similar to receivables that were acquired as of the Closing Date, the Applicant represents that for transactions occurring on or after May 23, 1997,[26] the characteristics of the subsequently acquired receivables will either be monitored by a credit support provider or other insurance provider which is independent of the Sponsor or an independent accountant retained by the Sponsor will provide the Sponsor with a letter (with copies provided to the Rating Agencies, the Underwriter and the Trustee) stating whether or not the characteristics of the additional receivables acquired after the Closing Date conform to the characteristics of the receivables described in the prospectus, private placement memorandum and/or Pooling and Servicing Agreement. In preparing such letter, the independent accountant will use the same type of procedures as were applicable to the receivables which were transferred as of the Closing Date.

Each prospectus, private placement memorandum and/or Pooling and Servicing Agreement will set forth the terms and conditions for eligibility of the receivables to be held by the Issuer as of the related Closing Date, as well as those to be acquired during the Pre-Funding Period, which terms and conditions will have been agreed to by the Rating Agencies which are rating the applicable Securities as of the Closing Date. Also included among these conditions is the requirement that the Trustee be given prior notice of the receivables to be transferred, along with such information concerning those receivables as may be requested. Each prospectus or private placement memorandum will describe the amount to be deposited in, and the mechanics of, the Pre-Funding Account and will describe the Pre-Funding Period for the Issuer.

F. Parties to Transactions

The originator of a receivable is the entity that initially lends money to a borrower (Obligor), such as a homeowner or automobile purchaser, or leases property to a lessee. The originator may either retain a receivable in its portfolio or sell it to a purchaser, such as a Sponsor.

[26] May 23, 1997, was the date the proposed 1997 Amendment to the Underwriter Exemption was published in the **Federal Register**.

Originators of receivables held by the Issuer will be entities that originate receivables in the ordinary course of their business including finance companies for whom such origination constitutes the bulk of their operations, financial institutions for whom such origination constitutes a substantial part of their operations, and any kind of manufacturer, merchant, or service enterprise for whom such origination is an incidental part of its operations. Each Issuer may hold assets of one or more originators. The originator of the receivables may also function as the Sponsor or Servicer.

The Sponsor will be one of three entities: (i) A special-purpose or other corporation unaffiliated with the Servicer, (ii) a special-purpose or other corporation affiliated with the Servicer, or (iii) the Servicer itself. Where the Sponsor is not also the Servicer, the Sponsor's role will generally be limited to acquiring the receivables to be held by the Issuer, establishing the Issuer, designating the Trustee, and assigning the receivables to the Issuer.

The Trustee of a Trust (or the Issuer, if it is not a Trust) is the legal owner of the obligations held by the Issuer and would hold a security interest in the collateral securing such obligations. The Trustee is also a party to or beneficiary of all the documents and instruments transferred to the Issuer, and as such, has both the authority to, and the responsibility for, enforcing all the rights created thereby in favor of securityholders, including those rights arising in the event of default by the servicer.

The Trustee will be an independent entity, and therefore will be unrelated to the Underwriter, the Sponsor or the Servicer or any other member of the Restricted Group. The Applicant represents that the Trustee will be a substantial financial institution or trust company experienced in trust activities. The Trustee receives a fee for its services, which will be paid by the Servicer, Sponsor or out of the Issuer's assets. The method of compensating the Trustee will be specified in the Pooling and Servicing Agreement and disclosed in the prospectus or private placement memorandum relating to the offering of the Securities.

The rights and obligations of the Indenture Trustee are no different than those of the Trustee of an Issuer which is a Trust. The Indenture Trustee is obligated to oversee and administer the activities of all of the ongoing parties to the transaction and possesses the authority to replace those entities, sue them, liquidate the collateral and perform all necessary acts to protect the interests of the debt holders. If debt is issued in a transaction, there may not be a pooling and servicing agreement. Instead, there is a sales agreement and servicing agreement (or these two agreements are sometimes combined into a single agreement). The agreement(s) set(s) forth, among other things, the duties and responsibilities of the parties to the transaction relating to the administration of the Issuer. The Indenture Trustee is often a party to these agreements. At a minimum, the Indenture Trustee acknowledges its rights and responsibilities in these agreements or they are contractually set forth in the indenture agreement pursuant to which the Indenture Trustee is appointed.

The Servicer of an Issuer administers the receivables on behalf of the securityholders. The Servicer's functions typically involve, among other things, notifying borrowers of amounts due on receivables, maintaining records of payments received on receivables and instituting foreclosure or similar proceedings in the event of default. In cases where a pool of receivables has been purchased from a number of different originators and transferred to an Issuer, it is common for the receivables to be ''subserviced'' by their respective originators and for a single entity to ''master service'' the pool of receivables on behalf of the owners of the related series of Securities. Where this arrangement is adopted, a receivable continues to be serviced from the perspective of the borrower by the local Subservicer, while the investor's perspective is that the entire pool of receivables is serviced by a single, central Master Servicer who collects payments from the local Subservicers and pays them to securityholders.

A Servicer's default is treated in the same manner whether or not the Issuer is a Trust. The original Servicer is replaced. The entity replacing the Servicer varies from transaction to transaction. In certain cases, it may be the Trustee (or Indenture Trustee if the Issuer is not a Trust) or may be a third party satisfactory to the Rating Agencies. In addition, there are transactions where the Trustee or Indenture Trustee will assume the Servicer's responsibilities on a temporary basis until the permanent replacement takes over. In all cases, the replacement entity must be capable of satisfying all of the duties and responsibilities of the original Servicer and must be an entity that is satisfactory to the Rating Agencies.

As noted above, the Underwriter Exemptions currently require that the Trustee not be an Affiliate of any

member of the Restricted Group. Thus, if a Servicer of receivables held by an Issuer which has issued Securities in reliance upon the Underwriter Exemptions (or an Affiliate thereof) merges with or is acquired by (or acquires) the Trustee of such Trust (or an Affiliate thereof), exemptive relief would cease to be available under the Underwriter Exemptions. The Applicant states that, as the result of legal constraints applicable to such merger and acquisition transactions (*e.g.,* confidentiality requirements), the entities involved in the transaction are unable before the transaction is consummated to cross check all relationships between the often numerous Affiliates of the entities involved in the transaction in order to determine whether or not any of the new affiliations resulting from the transaction will violate this non-affiliation condition of the Underwriter Exemptions. In response to this issue, the Department proposes to revise subsection II.A.(4) of the Underwriter Exemptions to provide that this condition will not be considered to be violated for transactions occurring on or after January 1, 1998, merely by reason of a Servicer becoming an Affiliate of the Trustee as the result of a merger or acquisition between or among the Trustee, such Servicer and/or their Affiliates which occurs after the initial issuance of the Securities, provided that: (i) Such Servicer ceases to be an Affiliate of the Trustee no later than six months after the later of August 23, 2000, or the date such Servicer became an Affiliate of the Trustee; and (ii) such Servicer did not breach any of its obligations under the Pooling and Servicing Agreement, unless such breach was immaterial and timely cured in accordance with the terms of such agreement, during the period from the closing date of such merger or acquisition transaction through the date the Servicer ceased to be an Affiliate of the Trustee. The Department proposes to make this revision retroactive to January 1, 1998 in response to the Applicant's representations that recent merger and acquisition transactions occurring within the financial services industry have resulted in an unknown but potentially significant number of inadvertent violations of this condition.

The Underwriter will be a registered broker-dealer that acts as Underwriter or placement agent with respect to the sale of Securities. Public offerings of Securities are generally made on a firm commitment or agency basis. Private placement of Securities may be made on a firm commitment or agency basis. It is anticipated that the lead or co-managing Underwriters will make a market in Securities offered to the public.

In some cases, the originator and Servicer of receivables to be held by an Issuer and the Sponsor of the Issuer (though they themselves may be related) will be unrelated to the Underwriter. In other cases however, Affiliates of the Underwriter may originate or service receivables held by an Issuer or may sponsor an Issuer.

G. Security Price, Interest Rate and Fees

In some cases, the Sponsor will obtain the receivables from various originators or other secondary market participants pursuant to existing contracts with such originators or other secondary market participants under which the Sponsor continually buys receivables. In other cases, the Sponsor will purchase the receivables at fair market value from the originator or a third party pursuant to a purchase and sale agreement related to the specific offering of Securities. In other cases, the Sponsor will originate the receivables itself.

As compensation for the receivables transferred to the Issuer, the Sponsor receives Securities representing the entire beneficial interest in the Issuer and/or debt Securities representing the Issuer's obligations to debt securityholders, or the cash proceeds of the sale of such Securities. If the Sponsor receives Securities from the Issuer, the Sponsor sells some or all of these Securities for cash to investors or securities underwriters.

The price of the Securities, both in the initial offering and in the secondary market, is affected by market forces including investor demand, the interest rate payable on the Securities in relation to the rate payable on investments of similar types and quality, expectations as to the effect on yield resulting from prepayment of the underlying receivables, and expectations as to the likelihood of timely payment.

The interest rate payable on the Securities is equal to the interest rate on receivables included in the Issuer minus a specified servicing fee.[27] This rate is generally determined by the same market forces that determine the price of a Security. The price of a Security and its interest, or coupon, rate, together determine the yield to investors. If an investor purchases a Security at less than par, that discount augments the stated interest rate; conversely, a Security purchased at a premium yields less than the stated coupon.

As compensation for performing its servicing duties, the Servicer (who may also be the Sponsor or an Affiliate thereof, and receive fees for acting as Sponsor) will retain the difference between payments received on the receivables held by the Issuer and payments (payable at the interest rate) to securityholders, except that in some cases a portion of the payments on the receivables may be paid to a third party, such as a fee paid to a provider of credit support. The Servicer may receive additional compensation by having the use of the amounts paid on the receivables between the time they are received by the Servicer and the time they are due to the Issuer (which time is set forth in the Pooling and Servicing Agreement). The Servicer typically will be required to pay the administrative expenses of servicing the Issuer, including in some cases the Trustee's fee, out of its servicing compensation.

The Servicer is also compensated to the extent it may provide credit enhancement to the Issuer or otherwise arrange to obtain credit support from another party. This ''credit support fee'' may be aggregated with other servicing fees, and is either paid out of the income received on the receivables in the Issuer in excess of the interest rate or paid in a lump sum at the time the Issuer is established.

The Servicer may be entitled to retain certain administrative fees paid by a third party, usually the Obligor. These administrative fees fall into three categories: (a) Prepayment fees; (b) late payment and payment extension fees; and (c) expenses, fees and charges associated with foreclosure or repossession, or other conversion of a secured position into cash proceeds, upon default of an obligation.

Compensation payable to the Servicer will be set forth or referred to in the Pooling and Servicing Agreement and described in reasonable detail in the prospectus or private placement memorandum relating to the Securities.

Payments on receivables held by the Issuer may be made by Obligors to the Servicer at various times during the period preceding any date on which interest payments to the Issuer are due. In some cases, the Pooling and Servicing Agreement may permit the Servicer to place these payments in non-interest bearing accounts in itself or to commingle such payments with its own funds prior to the distribution dates. In these cases, the Servicer would be entitled to the benefit derived from the use of the funds between the date of payment on a receivable and the

[27] The interest rate payable on Securities representing interests in Issuers holding leases is determined by breaking down lease payments into ''principal'' and ''interest'' components based on an implicit interest rate.

payment date on the Securities. Commingled payments may not be protected from the creditors of the Servicer in the event of the Servicer's bankruptcy or receivership. In those instances when payments from receivables are held in non-interest bearing accounts or are commingled with the Servicer's own funds, the Servicer is required to deposit these payments by a date specified in the Pooling and Servicing Agreement into an account from which the Issuer makes payments to securityholders.

The Underwriter will receive a fee in connection with the underwriting or private placement of Securities. In a firm commitment underwriting, this fee would normally consist of the difference between what the Underwriter receives for the Securities that it distributes and what it pays the Sponsor for those Securities. In a private placement, the fee normally takes the form of an agency commission paid by the Sponsor. In a best efforts underwriting in which the Underwriter would sell Securities in a public offering on an agency basis, the Underwriter would receive an agency commission rather than a fee based on the difference between the price at which the Securities are sold to the public and what it pays the Sponsor. In some private placements, the Underwriter may buy Securities as principal, in which case its compensation would be the difference between what the Underwriter receives for the Securities and what it pays the Sponsor for these Securities.

H. Purchase of Receivables by the Servicer

The Applicant represents that as the principal amount of the receivables held by an Issuer is reduced by payments, the cost of administering the Issuer generally increases, making the servicing of the receivables prohibitively expensive at some point. Consequently, the Pooling and Servicing Agreement generally provides that the Servicer may purchase the receivables remaining in the Issuer when the aggregate unpaid balance payable on the receivables is reduced to a specified percentage (usually between 5 and 10 percent) of the initial aggregate unpaid balance.

The purchase price of a receivable is specified in the Pooling and Servicing Agreement and will be at least equal to either: (1) The unpaid principal balance on the receivable plus accrued interest, less any unreimbursed advances of principal made by the Servicer, or (2) the greater of the amount in (1) or (b) the fair market value of such obligations in the case of a REMIC, or the fair market value of the receivables in the case of an Issuer which is not a REMIC.

V. Requested Modifications for Motor Vehicles, Residential/Home Equity, Manufactured Housing and Commercial Mortgage-Backed Securities Transactions

A. The Applicant's Request

The Applicant requests an amendment to the 1997 Amendment to provide relief for the offering of investment-grade mortgage-backed securities (MBS) and asset-backed securities (ABS) which are either senior or subordinated, and/or in certain cases, permit the Issuer to hold receivables with loan-to-value property ratios (LTV ratios) in excess of 100%. Specifically, this request relates to Securities issued by Issuers for a limited number of asset categories: (1) Automobile and other motor vehicle ABS which are senior or subordinated securities rated ''AAA,'' ''AA,'' ''A'' or ''BBB''; (2) residential and home equity ABS/MBS with senior or subordinated securities rated either ''AAA,'' ''AA,'' ''A'' or ''BBB,'' which are issued by Issuers whose assets may include mortgage loans with LTV ratios in excess of 100%; (3) manufactured housing ABS/MBS with senior or subordinated securities rated either ''AAA,'' ''AA,'' ''A'' or ''BBB'' and (4) commercial mortgage-backed securities (CMBS) which are senior or subordinated securities rated ''AAA,'' ''AA,'' ''A'' or ''BBB.''

The Applicant requests that the Department include high LTV loans as acceptable assets of the Issuer only in residential and/or home equity transactions, as long as such loans are secured by collateral whose fair market value on the Closing Date of the securitization transaction is at least equal to 80% of the sum of the outstanding principal balance due under the loan which is held as an asset of the Issuer and that of other loans if any, of higher priority (whether or not held by the Issuer) which are secured by the same collateral. This modification would also address the situation where a residential or home equity pool of assets contains a de minimis number of undercollateralized loans. According to TBMA, a pool could have, for example, 400 loans, 399 of which are fully secured and one of which is 99% secured, but the transaction would not qualify for the Underwriter Exemptions. The situation cannot always be cured by removing even a small number of loans from the pool because replacement loans may not be available by closing, and pre-funding may not be feasible. The Applicant has suggested as additional safeguards, that: (i) the rights and interests evidenced by the Securities issued in such Designated Transactions involving residential and/or home equity transactions with high LTV loans are not subordinated to the rights and interests evidenced by Securities of the same Issuer, and (ii) such Securities acquired by the plan have received a rating from a Rating Agency at the time of such acquisition that is in one of the two highest generic rating categories.

The Applicant believes that it is appropriate for the Department to provide relief for Designated Transactions for three principal reasons.

First, such ABS/MBS have proven to be extremely safe investments with superior credit performance and investment return. Defaults on investment-grade ABS/MBS have occurred in only isolated instances, despite significant down-market cycles experienced during the financial history of such securities. In addition, comparably rated corporate bonds have historically experienced more downgrades and a much greater number of defaults. Even during extreme credit market conditions, such as those of the late summer and early fall of 1998 which put severe cash flow stress on securitization Sponsors, ABS/MBS securitization structures maintained their integrity and continued to perform in accordance with their terms.

Second, allowing a broader range of ABS/MBS to be purchased by plan investors as an alternative to corporate bonds is beneficial to plan participants and their beneficiaries because it allows greater diversification of investments by plans without sacrificing the safety and credit quality of those investments. It also gives plan investors the flexibility of being able to structure a portfolio of fixed income securities with varying maturities and cash flow characteristics that can be tailored to the unique requirements of each plan.

Third, most ABS/MBS, unlike corporate bonds whose performance is dependent on the financial condition of one Obligor, constitute interests in a discrete pool of financial assets which can be evaluated by plan fiduciaries who have available to them a large body of historical data as to the performance of various types of ABS/MBS issued by many different issuers. Fiduciaries are also able to monitor the performance of the pool of assets supporting payments on the ABS/MBS on a contemporaneous basis, as investors are given monthly reports on collections, account balances, credit support levels and the status of the receivables. All of these points are discussed in greater detail below.

B. Reliance on Ratings

1. Background

The Applicant notes that when the Underwriter Exemptions originally were applied for in the mid-1980s, public and private offerings of ABS and MBS by private sector originators had only recently been introduced in the United States capital markets. The Applicant states that the Department, in granting exemptive relief under the original Underwriter Exemptions, was cognitive of the relative infancy of private sector ABS/MBS transactions when it originally considered the extent to which reliance should be placed on the determinations of the Rating Agencies in establishing the boundaries of exemptive relief. For example, in the Notice of Proposed Exemption relating to Application D–6555 made by First Boston Corporation, 53 FR 52851 at 52857 (December 29, 1988) the Department stated:

> After consideration of the representations of the applicant and the information provided by S&P's, Moody's and D&P, the Department has decided to condition exemptive relief upon the certificates in which a plan invests having attained a rating in one of the three highest generic rating categories from S&P's, Moody's or, in the case of certificates representing interests in trust containing multi-family residential mortgages or commercial mortgages, D&P.
>
> The Department believes that the rating condition will permit the applicant flexibility in structuring trusts containing a variety of mortgages and other receivables, while ensuring that the interests of plans holding certificates are adequately protected. In particular, in rating certificates, S&P's, Moody's and D&P take into account such factors as commingling of funds and conflicts of interest of the trust sponsor and servicer.
>
> However, the Department is not prepared to rely solely on determinations made by these rating agencies in providing exemptive relief. In this regard, the applicant originally requested that exemptive relief apply to trusts containing any type of receivable—secured or unsecured—provided that the rating condition is met.
>
> The Department is not prepared at this time to grant such broad exemptive relief. The Department believes that the rating agencies currently have more expertise in rating certificates representing interests in secured, as opposed to unsecured, receivable trusts. Consequently, the Department believes that the ratings are more indicative of the relative safety of the investment when applied to trusts containing secured receivables.
>
> Moreover, First Boston has represented that trusts containing different types of receivables are continuously being developed and rated. While the Department would generally prefer to be more specific as to the types of assets contained in the trusts, the Department recognizes the applicant's need for flexibility. At the same time, the Department believes that it is appropriate to ensure that the rating agencies have developed expertise in rating a particular type of asset-backed security and that such security has been tested in the marketplace prior to plan investment pursuant to this exemption. Consequently, the Department has further conditioned the proposed exemptive relief upon each particular type of asset-backed security having been rated in one of the three highest rating categories for at least one year and having been sold to investors other than plans for at least one year.

2. Rating Agency Expertise

The Applicant asserts that since the time of the First Boston Corporation application, the Rating Agencies have developed an enormous depth of experience in rating ABS/MBS due to the extensive growth of these markets. Since that time, investment-grade ratings have been assigned to a broad range of asset classes and transaction structures in the ABS/MBS markets. The Applicant notes that those ratings, and the credit quality of underlying collateral, have been the subject of continuing surveillance and active scrutiny by the Rating Agencies and that the historical performance record of these offerings clearly demonstrates that the Rating Agencies have developed the expertise necessary for the Department to conclude that ratings are extremely reliable indicators of the relative safety of the securities and the transactions with respect to which exemptive relief is requested.

3. Growth in the ABS/MBS Markets

According to the Applicant, ABS/MBS now constitute a major segment of the fixed-income marketplace. This growth, which is manifested in a rapid increase in issuance levels and the continuing entry and acceptance of new issuers, asset types and transaction structures into the market, has generated an accompanying growth in market depth, liquidity and efficiency.

The first pass-through security was issued in 1970, with a guarantee by Ginnie Mae. Soon, Freddie Mac and Fannie Mae began issuing mortgage securities as well. The development of the collateralized mortgage obligation (CMO) in 1983 expanded the market for mortgage securities by establishing a product appealing to a broad range of investors with various investment time frames and cash-flow needs. As a result of tremendous growth in the primary housing credit market and an increasing level of investor interest and comfort in these investments, the mortgage securities market is now one of the largest financial markets in the world. Total volume of outstanding agency mortgage securities exceeded $2.0 trillion at the end of 1998, as compared to the $372.1 billion outstanding level at year-end 1985. New issuance of agency pass-throughs totaled $726.9 billion in 1998, while agency CMO issuance reached $225.1 billion for the year. This compares to the $111.1 billion in agency pass-throughs issued in 1985. Private label CMO issuance was $135 billion in 1998. In contrast, total issuance in the corporate bond market was $678 billion in 1998.

Asset-backed securities constitute a relatively newer but fast-growing segment of the debt markets. The first ABS were issued in 1985, with the new issue dollar volume reaching $1.2 billion in that year. In comparison, $197.6 billion in ABS were issued in 1998, while the outstanding level of ABS was an estimated $630 billion at the end of the year. The ABS market has grown dramatically since its inception in the mid-1980s and has become a basic financing mechanism in the debt capital markets, with rapid domestic and international growth. Strong investor demand and the diversity of securities available have helped to fuel the growth in the ABS market.

The home equity, credit card and auto loan sectors are the mainstays of the ABS market. However, the strength in home equity-backed issuance has been the driving force behind the growth in ABS issuance in the past few years. This sector maintained its dominance in 1998, with volume representing 41.9% of total issuance in the period. Issuance in the home equity sector totaled $82.8 billion in 1998, a 28.7% increase over the $64.4 billion sold in 1997. Issuance in the credit card sector was relatively flat in 1998, with volume totaling $37.1 billion, essentially unchanged from 1997's $37.5 billion. Auto loan ABS issuance rose by 6.0% in 1998, totaling $35.1 billion, as compared to the $33.1 billion issued in 1997.

Commercial mortgage-backed securities (CMBS) issuance has grown sharply in recent years. Approximately 20% of all real estate debt is now securitized and held in the hands of investors in the form of CMBS. Standardization of loan structures, growing investor acceptance and the changing regulatory environment have all contributed to the market's growth. Issuance in the CMBS market increased by more than tenfold over the past eight years. CMBS issuance jumped sharply in 1998 with volume increasing to a record $78.3 billion in 1998, a 78.0% increase over the $44.3 billion reported in 1997 and 162.8% greater than the $29.8 billion issued in 1996. In

comparison, CMBS issuance totaled just $6.0 billion in 1990.

4. Congressional and Agency Reliance on Ratings

The Applicant states that Congress and governmental regulatory agencies rely on the efficacy of the rating process for many purposes. The United States Securities and Exchange Commission (the ''SEC'') has relied frequently on ratings assigned by a ''nationally recognized statistical rating organization'' (NRSRO). Two prime reasons that the ABS/MBS market has grown dramatically over the past five years are the ability to offer investment-grade asset-backed securities to the public on a shelf registration statement and changes to the Investment Company Act of 1940. With a shelf registration, the SEC review and comment period occurs prior to effectiveness of the registration statement. Thereafter, an issuer can sell securities on an expedited basis. No additional SEC review is necessary. However, each security offered on a shelf must be rated by at least one NRSRO in one of its four highest generic rating categories. The Investment Company Act of 1940 was a major impediment in developing the ABS/MBS markets. Absent an exemption, substantially all of the Trusts and other vehicles issuing ABS would be required to register as an ''investment company'' under this Act. Congress and the SEC realized that the securitization markets could not function as regulated investment companies. As a result, Rule 3a–7 under the Investment Company Act was enacted in 1992. If the conditions of this rule are satisfied, an issuer of ABS/MBS is not deemed to be an investment company. One requirement of the rule is that any security sold to investors (other than accredited investors or qualified institutional buyers) be rated, at the time of sale, in one of the four highest generic categories by at least one NRSRO.

5. Securities Ratings

The Securities in transactions which are not Designated Transactions (as described below) will have received one of the three highest generic ratings available from a Rating Agency. Insurance or other credit support (such as surety bonds, letters of credit, guarantees or overcollateralization) will be obtained by the Sponsor to the extent necessary for the Securities to attain the desired rating. The amount of this credit support is set by the Rating Agencies at a level that is typically a multiple of the worst historical net credit loss experience for the types of obligations included in the Issuer.

6. The Rating Process

Ratings on a class of Securities are an evaluation by the Rating Agency of the credit, structural and legal risks of a transaction, which is made to help predict the probability of an investor receiving timely payment of interest and payment of principal by the maturity date of the Securities. Ratings generally do not address risks arising from interest rate fluctuations or prepayments of the underlying obligations by borrowers. In order to make their assessment of a class of Securities, the Rating Agencies perform sophisticated analyses of the predicted frequency and severity of losses on the pool of obligations by conducting extensive investigative due diligence reviews of both the originator and assets to be securitized, sampling the asset pool or performing a review of the entire asset pool, comparing the expected performance of that particular pool against historical performance of pools containing similar assets (either from the same originator or based upon industry standards) and making determinations of the adequate levels of credit enhancement required to support each rating level. For all investment-grade ratings, including ''BBB,'' the credit support levels are set to require the transaction to withstand not just expected losses on the pool of assets but a multiple of such projected losses (or, in some cases, a more severe economic default model). Regression analysis is continually performed whereby the Rating Agencies determine how factors such as LTV ratios, geographic diversity, strength of borrower's credit history, type of loan and other factors correlate positively or negatively with both loss frequency and severity in order to predict how a pool will perform. The particular asset type is of primary importance in determining the nature and scope of the diligence review. Also, the type of asset will determine the type of legal and structural safeguards that must be implemented to safeguard the interests of the related securityholders and permit the issuance of the applicable rating.

The Rating Agencies differ slightly in what they consider their ratings to represent. Specifically, Moody's ratings express an opinion of the amount by which the internal rate of return in a diversified portfolio of similarly rated Securities would be reduced as a result of defaults on the Securities. For example, ''Aaa'' rated Securities held to maturity without any changes in rating are expected to suffer a reduction in realized yield over a ten-year period of less than one basis point (*i.e.*, 1/100th of a percent); 1–3 bps for an ''Aa'' rating; 5–13 bps for an ''A'' rating; 20–50 bps for a ''Baa'' rating; 75–150 bps for a ''Ba'' rating and 175–325 bps for a ''B'' rating. Accordingly, the expected reduction in yield for all investment-grade Securities, whether or not subordinated, is 0.5% or less, and as indicated below, for Securities has turned out to be virtually zero. The ratings of the three other Rating Agencies express an opinion on the probability that no losses will be experienced on the Securities in different rating categories. However, any slight differences in the technical meaning of a rating are not considered to be of any material significance in the capital markets.

The rating process generally rates to the ''weakest link'' in that if credit support is provided for by a third party, the rating given to the Securities cannot exceed that of the credit support provider. In addition, the Rating Agencies may also require minimum credit ratings of other parties to the transactions such as the Servicer, back-up Servicers and pool Insurers and, at a minimum, the credit strength of such parties is factored into the analysis of the pool when projecting losses.

7. Reasons to Extend Relief to Subordinated ABS/MBS and High LTV Receivables

As support for the requested modifications, the Applicant notes that the Department already has permitted securities with ratings of ''A'' or better to be eligible for relief under the Underwriter Exemptions, although, in particular transactions, the credit quality of the borrowers who are obligated on the loans held as Trust assets may be less than A.[28] Many securities issued in securitization transactions receive ''AAA'' ratings even if the borrowers on the loans have B and C credit. This risk is addressed by requiring greater credit support using conservative stress tests.

The Applicant asserts that subordinated securities and higher LTV ratio collateral for transactions in those rating and asset categories already approved by the Department would be equally as protective of plan investors as those transactions currently permitted with non-subordinated and lower LTV ratios. Granting this relief would also address the anomaly which now exists

[28] The applicant notes that borrowers are frequently categorized by originators as being of A, B, C or D credit quality, although other designations may be used.

where an ''A'' rated senior security is currently eligible for exemptive relief, but an ''AAA'' rated subordinated security or a senior security issued by a Trust with less than fully secured loans is not. While this anomaly developed because of the Department's concerns as to whether the Rating Agencies had the requisite experience to rate certain types of ABS/MBS, the market has developed to a point where this distinction is no longer necessary to protect plan investors. The ratings quantify the credit risk of a transaction at various rating levels, and any deficiencies in the credit quality of the assets, the credit of the borrowers, the strength of the parties to the transaction or the structure are factored into the credit support requirements, with the result that every rating of the same letter designation represents the same credit quality of a security without regard to the particular features of any single transaction. In this regard, at the request of the Department, the Applicant has provided letters from the Rating Agencies confirming their view to this effect.

The Applicant states that the need for flexibility is nowhere better exemplified than in the inclusion of subordinated securities in the type of securities eligible for exemptive relief. Transactions in the 1980s typically did not feature investment-grade subordinated securities. In contrast, the market has now evolved to the point where ABS/MBS offerings typically include multiple tranches of senior and subordinated investment-grade securities. In common market terminology, in transactions where there are two or more subordinated classes of securities, ''AAA'' rated ABS/MBS classes are described as ''senior'' classes, ''AA'' through ''BBB'' subordinated classes are described as ''mezzanine'' classes, and sub-investment-grade classes are described as ''subordinated'' classes. In other transactions, the ''AAA'' and ''AA'' classes may be referred to as senior, and the ''BBB'' class or classes may be referred to as either mezzanine or subordinated, depending on the number of classes and the structure. In contrast, under the current Underwriter Exemptions, all classes of ABS/MBS below the most senior ''AAA'' class are regarded as subordinated.

The Applicant believes that Rating Agencies can rate subordinated classes of securities with a high level of expertise, thereby ensuring the safety of these investments for plans through the use of other credit support (including increased levels of non-investment-grade securities). The subordination of a security, while factored into the evaluation made by the Rating Agencies in their assessment of credit risk, is not indicative of whether a security is more or less safe for investors. In fact, there are ''AAA'' rated subordinated securities.[29] Subordination is simply another form of credit support. The Rating Agencies, after determining the level of credit support required to achieve a given rating level, are essentially indifferent as to how these credit support requirements are implemented—whether through subordination or other means. If subordination is used, however, the subordinated class will have no greater credit risks or fewer legal protections in comparison with other credit-supported classes that possesses the same rating.

According to the Applicant, there is much benefit to plan investors in having subordinated securities eligible for exemptive relief. First, credit support provided through third-party credit providers is more expensive than an equal amount of credit support provided through subordination. As a result, the ability to use subordinated tranches to provide credit support for the more senior classes (which may or may not themselves be subordinated) creates economic savings for all the parties to the transaction which, in turn, can allow greater returns to investors. In addition, if the credit rating of a third-party credit support provider is downgraded, the rating of the securities is also downgraded. Second, the yields available on subordinated securities are often higher than those paid on comparably rated non-subordinated securities because investors expect to receive higher returns for subordinated securities. Third, subordinated securities are usually paid after other more senior securities, which results in their having longer terms to maturity. This is appealing to many investors who are looking for medium-term fixed income investments to diversify their portfolios. The combination of these factors benefits investors by making available securities which can provide higher yields for longer periods. It should be noted that as the rating of a security generally addresses the probability of all interest being timely paid and all principal being paid by maturity under various stress scenarios, the Rating Agencies are particularly concerned with the ability of the pool to generate sufficient cash flow to pay all amounts due on subordinated tranches, and several features of the credit support mechanisms discussed below are designed to protect subordinated classes of securities.

8. Performance of Investment-Grade ABS/MBS

The Applicant asserts that the arguments articulated for the safety of subordinated securities or securities issued by entities holding loans with high LTV ratios are supported by the statistics. Ratings have proven to be a remarkably accurate prognosticator of the probability of default on ABS/MBS and also support the appropriateness of extending exemptive relief to ''BBB'' rated securities. Accompanying the tremendous growth of the asset-backed and mortgage-backed markets has been a stellar record of repayment of principal and interest. After extensive investigative efforts and interviews with Rating Agencies, bond insurance companies and the TBMA dealer membership, the Applicant has concluded that, to the best of its knowledge, there have been only isolated instances of defaults on any investment-grade ABS/MBS.

During the three-year period from 1995–1997, 139 corporate issues representing $22 billion in corporate bonds defaulted. Yet, corporate bonds may be purchased by benefit plan investors without triggering prohibited transactions pursuant to a number of prohibited transaction class exemptions based on the identity of the plan investor or the fiduciary making the investment decision on behalf of the plan (''Investor-Based Exemptions'').[30] Equity investments in any type of corporate stocks (which can be highly speculative and have certainly experienced significant losses) are also not restricted by the prohibited transaction rules because of the operating company exception under the Plan Asset Regulation, set forth at 29 CFR § 2510–3.101(c). Similarly, plans can invest in a commercial mortgage loan, yet may not be able to invest in any investment-grade collateralized MBS which carries far less credit risk. In addition, while there have been rating downgrades of ABS/MBS, the ABS/MBS downgrade statistics are vastly superior to the comparable statistics for corporate debt instruments.

[29] For example, a transaction may have two classes of ''AAA'' rated securities and one is subordinated to the other. The subordinated class would be required to have more credit support to qualify for the ''AAA'' rating than the more senior ''AAA'' rated class.

[30] These exemptions include (a) PTE 84–14, regarding transactions negotiated by qualified professional asset managers; (b) PTE 90–1, regarding investments by insurance company pooled separate accounts; (c) PTE 91–38, regarding investments by bank collective investment funds; (d) PTE 95–60, regarding investments by insurance company general accounts; and (e) PTE 96–23, regarding investments determined by in-house asset managers.

The Applicant states that the purpose in drawing these comparisons is not to suggest that corporate bonds, commercial mortgage loans or any other instruments are unsafe plan investments. Rather, the point is that investment-grade ABS/MBS are equally as safe, if not safer, investments than other alternatives presently available to plans under various existing exemptions.

The Applicant believes that investment-grade ABS/MBS are an attractive investment alternative to plan fiduciaries. This is because in most ABS/MBS transactions, credit risk is spread across many Obligors instead of just one corporate borrower as would be the case with the issuance of a corporate bond. At least one reason for this is that if the Obligor on a corporate bond defaults, the bond holder will not be paid in full, whereas in a securitization, even if a number of the underlying obligations go into default, the holder of an investment-grade security is still likely to receive payment because of the size of the asset pool and/or credit support features of the transaction. In addition, the returns on ABS/MBS are generally higher than those paid on corporate debt instruments in comparable rating categories in order to compensate investors for prepayment risk (*i.e.*, the risk that an investor may receive a return of the principal it invested earlier than anticipated).

The Applicant believes that allowing a greater proportion of ABS/MBS to be eligible for relief under the Underwriter Exemptions is of considerable benefit to plan participants and their beneficiaries because it increases the access plans have to fixed income investments with high credit quality as an alternative to corporate bonds and other forms of investments. Plan fiduciaries have available to them a significant amount of statistical data as to the historical performance of ABS/MBS by asset type, investment rating and originator which can assist them in evaluating the pool of assets being securitized. Plan investors are also able to contemporaneously monitor the performance of ABS/MBS because they are provided periodic reports in which they receive, in general, the following information: the amount of principal and source of principal (*e.g.*, from regular loan principal payments, prepayments or reserve accounts), the amount of interest, the status of the payments on the underlying mortgages (*e.g.*, are any 30, 60 or 90 days in arrears) and the status of the credit support (*e.g.*, overcollateralization levels and reserve account balances).

C. Description of Rating Agencies' Due Diligence With Respect to Parties Involved in Transactions

The Applicant states that the due diligence performed by the Rating Agencies with respect to the parties to the transaction, such as the Sponsor, Servicer, Trustee and Insurer, and their requirements regarding these parties which are described below, are generally common to all securitizations.

1. The Sponsor

The Rating Agencies do not have minimum credit rating requirements for the Sponsor if it is not also acting as a Servicer because its assets are not subject to the claims of the Issuer. However, the Rating Agencies do apply a factor to the expected loss estimate for a pool of mortgages or other assets based upon the quality of the Sponsor, and they evaluate the Sponsor's underwriting standards and operations in order to determine the general financial stability of the Sponsor. Such an evaluation provides an indication of the credit quality of the assets being securitized. An on-site investigation may be made, including meetings with management. This will generally include a review of the operations, policies and procedures of the Sponsor, including the quality and completeness of loan documentation. For example, the historic and current lending criteria of the Sponsor, including the Sponsor's policies regarding allowing extensions of payment schedules, renegotiating contracts, granting grace or cure periods and loan liquidation procedures, will be reviewed. Its manner of competing in the market for borrowers is also examined (*e.g.*, to see whether borrowers are sought without conducting adequate review of their finances and whether the Sponsor has adequate capital to support a growing loan portfolio and its access to bank financing or other sources of liquidity). Historic delinquency rates with respect to the Sponsor's receivables will generally also be examined, as will the underwriting standards of the Sponsor (*i.e.*, evaluating the credit of potential borrowers within stated lending guidelines and the use of credit checks). If such guidelines are applied consistently, the Sponsor's historical record may be helpful in predicting future performance of the loan portfolios. The information presented by the Sponsor will also be evaluated in order to determine the overall stability of the Sponsor, including its historic and expected financial performance, its organizational strengths and weaknesses and its competitive position. The importance of the financial stability of the Sponsor in determining the overall rating of the securitization transaction will depend on determination of the correlation between the performance of the receivables and any fundamental risks inherent in the Sponsor's business operations. The process by which the receivables are chosen for a transaction is also reviewed in order to ensure that the pool represents either a random sampling or quality-oriented sampling of the Sponsor's receivables and not predominately lower-quality receivables.

2. The Servicer

(a) Review of Servicer's Operations—The Servicer is required to service the receivables held by an Issuer. The Rating Agencies, therefore, perform a thorough evaluation of the Servicer as part of their evaluation of the general credit risk of a particular transaction. A complete review of the Servicer is conducted beginning with its formation. If it has been in business for less than three to five years or has shown weak portfolio performance, bond insurance for the Securities offered may be required providing full coverage against borrower defaults. The management of the Servicer is reviewed to assess the experience, character and integrity of management. The Rating Agencies will also conduct a review of the Servicer's operations and capabilities, such as the degree to which the recordkeeping and collection process is automated, the internal audit and review systems, capacity constraints, fraud prevention procedures and collection methods. The evaluation of the Servicer usually involves an on-site visit, including a meeting with management to discuss procedures, methodology, past history and future financial outlook. High-quality servicing provides investor protection which is required in order for a high rating of the Securities and, conversely, low-quality servicing could lower a rating.

(b) Collection and Handling of Funds—The Servicer will usually be in the asset servicing business and may, therefore, have responsibility for the assets of many securitization transactions. Often operating efficiencies require that payments be made to one source and then be allocated to the individual Issuers. This central collection feature causes short-term commingling of assets. Accordingly, unless the Servicer is highly rated, the Rating Agencies will require the servicer to transfer all collections it receives in the course of its acting as a servicer for different issuers to segregated accounts for each

issuer which are held at highly rated banks within two to three days of receipt. The Rating Agencies also examine the effect that bankruptcy or other insolvency would have on the Servicer's ability to service the loans or advance funds to pay securityholders or pay other required fees.

(c) Payment Support Features—As part of its servicing responsibilities, the Servicer may also be required to provide two payment support features to the securityholders. The first is a liquidity facility or monthly advance requirement, and the second is a ''compensating interest'' feature. The overall credit quality of the Servicer affects the Servicer's ability to perform these functions. Accordingly, if a Servicer provides financial support, the Rating Agencies prefer that such Servicer have a rating which is not lower than the rating to be assigned to the Securities. If the Servicer's rating is lower, additional protections may be required, such as requiring the Servicer to obtain a surety bond, letter of credit or other rated credit support for its financial support.

(i) Servicer Advances—Where advancing is required, the Servicer is generally required to advance funds to the Issuer in an amount equal to delinquent payments of interest and, in some transactions principal, to the extent that the Servicer believes that these amounts may be recovered from subsequent payments and collections. If an Obligor is late in making payments, the Servicer will advance the funds to the Issuer. The Servicer is entitled to a return of these funds from future collections. The Servicer is essentially making an interest-free loan to the Issuer, but it is the Issuer that bears the ultimate risk of loss. An alternative to Servicer advancing is an advance claims payment provision. An advance claims payment provision is an insurance policy that guarantees timeliness of payments to the securityholders. In addition, the Rating Agencies require errors and omissions insurance in at least the amount of the maximum cash balance anticipated to be in the Issuer's accounts held by the Servicer, Issuer, paying agent or other agent covering potential losses arising from errors and omissions of officers, directors and employees of such transaction participants to the extent they have access to Issuer funds.

(ii) Servicer Compensating Interest—When an Obligor on a mortgage loan or other prepayable asset makes a prepayment (either full or partial) on the obligation, interest is only required to be paid that month up until the date of the prepayment, but the securityholder is entitled to a full month's interest on that loan. The Servicer may be required to fund the difference between a full month's interest on such prepaid loan and the interest actually received from the Obligor. The Servicer is generally only required to make such compensating interest payments in amounts that will not exceed its servicing compensation for that month.

(d) Successor Servicers and Subservicers—Transaction documents will provide for the appointment of a successor Servicer if the original Servicer is deemed unable to perform its required duties. Typically, a Trustee with an acceptable rating may act as a back-up Servicer by assuming an obligation to perform the servicing function in the event of a default by the Servicer. However, a Servicer is not permitted to resign voluntarily until a replacement is appointed. Servicing compensation is also set at a level so that a successor Servicer will be adequately compensated for assuming such servicing responsibilities. Transaction documentation may also allow the Servicer to subcontract some or all of its servicing obligations to qualified Subservicers. While these Subservicers may perform the actual servicing work on a selected portion of the pool of assets, the Servicer remains responsible for the ultimate performance of the servicing activities and is liable for any failure to adequately perform the required servicing duties.

Prior to the transfer of servicing responsibilities to a successor Servicer and prior to a merger or consolidation affecting the Servicer, the parties to the transaction must obtain the Rating Agency's written confirmation that the rating of the rated Securities in effect immediately prior to the transfer of servicing responsibilities will not be qualified, downgraded or withdrawn as a result of such resignation, merger or other transfer. Typically, a Servicer may voluntarily resign only upon a determination that the performance of its servicing duties under the servicing agreement is no longer permissible under applicable law and appointment by the Trustee or securityholders of, and acceptance by, a successor Servicer. A Servicer may be forced to resign by the Trustee or securityholders if the continuation of the Servicer's servicing responsibilities would result in the qualification, downgrade or withdrawal of the rating assigned to the Securities or in the event of a default of the Servicer's obligations under the Pooling and Servicing Agreement.

(e) Reports to Investors—The Servicer will be responsible for preparing periodic reports on the performance of the pool of assets containing such information as: beginning principal balance, ending principal balance, the allocation of payments received between interest and principal, scheduled principal payments, prepayments received, delinquencies and status of various categories of delinquent accounts (e.g., number of accounts 30–59 days, 60–89 days and 90 or more days delinquent), defaults, foreclosures, if any, and other relevant information for the related Trustee. The Trustee will utilize this data in preparing the reports to securityholders.

3. The Trustee

The Trustee is also examined by the Rating Agencies to ensure that credit problems of the Trustee do not affect the Issuer. Monies received by the Issuer from the Servicer must be immediately deposited into segregated accounts earmarked for the Issuer so that no commingling occurs in the hands of the Trustee. If these funds are to be invested, they only may be invested in instruments that have been rated at a level specified by the Rating Agency as acceptable for the rating given to such Securities (a ''Rating Condition''). Transaction documentation will specify a list of permitted investments acceptable to the applicable Rating Agencies. Typical examples of permitted investments include the following: (a) Direct obligations or obligations guaranteed by the United States or an agency or instrumentality thereof; (b) demand or time deposits, federal funds or bankers' acceptances issued by banks or trust companies that are subject to federal and/or state banking authorities (subject to the Rating Condition or FDIC insurance); (c) repurchase obligations with respect to (a) and (b) above; (d) discount or interest-bearing Securities issued by United States corporations that meet the applicable Rating Condition; (e) commercial paper meeting the applicable Rating Condition; and (f) money market funds or common trust funds that meet the applicable Rating Condition.

The Trustee must be capable of performing the duties of the Servicer in case the Servicer cannot perform its duties and a successor has not been appointed. Transaction documentation will usually specify minimum capital and surplus requirements for a Trustee and any successor. As with the Servicer, adequate compensation for the services performed by the Trustee will be provided for in the governing documents. The Trustee is examined for its ability to administer transactions; its

ability to assume successor Servicer responsibilities (or hire another entity to do so); its plan to assume successor servicing, if necessary, and whether its computer systems are compatible with the Servicer's systems.

4. The Insurer

In transactions using third-party credit support, the rating of Securities normally can be no higher than that of the claims-paying ratings of the credit support provider. For this reason, selection of an insurance company to provide advance claims payment insurance, Security or bond insurance, pool insurance, mortgage insurance or special hazard insurance is an important element in the structuring of a securitization transaction. In assessing the credit of mortgage insurance companies, the Rating Agencies make a number of determinations as part of their review. The review includes a determination of standing with the applicable state insurance commission, adequacy of surplus and contingency reserves, historic underwriting performance and operating profitability, quality of investment portfolio, quality in management and internal control and secondary support, such as reinsurance policies. Similar factors are considered in the assessment of the claims-paying ability of Security or bond insurance providers.

D. Types of Credit Support

Credit support consists of two general varieties: external credit support and internal credit support. The Applicant notes that the choice of the type of credit support depends on many factors. Internal credit support which is generated by the operation of the Issuer is preferred because it is less expensive than external credit support which must be purchased from outside third parties. In addition, there is a limited number of appropriately rated third-party credit support providers available. Further, certain types of credit support are not relevant to certain asset types. For example, there is generally little or no excess spread available in residential or CMBS transactions because the interest rates on the obligations being securitized are relatively low. Third, the Ratings Agencies may require certain types of credit support in a particular transaction. In this regard, the selection of the types and amounts of the various kinds of credit support for any given transaction are usually a product of negotiations between the Underwriter of the securities and the Ratings Agencies. For example, the Underwriter might propose using excess spread and subordination as the types of credit support for a particular transaction and the Rating Agency might require cash reserve accounts funded up front by the Sponsor, excess spread and a smaller sized subordinated tranche than that proposed by the Underwriter. In addition, market forces can affect the types of credit support. For example, there may not be a market for subordinated tranches because the transaction cannot generate sufficient cash flow to pay a high enough interest rate to compensate investors for the subordination feature, or the market may demand an insurance wrap on a class of securities before it will purchase certain classes of securities. All of these considerations interact to dictate which particular combination of credit support will be used in a particular transaction.

1. External Credit Support

In the case of external credit support, credit enhancement for principal and interest repayments is provided by a third party so that if required collections on the pooled receivables fall short due to greater than anticipated delinquencies or losses, the credit enhancement provider will pay the securityholders the shortfall. Examples of such external credit support features include: insurance policies from ''AAA'' rated monoline [31] insurance companies (referred to as ''wrapped'' transactions), corporate guarantees, letters of credit and cash collateral accounts. In the case of wrapped or other credit supported transactions, the Insurer or other credit provider will usually take a lead role in negotiating with the Sponsor concerning levels of overcollateralization and selection of receivables for inclusion into the pool as it is the Insurer or credit provider that will bear the ultimate risk of loss. As mentioned above, one disadvantage of insurance, corporate guarantees and letters of credit is that they are relatively expensive in comparison with other types of credit support. Also, if the credit rating of the insurance company or other credit provider is downgraded, the rating of the Securities is correspondingly downgraded because the Rating Agencies will only rate the Securities as highly as the credit rating of the credit support provider. In any event, credit support providers require that each class of Securities they insure be ''shadow rated'' no lower than ''BBB.'' A shadow rating is the rating that the Securities would have received from the Rating Agency if the class of Securities had not been wrapped, and the Rating Agency will provide a letter addressed solely to the credit support provider verifying such rating. However, there are only a handful of ''AAA'' monoline insurance providers, and investors do not want to have too high a concentration of Securities which are backed by such Insurers. There are also few providers of letters of credit or corporate guarantees that have sufficiently high long-term debt credit ratings. These disadvantages are some of the reasons why subordination is often used as an alternative form of credit support. Cash collateral accounts include reserve accounts which are funded, usually by the Sponsor, on the Closing Date and are available to cover principal and/or interest shortfalls as provided in the documents.

2. Internal Credit Support

Internal credit support relies upon some combination of utilization of excess interest generated by the receivables, specified levels of overcollateralization and/or subordination of junior classes of Securities. Transactions that look almost exclusively to the underlying pooled assets for cash payments (or ''senior/subordinated'' transactions) will contain multiple classes of Securities, some of which bear losses prior to others and, therefore, support more senior Securities. A subordinate Security will absorb realized losses from the asset pool, and have its principal amount ''written down'' to zero, before any losses will be allocated to the more senior classes. In this way, the more senior classes will receive higher rating classifications than the more subordinate classes. However, the Rating Agencies require cash flow modeling of all senior/subordinated structures. These cash flows must be sufficient so that all rated classes, including the subordinated classes, will receive timely payment of interest and ultimate repayment of principal by the maturity date. The cash flow models are tested assuming a variety of stressed prepayment speeds, declining weighted average interest payments and loss assumptions. Other structural mechanisms to assure payment to subordinated classes are to allow collections held in the reserve account for the next payment date to be used if necessary to pay current interest to the subordinated class or to create a separate interest liquidity reserve. The collections held in the reserve account are from principal and interest paid on the underlying mortgages or other receivables held in the Issuer and are not from the securities issued by the

[31] The term ''monoline'' is used to describe such insurance companies because writing these types of insurance policies is their sole business activity.

Issuer.[32] Also, some structures allow both principal and interest to be applied to all payments to securityholders, and in others, principal can be used to pay interest to the subordinate tranches.

Interest which is received but is not required to make monthly payments to securityholders (or to pay servicing or other administrative fees or expenses) can be used as credit support. This excess interest is known as ''excess spread'' or ''excess servicing'' (''Excess Spread'') and may be paid out to holders of certain Securities, returned to the Sponsor or used to build up overcollateralization or a loss reserve. The credit given to Excess Spread is conservatively evaluated to ensure sufficient cash flow at any one point in time to cover losses. The Rating Agencies reduce the credit given to Excess Spread as credit support to take into account the risk of higher coupon loans prepaying first, higher than expected total prepayments, timing mismatching of losses with Excess Spread collections and the amounts allowed to be returned to the Sponsor once minimum overcollateralization targets are met (thereby reducing the amounts available for credit support).

''Overcollateralization'' is the difference between the outstanding principal balance of the pool of assets and the outstanding principal balance of the Securities backed by such pool of assets. This results in a larger principal balance of underlying assets than the amount needed to make all required payments of principal to investors. In all senior/subordinated transactions, the requisite level of overcollateralization and the amount of principal that may be paid to holders of the more subordinated Securities before the more senior Securities are retired (since once such amounts are paid, they are unavailable to absorb future losses) is determined by the Rating Agencies and varies from transaction to transaction, depending on the type of assets, quality of the assets, the term of the Securities and other factors.

The senior/subordinated structure often combines the use of subordinated tranches with overcollateralization that builds over time from the application of excess interest to pay principal on more senior classes. This is often referred to as a ''turbo'' structure. The credit enhancement for each more senior class is provided by the aggregate dollar amount of the respective subordinated classes, plus overcollateralization that results from the payment of principal to the more senior classes using excess spread prior to payment of any principal to the more subordinated classes. As overcollateralization grows, the pool of loans can withstand a larger dollar amount of losses without resulting in losses on the senior Securities. This also has the effect of increasing the amount of funds available to pay the more subordinated classes as an ever-decreasing portion of the principal cash flow is needed to pay the more senior classes. Excess interest is used to pay down the more senior Security balances until a specific dollar amount of overcollateralization is achieved. This is referred to as the overcollateralization target amount required by the Rating Agencies. Typically, the targeted amount is set to ensure that even in a worst-case loss scenario commensurate with the assigned rating level, all securityholders, including holders of subordinated classes, will receive timely payment of interest and ultimate payment of principal by the applicable maturity date. In these transactions, the targeted amount is usually set as a percentage of the original pool balance. It may be reduced after a fixed number of years after the Closing Date, subject to the satisfaction of certain loss and delinquency triggers. These triggers ensure that overcollateralization continues to be available if pool performance begins to deteriorate. In a senior/subordinated structure, every investment-grade class (whether or not subordinated) is protected by either a lower rated subordinated class or classes or other credit support.

E. Provision of Credit Support Through Servicer Advancing

In some cases, the Master Servicer, or an Affiliate of the Servicer, may provide credit support to the Issuer (*i.e.*, act as an Insurer). In these cases, the Servicer will first advance funds to the full extent that it determines that such advances will be recoverable (a) out of late payments by the Obligors, (b) from the credit support provider (which may be the Master Servicer or an Affiliate Servicer) or, (c) in the case of an Issuer that issues subordinated Securities, from amounts otherwise distributable to holders of subordinated Securities, and the Master Servicer will advance such funds in a timely manner. When the Servicer is a provider of the credit support and provides its own funds to cover defaulted payments, it will do so either on the initiative of the Trustee, or on its own initiative on behalf of the Trustee, but in either event it will provide such funds to cover payments to the full extent of its obligations under the credit support mechanism. In some cases, however, the Servicer may not be obligated to advance funds but instead would be called upon to provide funds to cover defaulted payments to the full extent of its obligations as Insurer. Moreover, a Master Servicer typically can recover advances either from the provider of credit support or from the future payments on the affected receivables.

If the Master Servicer fails to advance funds, fails to call upon the credit support mechanism to provide funds to cover delinquent payments, or otherwise fails in its duties, the Trustee would be required and would be able to enforce the securityholders' rights as both a party to the Pooling and Servicing Agreement and the owner of the Trust estate where the Issuer is a Trust (or as the holder of the security interest in the receivables), including rights under the credit support mechanism. Therefore, the Trustee, who is independent of the Servicer, will have the ultimate right to enforce the credit support arrangement.

When a Master Servicer advances funds, the amount so advanced is recoverable by the Master Servicer out of future payments on receivables held by the Issuer to the extent not covered by credit support. However, where the Master Servicer provides credit support to the Issuer, there are protections, including those described below, in place to guard against a delay in calling upon the credit support to take advantage of the fact that the credit support declines proportionally with the decrease in the principal amount of the obligations held by the Issuer as payments on receivables are passed through to investors. These protective safeguards include:

1. There is often a disincentive to postponing credit losses because the sooner repossession or foreclosure activities are commenced, the more value that can be realized on the security for the obligation;

[32] A collections reserve account is established for almost all transactions to hold interest and principal payments on the mortgages or receivables as they are collected until the necessary amounts are paid to securityholders on the next periodic distribution date. In some transactions, the Rating Agencies or other interested parties may require, in order to protect the interests of the securityholders, that excess interest in amount(s) equal to a specified number of future period anticipated collections be retained in the collection account. This protects both senior and subordinated securityholders in situations where there are shortfalls in collections on the underlying obligations because it provides an additional source of funds from which these securityholders can be paid their current distributions before the holders of the residual or more subordinated securities receive their periodic distributions, if any. Accordingly, any reference to ''collections'' from principal and interest paid on the mortgages is intended to describe such excess interest or principal not required to cover current payments to the senior and subordinated class eligible to be purchased by plans. Thus, this mechanism is not harmful to the interests of senior securityholders.

2. The Master Servicer has servicing guidelines which include a general policy as to the allowable delinquency period after which an obligation ordinarily will be deemed uncollectible. The Pooling and Servicing Agreement will require the Master Servicer to follow its normal servicing guidelines and will set forth the Master Servicer's general policy as to the period of time after which delinquent obligations ordinarily will be considered uncollectible;

3. As frequently as payments are due on the receivables held by the Issuer, as set forth in the Pooling and Servicing Agreement (typically monthly, quarterly or semi-annually), the Master Servicer is required to report to the independent Trustee the amount of all payments which are past due more than a specified number of days and the amount of all Servicer advances, along with other current information as to collections on the assets and draws upon the credit support. Further, the Master Servicer is required to deliver to the Trustee annually a certificate of an executive officer of the Master Servicer stating that a review of the servicing activities has been made under such officer's supervision, and either stating that the Servicer has fulfilled all of its obligations under the Pooling and Servicing Agreement or, if the Master Servicer has defaulted under any of its obligations, specifying any such default. The Master Servicer's reports are reviewed at least annually by independent accountants to ensure that the Master Servicer is following its normal servicing standards and that the Master Servicer's reports conform to the Master Servicer's internal accounting records. The results of the independent accountant's review are delivered to the Trustee; and

4. The credit support has a ''floor'' dollar amount that protects investors against the possibility that a large number of credit losses might occur towards the end of the life of the Issuer, whether due to Servicer advances or any other cause. Once the floor amount has been reached, the Servicer lacks an incentive to postpone the recognition of credit losses because the credit support amount becomes a fixed-dollar amount, subject to reduction only for actual draws. From the time that the floor amount is effective until the end of the life of the Issuer, there are no proportionate reductions in the credit support amount caused by reductions in the pool principal balance. Indeed, since the floor is a fixed-dollar amount, the amount of credit support ordinarily increases as a percentage of the pool principal balance during the period that the floor is in effect.

F. Description of Designated Transactions

The Applicant requests relief for senior and/or subordinated investment-grade securities issued by Issuers with respect to a limited number of asset categories: Motor vehicles, residential/home equity, manufactured housing and CMBS. Accordingly, the Applicant has provided the Department with detailed, separate profiles of a typical transaction for each asset category. Each profile describes specifically how each type of transaction generally is structured, the due diligence that the Rating Agencies conduct before assigning a rating to a particular class of such securities, the calculations that are performed to determine projected cash flows, loss frequency and loss severity and the manner in which credit support requirements are determined for each rating class. The motor vehicle, residential/home equity, manufactured housing and commercial ABS/MBS transactions, as described in this section will collectively be referred to as ''Designated Transactions.'' [33]

Each of the four types of Designated Transactions is already encompassed within the existing asset categories. Specifically:

(i). Automobile and other motor vehicle ABS would principally fall within category III.B.(1)(d) obligations that are secured by motor vehicles or equipment but could also be covered under category III.B.(1)(a) secured consumer receivables or III.B.(1)(b) secured credit investments between business entities, depending on the factual situation.

(ii). Home equity and residential ABS/MBS would fall within categories III.B.(1)(a) which specifically refers to home equity loans and III.B.(1)(c) which specifically refers to single-family residential real property.

(iii). Manufactured housing would fall within category III.B.(1)(a) if the manufactured housing is considered to be personal property under local law, or within category III.B.(1)(c) if the manufactured housing is considered real property under local law.

(iv). CMBS would fall within category III.B.(1)(c) which specifically refers to multi-family residential and commercial real property.

1. Motor Vehicle Loan Transactions

The Applicant asserts that many motor vehicle loan securitizations are currently ineligible for exemptive relief under the Underwriter Exemptions if such transactions have subordinated tranches, notwithstanding being rated ''A'' or better. The Applicant notes that in a typical motor vehicle transaction, ''AAA'' rated senior Securities are issued that might represent approximately 90% or more of the principal balances of the Securities, with ''A'' rated subordinated Securities issued that might represent the remaining 10% or less of the principal balance of the Securities. The total level of credit enhancement from all sources, including Excess Spread, typically averages approximately 7% of the initial principal balance of Securities issued by prime issuers and 14% for subprime Issuers in order to obtain an ''AAA'' rated Security. Credit support equaling 3% for prime Issuers is usually required in order to obtain an ''A'' or better rating on the subordinated Securities. Typical types of credit support used in auto transactions are subordination, reserve accounts, Excess Spread and financial guarantees from ''AAA'' rated monoline insurance companies. Transactions with subprime Sponsors generally use surety bonds as credit enhancement, so there is no subordinated class.

The Applicant states that as 70% of the motor vehicle securitization market is attributable to automobile loans, the following discussion principally relates to automobiles. (The term ''automobile'' as used herein also is intended to include light trucks.) Other types of motor vehicles include boat loans, agricultural equipment, construction equipment and recreation vehicles (RVs). The Applicant is not requesting additional exemptive relief at this time for motor vehicle leasing transactions or dealer floor plan financing.

The Applicant provided the following description of the analysis performed by the Rating Agencies in their consideration of automobile securitizations and their determination of appropriate credit support requirements:

(a) Motor Vehicles—General Considerations—The credit rating of the borrower in auto loan securitizations is much more important than in real estate mortgage loan securitizations, where the value of the collateral is one of the principal considerations. LTV ratios in auto transactions increase over time due to the depreciation in value of the automobiles over the term of the loan.

[33] The modifications requested with respect to the type of securitization vehicle (*i.e.*, both Trust and non-Trust) and type of security (both debt and equity securities) or the use of interest rate swaps or yield supplement agreements with notional principal amounts would be applicable to both Designated Transactions and all other types of asset categories currently permitted under the Underwriter Exemptions.

This makes it much more likely that borrowers will default if they fall behind in their payments because they cannot pay off the loan with the proceeds realized from selling the automobile. Accordingly, a particularly intensive review of the underwriting policies and procedures of the loan originators and the loss histories of each originator is conducted in order to evaluate the predicted strength of the borrowers. In addition, in order to insure timely payment to the securityholders, the financial strength of the Sponsor/Servicer and its operations and procedures, particularly with respect to how diligently and timely it acts to monitor and correct late monthly payments and/or to declare a default on the loan and repossess the collateral, are closely scrutinized.

(b) Motor Vehicles—Due Diligence—The particular aspects of the Rating Agencies' due diligence that are specific to motor vehicle transactions are as follows. The originator's dealer network is examined to determine the presence of any significant dealer concentration, the composition of business across manufacturer franchised new and used car dealerships, the selection process for new dealerships, management tools to track performance by dealers, how business is solicited and the methods used to prevent and detect dealer fraud. Because the automobile sales market is extremely competitive, companies are under pressure to meet certain growth targets. Therefore, the Rating Agencies conduct an extensive review of the originator's underwriting (loan approval) standards and monitoring controls. Both the originator's underwriting criteria and the nature and frequency of updates are examined. Factors included in this review are: how many years of the borrower's credit history are considered; stability of the borrower in job and residence; income levels; payment-to-income and debt-to-income ratios; approval rates of origination; presence of first-time buyers and whether and what type of credit scoring of borrowers is performed.

(c) Motor Vehicles—Determination of Expected Losses—In order to determine the correct amount of credit support which will be required to support a particular rating for a class of auto loan Securities, a base-case securitized pool loss assumption is calculated using the following factors. Static pool data, if available, is compiled by taking a discrete period of originations of the originator, such as a financial quarter, and that pool's performance is tracked on a monthly basis as the loans amortize, particularly focusing on loans which have been outstanding (seasoned) 18–24 months and have been substantially paid down. This allows a determination of the shape of the loss curve and project timing of losses to be made. The cumulative net loss on the less seasoned pools can then be extrapolated from the older pools. Static pool data is preferred over active pool data, which can mask losses during periods when the originator's pool of loans is rapidly growing.

In creating the base-case expected loss amount, a detailed breakdown of originations, delinquencies, repossessions, gross and net losses and recoveries are examined. Any understatement of portfolio losses are isolated and all originators are placed on a comparable basis by dividing net annual losses by the outstanding principal balance of a prior period, which creates a growth adjustment factor. Once expected losses are estimated, the expected cumulative losses are derived by multiplying these expected losses by the weighted average life of the collateral, using conservative assumptions regarding losses and prepayments.

The pool of loans selected for the securitization is examined in order to assure that it is representative of the base-line loss assumption for that originator and has not been selected from lesser-quality receivables. The selection process used by the originator is monitored by checking the annual percentage rate on the loans, the principal amount of the loan, the LTV ratios, original maturity date of the loans and remaining maturity, the new and used mix, the model year and mileage of the vehicles, the amortization methods and geographic concentrations. The characteristics of the borrowers are also examined to monitor representative creditworthiness and stability by looking at gross income, monthly debt service, debt-to-gross income ratio, down payment-to-value ratio, years of credit history, credit scores, length of time at the borrower's residence, employment term and past credit problems to make sure that these criteria are representative of the originator's broader portfolio. Credit scoring is a relatively new method used by lending facilities to assess a borrower's likelihood of repaying a loan. The Rating Agencies monitor the correlation between such scores and actual losses to refine the appropriate weighting to be given to credit scores.

Delinquency data is broken out over 30-day, 60-day and 90-day groups, and delinquencies are examined based on the loan contract terms. In order to make sure that default data is not misleading, the Rating Agencies examine whether all loans that are not performing and are not charged off (even if the debtor is in bankruptcy or where the automobile has been repossessed) are considered to be in default. The originator's charge-off policy and accounting method used to calculate losses are examined, as the timing of the charge-off is important because it affects loss statistics, and delays in charge-offs put stress on liquidity.

(d) Special Factors Applicable to Motor Vehicles other than Automobile—(i) Recreational Vehicles—The methodology used in evaluating the credit quality of a pool of RV loans is very similar to that used to assess auto loan pools but takes into account the fact that the average RV Obligor is of higher credit quality than the average auto loan Obligor. However, as RVs are generally regarded as luxury items, buyers tend to default on them before debt obligations on necessities. The characteristics of the RV Obligor base can vary widely across pools, depending on such factors as the specific types of vehicles in the pools and whether they are new or used, and therefore must be evaluated on a case-by-case basis.

(ii) Boat Loans—Boat loan pools are similar in many ways to RV loan pools as the underlying assets are luxury goods purchased by persons who are generally more affluent than the average consumer. However, there are some significant differences. There is an extremely wide range of boats that can be purchased with costs ranging from a few thousand dollars to more than $1 million. Consequently, the characteristics of the obligations also span a wide range. Boat buyers, especially those of small boats, tend to be younger than the typical RV purchaser and are slightly higher credit risks. The resale value of boats is highly seasonal, causing the recovery values on defaulted loans to be highly variable. Finally, boats are produced by a large number of generally small manufacturers. Accordingly, if a manufacturer goes out of business, the resale value of its boats can decline sharply since parts may be hard to replace; this increases the expected pool losses and the variability of those losses. Second, there is an increased risk of pool losses resulting from the bankruptcy of a manufacturer; if the manufacturer has received the purchase price and becomes bankrupt before delivery of the boat, the buyer may default on the loan.

(iii) Agricultural Equipment—Special factors which are taken into account in agricultural equipment (tractors and combines) (''AG'') securitizations include the following. These loan

portfolios are particularly affected by commodity prices, weather, financial stability of the borrower's business operations and governmental price supports. Extensions granted for late payments are also common in cases of floods, crop failures, etc., and for this reason, geographic diversity in AG pools is especially desirable because of varying weather patterns across the United States. Expected losses are lower than those experienced in automobile transactions because changes in the general economy do not affect frequency of AG losses as much, and the equipment has a relatively stable value over the life of the loans. However, the loss curve for AG securitizations peaks much earlier than for auto loans, with 70% of defaults occurring by 18 months, which is a significant factor in analyzing cash flows. The size of the average AG loan is significantly higher than for other motor vehicles, and the terms are longer (five to seven years). It is not unusual for loan payments to be made only once per year to coincide with income from annual harvests so the Rating Agencies are concerned with an inability of Servicers to ascertain whether a borrower is in financial difficulty as quickly. Because the condition of the equipment is crucial to generating farm income, the strength of the dealer's service department is also considered. On the other hand, companies providing financing for AG dealers require such dealers to maintain significant cash reserves against potential losses.

(iv) Construction Equipment Loans—The particular factors which relate to construction equipment (''CE'') are as follows. CE includes heavy equipment used in highway construction, forestry and mining and includes, for example, back-hoes, bulldozers, excavators, truck loaders and asphalt pavers. Unlike farm equipment, the health of the general economy (and specifically housing starts, interest rates and public and private project financing) impacts construction starts which directly affects the Obligor's cash flow and thus loss frequency. In addition, CE depreciates in value during the loan terms, and the amounts borrowed are relatively large, which increases loss severity. Like AG equipment loans, the equipment is needed to produce revenue so the Obligor has a strong incentive to repay the loan. The cash flow of Obligors is often seasonal, and although these loans pay monthly, losses can be sudden. On the other hand, loans typically are structured to suspend payments during winter months which lessens the frequency of defaults. Most loans are serviced by rural businesses which negatively impacts on the efficiency of the collection process. The loss curve for CE is also early, with 70% of defaults occurring in the first 18 months. The terms of a CE may not require any payments in the first six months of the loan, depending on the time of year the loan was initiated, so seasoning statistics need to be adjusted for this factor.

(e) Motor Vehicles—Determining Required Credit Support—The total credit support required by the Rating Agencies for the desired ratings of each class of Securities being offered must be sufficient to cover certain pre-established loss multiples which are applied to a base-case loss model. For example, a Rating Agency might require sufficient credit support from all sources to be able to withstand five times the base-case losses for an 'AAA' rating and to cover three times the base-case losses for an 'A' rating (whether or not the Security is subordinated).

Cash flow modeling is performed so that the minimum credit support levels required on the Closing Date which, when combined with structural features that trap Excess Spread, are sufficient to cover losses at various levels. The cash flow modeling also allows the liquidity of a proposed structure to be tested, using worst-case scenarios regarding repossession, recovery periods and amounts, prepayments and reinvestment rates for investment and cash on deposit. The amount of scheduled principal payments available to retire these Securities under various stress scenarios; *e.g.,* higher than expected prepayments, delinquencies and losses or less than expected Excess Spread is also considered. In addition, the sufficiency of liquidity (funds on deposit in reserve accounts) to pay the principal balances by the legal final maturity date is examined.

A loss curve showing the timing of losses is then determined in order to decide which types of credit support are necessary. For example, auto loan loss curves are significantly front-loaded with peak losses occurring between 6 to 18 months for most five-year collateral pools. Credit is given to Excess Spread on a discounted, conservative basis. The presence of triggers (see below), which raise the level of the reserve account as a percentage of current outstanding Securities or collateral if performance begins to deteriorate, is also given credit. A conservative estimate of investment return on any cash held pending distribution in reserve/spread accounts is made; *e.g.,* 2.5%, unless a guaranteed investment contract issued by an entity with a rating at least equal to the desired transaction rating is used.

Greater credit support is required if there is insufficient geographic loan distribution or disproportionate amounts in states which are not economically diverse or which have onerous repossession requirements. Greater credit support may also be required to address liquidity risks as the rating addresses the likelihood of timely payment of interest. The common liquidity risks addressed in motor vehicle loan transactions include the following: early maturity, differences in how borrowers are credited with having made interest and principal payments under the terms of the loan and how interest and principal are paid to securityholders. Interest rate risk where the motor vehicle loans are fixed rate but the Securities have a variable interest rate is also considered.

In auto transactions which feature declining credit support requirements over the life of the transaction, credit support floor coverage, which provides a minimum percentage of credit support at the end of a securitization, may be required. This is because even though most losses occur between 6–18 months and borrowers are less likely to default once they have built up equity, losses may increase as a transaction enters its final stages. In general, for an ''AAA'' rated auto transaction, a reserve account floor is required when the pool has amortized down to 20% of its original total balance. Auto loan securitizations may use overcollateralization and subordination as credit support.

Excess spread in automobile transactions usually ranges between 2%–3% for prime issues and 7%–14% for subprime issues and can be used to absorb credit losses and/or to build up reserve/spread accounts or to create overcollateralization. Spread and reserve accounts protect against disruptions in cash flows for delinquencies and payment disruptions (e.g., bankruptcy of the Sponsor/Servicer). The amount of cash available in these accounts is a very important rating consideration. However, a reserve or spread account which is funded on the Closing Date is more favorably regarded than Excess Spread. This is because if the amounts are set aside on the Closing Date, they are immediately available; whereas, if they are to be funded over time from projected Excess Spread, their availability is less certain. Accordingly, if losses are projected such that credit support equaling 8% of the transaction were to be required, the entire 8% could not be provided solely through Excess Spread.

Automobile securitizations often feature credit support triggers, which allow initial credit enhancement levels to be maintained until certain levels of pool loan delinquencies or losses occur, at which point higher credit enhancement levels are ''triggered.'' If the performance of the securitized pool of loans deteriorates beyond the specified levels, the cash flow mechanics of the transaction will divert the flow of funds (typically Excess Spread is captured to enhance the spread account to a particular level) to provide additional protection for the Securities. Conversely, because the quality of an auto loan pool increases over time, credit support levels are generally permitted to decline proportionately as a tranche amortizes, provided that losses and delinquencies are within expectations. However, once delinquency and loss triggers are reached, the dollar amount of credit support either stops declining or increases to a higher specified level, in both cases by retaining some or all Excess Spread. The effectiveness of the triggers and the incremental amount of Excess Spread that must be retained as performance deteriorates are considered, as is the timing of the trigger being reached.

2. Residential/Home Equity Mortgage Transactions

The Applicant provided the following information on typical transactions. In a typical residential mortgage transaction, ''AAA'' rated senior Securities might be issued which represent approximately 95% of the principal balances of the Securities; ''AA'' rated subordinated Securities might comprise 2%; ''A'' rated subordinated 1%; ''BBB'' rated subordinated 1% and junior subordinated Securities might constitute 1%. The total level of credit enhancement from all sources averages about 4% in order to obtain ''AAA'' rated Securities, 2% for an ''AA'' rating, 1.5% for an ''A'' rating and 1% for a ''BBB'' rating. Subordination is the predominant type of credit support used in traditional residential mortgage transactions.

In a typical ''B&C home/equity loan'' transaction (see description below), ''AAA'' rated senior Securities might be issued which represent 80% of the principal balances of the Securities; ''AA'' rated subordinated Securities might comprise 11%; ''A'' rated subordinated 6%; ''BBB'' or lower rated subordinated Securities might constitute 3%. The total level of credit enhancement from all sources averages about 13% in order to obtain ''AAA'' rated Securities, 10% for an ''AA'' rating, 7% for an ''A'' rating and 3% for a ''BBB'' rating.

In a typical high LTV ratio (i.e., above 100%) second-lien loan transaction, ''AAA'' rated senior Securities might be issued which represent approximately 76% of the principal balances of the Securities; ''AA'' rated subordinated Securities might comprise 10%; ''A'' rated subordinated 3%; ''BBB'' rated subordinated 4% and junior subordinated Securities might constitute 7%. The total level of credit enhancement from all sources averages about 24% in order to obtain ''AAA'' rated Securities, 14% for an ''AA'' rating, 10% for an ''A'' rating and 7% for a ''BBB'' rating.

Typical types of credit support used in home equity transactions are subordination, reserve accounts, Excess Spread, overcollateralization and in transactions which do not use subordination, financial guarantees from ''AAA'' rated monoline insurance companies or highly rated Sponsors. The Applicant provided the following description of the analysis performed by the Rating Agencies in their consideration of residential/home equity securitizations and their determination of appropriate credit support requirements.

(a) Residential/Home Equity—General Considerations—The non-commercial mortgage securitization market can generally be divided into two basic types of assets: ''residential mortgages,'' the majority of whose Obligors have ''prime'' credit ratings, and all other securitizations of residential real estate which are collectively referred to as ''sub-prime'' or ''home equity'' loans (manufactured housing is treated as a separate type of asset and is discussed below). The term ''home equity'' loan includes second mortgages taken out to finance home improvements as well as first and second-lien loans where the purpose of the loan is either for refinancing an existing loan, a source of credit in lieu of using credit cards or for debt consolidation. In addition, it includes first-lien and second-lien loans used to purchase a residence where the borrower does not have an A credit rating.

The dollar volume of home equity loan Securities is now the largest segment of the securitization market, surpassing credit cards. The primary reason for this is that borrowers are increasingly turning to first and second-lien home equity loans instead of other forms of consumer borrowing (i.e., credit cards), as the interest rates on the loans are lower, and the interest payments may be tax deductible. These types of loans have a higher credit risk than traditional first-lien mortgages. However, the Rating Agencies adjust for the additional risk by requiring additional credit support for each tranche of Securities in order to achieve the same rating as would be given to a comparably rated tranche in a residential mortgage securitization.

Another significant feature of home equity loans is that they may have higher LTV ratios than residential mortgages, often higher than 100%. In transactions where LTV ratios are in excess of 100%, little or no credit is given to the collateral in determining necessary credit support, which instead must be supplied from other sources. In the traditional rating analysis for residential mortgage securitizations, the single most significant factor historically was the loan-to-value ratios of the mortgages in the pool. However, statistical information has clearly shown that LTV's on both residential and home equity mortgages are much less important as a predictor of risk than the quality of the borrowers and their capacity to make loan payments. This is due to a borrower's reluctance to default on his residence, without regard to the amount of equity that is built up. There is an increased ability to assess borrower credit risk through the use of credit/mortgage scoring systems. In order for an originator's credit scoring system to be incorporated into the rating process, however, the system is tested against a blind pool of loans with known default rates to verify the validity of the scoring system to predict losses. Capacity to pay is indicated by the borrower's monthly debt-to-income ratio. The Rating Agencies test the predictability of such scoring systems before relying upon them in their credit analysis.

Home equity loans can be subdivided into different categories. The first category, known as ''B & C home equity loans,'' are made primarily to B & C quality borrowers for consolidating credit card and other consumer debt or refinancing existing mortgage loans. The second category, known as ''home equity lines'' of credit,[34] are usually made to A quality buyers for large specific purchases, such as a car or their children's college education expenses. The third category, known as home improvement loans, include loans which are guaranteed by governmental

[34] While this group of transactions may include pools where some portion of the mortgages may be substituted throughout the life of the transaction to provide additional credit support, substitution is currently permitted under the Underwriter Exemptions only for defects in documentation. The Underwriter is not requesting relief for transactions with this feature.

agencies such as the U.S. Department of Housing and Urban Development (''HUD'') but have borrowers with poor credit quality (below B & C) or are non-guaranteed home improvement loans with B & C credit borrowers. The fourth category refers to high LTV ratio loans with borrowers of mixed credit quality but on average above B & C quality.

In transactions where the credit quality of the borrower is lower and LTV ratios are higher, the interest rates charged on the loans are significantly greater than those on traditional residential loans. This results in Excess Spread of typically 450–550 bps which can be used as credit support. The home equity market has had a sufficient track record to provide the Rating Agencies with a depth of expertise and statistical information to rate these Securities with a high degree of reliability. The Securities have been well received by investors as they have tended to offer higher returns than comparably rated residential mortgage Securities in all rating categories other than 'AAA.' In addition, although the prepayment rates are higher for home/equity Securities than for traditional residential Securities, these prepayment rates are more constant and thus more predictable.

(b) Residential/Home Equity—Determination of Expected Losses and Amount of Credit Support—The basic approach used by all of the Rating Agencies to determine the level of credit support necessary for each tranche of a residential/home equity securitization is similar. Historical data is used to predict loss frequency and severity of loss in arriving at the necessary amount of credit support for each rating level. Essentially, the process may be described as follows.

The appropriate credit enhancement for a residential/home equity Security is determined by evaluating the individual characteristics of the mortgages supporting the Security, the aggregate characteristics of the mortgages considered as a pool and the structure of the Securities offered. The model identifies the characteristics of the mortgage that contribute to the likelihood of default and loss (i.e., loss frequency) and the size of the mortgage loss in the event of default (i.e., the loss severity). Among the characteristics examined are the LTV ratio of the mortgage, the type and term of the mortgage, the type of mortgaged property, the guidelines used in approving the mortgage and the quality of the borrower. The credit enhancement required for a mortgage is calculated by multiplying the loss frequency for the mortgage by its loss severity. In assessing potential severity, the calculated severity is compared to a minimum loss percentage, using the larger of the two figures to calculate the credit enhancement for the mortgage.

The sum of the credit enhancements for the individual mortgages represents the initial credit enhancement requirement for the mortgage pool. This figure is then adjusted for mortgage pool characteristics and for originator and Servicer quality. Pool characteristics, including the number of mortgages and the geographic concentration of the mortgaged properties, are important because they impact the statistical independence of the mortgage level credit enhancement calculations. The originator adjustment reflects an assessment of the originator's ability to generate mortgages that perform better or worse than otherwise similar mortgages. The Servicer adjustment reflects an assessment of the Servicer's ability to keep mortgagors paying and to mitigate losses in the event of default. The credit enhancement requirement established after these adjustments reflects a full assessment of the credit risk of the entire mortgage pool. Additional adjustments may be necessary in response to structural aspects of the transaction. Among the transaction characteristics that can have a significant impact on credit enhancement levels are the sequence of payments among different classes of Securities, the allocation of mortgage principal prepayments, the form of credit enhancement and its provider and the relative size of the classes offered. An analysis of the cash flow necessary to make timely payments of principal and interest is performed, and the last step in determining the amount of credit support necessary for each rated Securities tranche is to test the ability of a pool of mortgages to withstand certain stress tests and still be able to generate timely payments of interest and pay principal on or before maturity.

In developing a stress model, conservative assumptions are made as to real estate market conditions, economic factors and expenses associated with events of loss, applying a worst-case scenario incorporating high unemployment, deflation and sharply falling real estate values. The worst-case model considered by S&P to be appropriate for its highest rating categories incorporates the foreclosure frequencies and loss severity experienced during the Great Depression of the 1930s, whereas other Rating Agencies use those experienced in the Houston, Texas disastrous housing market in the mid-1980s. The choice of economic model is selected based on the severity of the stress to be applied. Generally, ''AAA'' and ''AA'' rated Securities have to withstand so-called national depression models based on the Great Depression/Houston, Texas models. For ''A'' and ''BBB'' rating categories, other geographic severe depression models, such as Boston in the 1980s or New York and Los Angeles in the early 1990s, might be used as the basis for the stress model. Alternatively, a system of local forecasting models or some other statistically derived stress models may be created for these purposes. ''BB'' rated Securities or lower would have to withstand less severe recession models.

The initial frequency and severity of loss analysis on each mortgage in the pool may be described as follows. A computer model is used to analyze the expected losses on a mortgage pool backing Securities. The model examines (i) characteristics of each underlying mortgage to determine the probability of it defaulting and (ii) the default performance of several million mortgages originated or serviced by established originators. A housing price index may be used which combines housing price and other economic data and refines the analysis to the smallest geographic unit for which reliable information can be found (usually a metropolitan statistical area). This approach enables the Rating Agencies to analyze variations in losses arising from differences in real estate markets with separate housing price histories, regional economic conditions and foreclosure experience. Through an analysis of adverse economic conditions for discrete geographic areas, the localized impact of regional business cycles and economic restructuring can be factored into the process.

Mortgages in a pool must have certain preferred characteristics to qualify as prime mortgages. In the absence of other mitigating factors, additional loss coverage will be required for pools failing to meet prime pool criteria. The following are the basic criteria for mortgages in a prime pool: first liens on single-family detached properties located in the United States; fixed-rate loans; level payment, fully amortizing loans on the mortgagor's primary residence; mortgages not in excess of a dollar-ceiling amount; a loan-to-value ratio of 80% or less; mortgage documentation and underwriting consistent with Fannie Mae/Freddie Mac guidelines, including minimum underwriting criteria of a fixed percent ratio of borrower's monthly housing expense (*e.g.*, 28%) to gross monthly income and a fixed ratio of borrower's

total monthly debt obligations to gross monthly income (*e.g.*, 36%); whether properties securing mortgages in the pool are well dispersed throughout an area having a strong and diversified economic base and whether there is a minimum number of loans in the pool (*e.g.*, 300). Because most mortgage loan pools do not meet prime pool criteria in each category, rating a portfolio involves assessing the additional credit enhancement required owing to the deviation from prime pool criteria.

Other factors may have a bearing on default rates and could counterbalance negative characteristics of a pool. Thus, a portfolio of well-seasoned mortgage loans would be expected to experience a lower default rate than newly originated loans due to both the history of the creditworthiness of the borrowers and the lower loan-to-value ratio associated with seasoned loans. (For example, default rates are highest in the 3–8 year period of a loan.) The marketability of the underlying mortgages is also an important factor in determining required loss coverage because collateral underlying a defaulted loan needs to be liquidated as quickly as possible. Another significant factor is the availability and type of insurance in connection with the pooled mortgages and their underlying properties. Mortgage insurance, hazard insurance, special hazard insurance, pool insurance on the underlying properties and bankruptcy insurance covering mortgagor bankruptcy and insolvency all may be relevant to the rating of the Security. Primary mortgage insurance (PMI) also can reduce the loss coverage required on a mortgage pool. The credit of the PMI issuer and the quality of its underwriting standards are considered by the Rating Agencies. However, the full benefit of a reduced loss coverage requirement will be available only if the PMI issuer meets Rating Agency standards.

The rating of a residential mortgage loan pool will also vary depending upon the purpose for which the mortgage loans have been made. The most desirable loan is a purchase money mortgage loan for the financing of the mortgagor's single-family detached primary residence. In contrast, home equity loans and apartments, condos, coops, non-owner occupied or vacation homes are projected to have higher losses. The type of loan is also considered. For example, adjustable rate, balloon payment and negative amortization of principal features are all negative factors. The loss severity analysis assumes that the potential for loss upon foreclosure of a second mortgage is greater than for loss upon foreclosure of a comparable first mortgage. The foreclosure frequency analysis for second mortgage loans focuses on the increased credit risk generally associated with second mortgage loans, which frequently are not subject to standard underwriting criteria based upon Fannie Mae and Freddie Mac standards and generally have lower combined LTV ratios than is the case for first mortgages. Geographic diversification of the properties securing mortgages in the pool is important to spread the risk of loss, and higher loss coverage is required for pools of fewer than 300 loans.

As many insurable risks as possible are reduced or eliminated, which is generally accomplished by requiring various types of insurance or bonding expressly covering such risks. Because costs of insurance premiums are in some cases prohibitive, Issuers over the years have devised alternative forms of credit enhancement to avoid the purchase of third-party insurance. Frequent substitutes include lines of credit from large commercial banks, self insurance (available only to Issuers with high credit ratings) and overcollateralization. Hazard insurance must be in place with respect to all properties securing the mortgages that constitute the pool.

(c) Residential/Home Equity—Selecting the Type of Credit Support—The most prevalent forms of credit support for residential/home equity Securities are the senior/subordinated tranched structure, overcollateralization, Excess Spread, reserve funds and surety bonds. In addition, as described above, pool insurance may be obtained for credit losses on the mortgages.

3. Manufactured Housing Transactions

The Applicant states that, in a typical manufactured housing transaction, ''AAA'' rated senior Securities might be issued which represent approximately 80% of the principal balances of the Securities; ''AA'' rated subordinated Securities might comprise 6%; ''A'' rated subordinated 5%; ''BBB'' rated subordinated 5% and junior subordinated Securities might constitute 4%. The total level of credit enhancement from all sources including Excess Spread averages about 15%–16% in order to obtain ''AAA'' rated Securities, 10%–11% for an ''AA'' rating, 7.5%–8.5% for an ''A'' rating and 3.5%–9% for a ''BBB'' rating. Typical types of credit support used in manufactured housing transactions are subordination, reserve accounts, Excess Spread, overcollateralization and financial guarantees from ''AAA'' rated monoline insurance companies or highly rated Sponsors. The Applicant provided the following description of the analysis performed by the Rating Agencies in their consideration of manufactured housing securitizations and their determination of appropriate credit support requirements.

(a) Manufactured Housing—General Considerations—There has been a general growth in the sale of manufactured housing and an improvement in the construction of the units. Transactions with a greater percentage of multi-wide units, customized units and units financed with land privately purchased (as opposed to being placed in trailer park rental spaces) are being securitized which results in less loss severity, as such units have greater resale value, and these types of units are increasingly being purchased by owners with better credit histories. There has also been an increased public market for manufactured housing-backed Securities since the 1980s due to a trend toward lower repossessions and lower losses on such mortgages as a result of improved underwriting and servicing throughout the industry, strong investor interest in medium-term structured investments with loan terms typically between 15–20 years (versus 5 for autos and 30 for residential mortgages) and the inclusion of manufactured housing contracts as qualifying assets for REMICs, which facilitates the issuance of multi-class Securities.

(b) Manufactured Housing—Determination of Expected Losses—LTV ratios are not considered as significant a factor in predicting loss frequency in manufactured housing securitizations as they are for conventional home mortgages because the loan amounts are lower and significant equity is not built up. Instead, the Rating Agencies assign a frequency of default and loss severity factor to the pool of loans (in some cases, on a loan-by-loan basis) to project losses.

An analysis of the credit quality of the underlying pool of manufactured housing contracts in a particular securitization transaction is performed by developing static pool data based on the historical performance of the specific originator of the contracts. This information (which is continuously updated) is then used to predict expected cumulative net losses for the particular pool which takes into account both foreclosure frequency and loss severity. The historical data is adjusted depending on the Servicer's capacity to service the loans, the type of collateral being financed, LTV ratios, loan seasoning, underwriting of loan

standards, experience of management and the quality and quantity of the historical information provided by the originator. As a result, the expected cumulative losses will vary from originator to originator.

An analysis of the actual pool is also performed to predict loss frequency based on collateral characteristics such as type of unit (single versus multi-wide) and real property type (trailer park, private rental or private owned) and loan attributes such as whether the LTV ratios, loan interest rates, loan terms and monthly payments are high (which is a negative factor) and how long the loan has been outstanding (as the risk of default is higher in the earlier years of the loan). Also considered are borrower demographics. The elements regarding borrower demographics which have the greatest impact on default frequency are the originator's borrowing credit scoring methodology, debt-to-income ratios, purchase versus refinance status, employment period, employment status, borrower's age, existing versus first-time home buyer and presence of a co-signer. The specific impact of geographic distribution is forecasted using a mortgage default model which divides the United States in a myriad of counties, standard metropolitan statistical loan areas and state and multi-state regions. This model is used to forecast foreclosure rates and home price trends by projecting economic conditions over a fixed number of years.

Loss severity is determined by predicting the expected recovery rate in case of loan default (*i.e.,* the percentage of the outstanding balance realized upon liquidation of the unit). For example, recovery rates are high (typically 70%) during the first two years after origination and thereafter drop to a lower constant level. The most significant factors affecting loss severity are the age of the unit and the delay time in repossessing and recovering on the unit. Here LTV ratios are a significant indicator of loss severity as repossession costs are usually fixed and, therefore, the lower the net equity the lower the percentage recovery. Also, whether the originator/Servicer has good access to retail distribution for repossessed units significantly affects recoveries. Dealer/manufacturer recourse is also a very important factor in determining both frequency and severity of loss expectancies. Some originators have recourse programs under which dealers or manufacturers will repurchase a defaulted contract at the time of default or cover any loss associated with liquidation of the repossessed unit. The recourse obligation can vary from six months to five years. The amount of credit given to dealer recourse is affected by whether the dealers have historically honored their recourse commitments. The use of dealer recourse is also scrutinized to determine whether a repossession is treated as a default, and if dealer recourse is applicable, to make sure that the originator is not understating its default rates.

(c) Manufactured Housing—Determining Required Amount of Credit Support—In order to determine how much credit support is required, a determination is made as to how much principal liquidation losses can be covered by Excess Spread collection, as opposed to other credit support. Through various cash flow tests, an amount of credit support is calculated that, when combined with Excess Spread, is sufficient to cover all losses under the various rating stress scenarios, while still paying timely interest and principal by the final maturity date for all tranches of Securities issued. Various cash flow runs are reviewed assuming multiples of expected repossession, losses and prepayments to value the amount of Excess Spread that would be generated over the life of the transaction. In a typical manufactured housing securitization, the cumulative net losses on the pool of loans are expected to represent approximately 6%–8% of the original pool balance. Various minimum standards for cash flows at each rating category level are then fixed. For example, in order to merit an ''AAA'' rating, the Rating Agency might require the cash flows sufficient to pay all interest and principal while withstanding a 44% cumulative default frequency, a recovery of 37% (assuming a recovery time lag of six months) and 28% in cumulative net losses. For a ''BBB'' rated tranche, cash flows might be required to withstand a 28% cumulative default frequency, a recovery upon default of 50% and 44% in cumulative losses. The originator's expected loss curve, i.e., how soon defaults occur in the life of the securitization are factored into the cash flow runs, which are then subjected to additional stress (e.g., if the originator's expected loss curve is such that 65% of all anticipated defaults will occur by year five after origination, the Rating Agency will assume 75% will occur in this time period). Finally, if such information is available, prepayments are presumed to occur first on the highest coupon-bearing loans, which maximizes the stress put on the cash flow runs. The final credit support is determined by setting the final loss coverage level required which represents some multiple of the cumulative credit losses expected over the life of the transaction.

At the time the original Underwriter Exemptions were requested, manufactured housing securitizations were structured to offer only ''AAA'' rated senior Securities using third-party letters of credit (LOC) as security, with spread accounts and Issuer recourse protecting the LOC. However, since that time, such transactions are typically structured using a senior/subordinated structure. All subordinated Securities which receive ''A'' or ''BBB'' ratings themselves have other forms of credit support. A typical transaction would have a large percentage of subordinated classes, representing 20% of the principal balances of the Securities, and such subordinated classes could range from ''AA'' to ''B'' rated tranches. These subordinated Securities have longer lives than the single tranche senior-only securitization transactions structured with credit support solely from third-party LOC and spread accounts.

Overcollateralization is also used as credit support for the subordinated Securities once the seniors have been paid. Because the coupon rate on manufactured housing loans is substantially higher than that charged on traditional residential mortgages, there is a large amount of Excess Spread (typically more than 300 bps) that can be used for credit support of both senior and subordinated tranches. In other structures, the Excess Spread is trapped into a reserve fund which provides the credit support for the subordinated tranches. In still other cases, credit support is provided to an investment-grade subordinated tranche through a junior subordinated tranche which receives principal only after the more senior subordinated tranches are paid. Sponsor guarantees are also used as credit support.

4. Commercial Mortgage-Backed Securities (CMBS)

The Applicant states that in a typical CMBS transaction, two classes of ''AAA'' rated Securities might be issued which represent approximately 78% of the principal balances of the Securities (one such ''AAA'' class will be issued with a shorter, and the other ''AAA'' class with a longer, expected maturity); ''AA'' rated subordinated Securities might represent 5%; ''A'' rated subordinated 5%; ''BBB'' rated subordinated 5% and junior subordinated Securities 7%. The total level of credit enhancement from all sources averages about 23% in order to

obtain ''AAA'' rated Securities, 18% for an ''AA'' rating, 13% for an ''A'' rating and 7% for a ''BBB'' rating. Subordination is generally the only type of credit support used in CMBS transactions. The Applicant provided the following description of the analysis performed by the Rating Agencies in their consideration of CMBS securitizations and their determination of appropriate credit support requirements.

(a) CMBS—General Considerations—CMBS transactions securitize pools of commercial mortgage loans which generally represent a mix of asset types, principally retail, multi-family, office, hotel/motel and industrial. While most CMBS transactions have pools with multiple Obligors on the loans, the term also includes securitizations which are ''property specific'' and represent either a single or small number of high-quality properties with respect to which there is one Obligor. While property specific CMBS securitizations do not represent a pool of mortgages with different Obligors, the LTV ratios are much lower, and the credit quality of the single Obligor is much higher, than would be the case in a CMBS securitization of a pool of assets. In property specific CMBS transactions, Securities are generally not issued with a rating lower than ''BBB'' which is an indication of the superior credit quality of the Obligors. Another category of CMBS transactions is the credit (or net) lease transaction where a loan is made to the ground lessor of the real estate and the securitization rating is based on the credit quality of the underlying lessee instead of the lessor/Obligor on the note. In a net lease transaction, the obligor on the note which is being securitized is the lessor of the property, and the lessee of the property is the party actually involved in the management of the property.[35] Accordingly, the true source of payment on the note is the cash flow generated by the lease payments. As a result, the ratings agencies look to the credit quality of the lessee and not that of the lessor/note obligor. However, the rating process for all three types of CMBS transactions is generally similar.

(b) CMBS—Due Diligence—Due diligence for CMBS is performed by multiple parties, at multiple levels. Every CMBS pool is sampled and analyzed by the originator, the Rating Agencies, the Underwriter and the purchasers of subordinated classes. Every mortgage pool is sampled for underwriting and site inspection due diligence. A representative sample of the collateral by loan size, geographic location, property type, originator and other common features is reviewed in conjunction with the assets that pose the largest risks to the transaction, such as loans with the largest balance or related borrowers. The asset summaries and files are reviewed to assure that the sample selection is representative of the pool. If the initial sample is insufficient, further sampling will be required until the Rating Agency is comfortable extrapolating the findings to the remainder of the pool. In property specific transactions, due diligence is performed for each property. Site inspections and file reviews are performed to determine the quality of the real estate and the integrity of the asset files. A quality grade may be assigned to each visited property. The quality grade will reflect the property location, condition, tenancy, management, amenities, competitive market position and other relevant information that may affect the underwriting of the asset. Asset summaries and loan files are reviewed to obtain more detailed information about pool assets and the quality of the underwriting.

The originator's mortgage loan systems are examined, as well as their actual execution through meetings with management and extensive file reviews. The number of years of the originator's real estate experience, whether it escrows taxes and insurance, whether it is able to provide several years of operating statements verified by source documents and whether there is recourse to a third party in case of fraud are considered. Audit checks and legal searches may also be performed on the originators.

The Servicer function in a CMBS transaction is particularly important because not only does the Servicer or Servicers fulfill the normal functions of collecting and remitting loan payments from borrowers to securityholders and advancing funds for such purposes, but the Servicer may also become responsible for activities relating to defaulted or potentially defaulting loans (which are more likely to be restructured than in non-commercial transactions where the loans are usually liquidated). If a Servicer advances funds, its credit rating cannot be more than one rating category below the highest rated tranche in the securitization and no less than ''BBB'' unless it has a qualifying back-up advancer. All entities servicing CMBS transactions must be approved by the Rating Agencies.

An additional responsibility of the Servicer is ensuring that insurance is maintained by each borrower covering each mortgaged property in accordance with the applicable mortgage documents. Insurance coverage typically includes, at a minimum, fire and casualty, general liability and rental interruption insurance but may include flood and earthquake coverage depending on the location of a particular mortgaged property. If a borrower fails to maintain the required insurance coverage or the mortgaged property defaults and becomes an asset of the Issuer, the Servicer is obligated to obtain insurance which, in pool transactions, may be provided by a blanket policy covering all pool properties. Generally, the blanket policy must be provided by an insurance provider with a rating of at least ''BBB.''

Each Servicer, special Servicer and Subservicer is required to maintain a fidelity bond and a policy of insurance covering loss occasioned by the errors and omissions of its officers and employees in connection with its servicing obligations unless the Rating Agency allows self-insurance. All fidelity bonds and policies of errors and omissions insurance must be issued in favor of the Trustee or the Issuer by insurance carriers which are rated by the Rating Agency with a claims-paying ability rating no lower than two categories below the highest rated Securities in the transaction but no less than ''BBB.'' Subservicers may not make important servicing decisions (such as modifications of the mortgage loans or the decision to foreclose) without the involvement of the Master Servicer or special Servicer, and the Trustee or any successor Servicer may be permitted to terminate the subservicing agreement without cause and without cost or further obligation to the Issuer or the holders of the rated Securities.

Loans secured by credit tenant leases require special analysis. Credit enhancement for credit tenant loans is based on an analysis of the probability that the lessee will file bankruptcy, and the likelihood that the lessee will disaffirm the lease and loan structures that may present a risk other than that of the lessee filing bankruptcy.

(c) CMBS—Determination of Expected Losses and Required Credit Support—The approach to rating CMBS transactions is not that different from other asset types, as it is based on the concept of estimating default frequency and loss severity for the loans being securitized, applying adjustments for

[35] In the case where the landlord owns the land and retains ownership of the building, the lessor would be both the ground lessor and the building lessor. In other cases, where the tenant owns the building, the landlord would be only the ground lessor. The obligation held by the Issuer would be secured by either the ground lease or the real estate.

various factors relating to the pool as a whole and stressing the pool projected performance at various levels to determine the credit support necessary for particular rating categories. However, the methodology differs from that used for other asset types because the payments on the loans are being made from the cash flow from the property's operations and not a borrower's personal funds. Accordingly, the focus of the rating process is on the ability of each property in the pool to generate sufficient net operating income to comfortably carry the debt service on a loan and to project the value of the business operation based on capitalization of such projected income. This allows the Rating Agencies to predict both default frequency and loss severity in case of a borrower defaulting on a loan and is accomplished by an in-depth evaluation of the properties that are being sampled in order to essentially ''reunderwrite'' the loans in the pool. An analysis is done to determine the ''debt service coverage ratio'' (DSCR) for each loan which is similar in concept to the due diligence performed by the original lender on the loan in deciding whether to make the loan and in what amount. However, the estimates given by the borrower are not used other than for informational purposes. Instead, the numbers are reconfigured by increasing projected expenses and decreasing projected income to take into account various contingencies using a worst-case scenario. The Rating Agencies differ somewhat in how they perform these calculations, but the analysis is intended to predict loss frequency and loss severity in order to make informed decisions about the credit support they will require at the different rating levels.

For example, the basic approach used by S&P to rate CMBS is to analyze the cash flow generated by each loan, the loan's DSCR based on stabilized net cash flow and its LTV ratio based on estimated property values, which value is determined by capitalization of the net cash flow generated by the property. These analyses are then used to determine whether that loan is likely to default under various stress scenarios, and if so, what the loss of principal might be. Further adjustments are made for a presumed percentage decline in the value of the property upon default and a lag time with an accompanying loss of income before the defaulted loan is actually liquidated. Each stress scenario is related to a particular rating category, so the aggregate estimated losses of all loans in the pool under a given scenario determine the amount of credit support required at each rating category. A matrix model is used to generate estimated losses under a variety of default scenarios which assume that the mortgage loans have a 100% probability of defaulting at specific DSCR and LTV thresholds and that the thresholds vary by property type and rating category. For example, in an ''AAA'' rating category, all multi-family loans with a DSCR below 1.65 and LTV ratios above 50% are presumed to default, and for a ''BBB'' rating, all such loans with DSCR below 1.30 and LTV ratios above 70% will default.

Fitch has a somewhat different approach to rating CMBS transactions. The Fitch performing loan model is based on research indicating that DSCR is the best indicator of loan default and that a loan with a high DSCR is less likely to default than a loan with a DSCR below 1.00. The modeling analysis is performed by calculating each DSCR assuming an ''A'' stress environment. After reunderwriting asset cash flows and stressing debt service, the DSCR is calculated. Based on the stressed DSCR, a default probability and loss severity is assigned. The expected loss on each loan is its percentage of the pool times its default probability times its loss severity. The default probability and loss severity assumptions based on the DSCR for each loan are then adjusted based on certain property and loan features to determine the necessary credit enhancement based on the individual loan characteristics. Next, the composition of the pool is analyzed to identify any concentration risks. Finally, the transaction structure is evaluated and incorporated into the ratings. The results are further adjusted to reflect various stresses from ''AAA'' to ''B.'' The final credit enhancement levels for a transaction equal the sum of the loan-by-loan expected losses based on the DSCR analysis plus or minus adjustments for particular asset characteristics, pool concentration issues and structural requirements.

Factors that are considered in determining cash flows are extensive and may differ among Rating Agencies but could include the following items. Management's budget for the property for the next year is reviewed taking into consideration economic and demographic information about the market in which a property is located. Trends in population growth, household formation and composition, employment, income, existing competition, the vacancy rate, trends in building permits and proposed construction are examined. In arriving at a stabilized income figure for all types of commercial properties, rents are adjusted to reflect market rates, and any seasonal changes in the income stream are factored into the analysis. Gross potential rental income and income from other sources are reduced by vacancy and collection losses. Assumptions based on property type of combined vacancy and credit losses are made, even if the historical vacancy and credit loss has been lower. All normal expenses for the property are accounted for whether currently incurred or not. If the property is subject to a ground lease, ground rent must also be included in expenses. If the ground rent payments increase significantly over time, the amount of the payment is stabilized by taking an average or calculating a level annual equivalent at an appropriate yield. Revenue is marked to the lower of market or actual rent and occupancy. Consideration is given for future conditions, such as new construction, that could affect rents and/or occupancy. Reserves are taken for normalized tenant improvement, leasing commissions and capital repair and maintenance. Care is taken to incorporate all material facts with respect to the property, such as lease rollover risk, credit tenants, ground lease payments, recent capital improvements, market conditions and collateral quality.

Debt service analysis estimates debt service payments required in the event a loan must be refinanced under a stress environment. A specific interest rate and amortization terms based on property types is assumed to determine a hypothetical constant payment rate. The refinance rate is not based on the prevailing interest rate or the highest historical rate but, rather, on rates generally available over a fixed period of years using a designated environment. For fixed-rate loans, the interest rate is reduced by a specified number of basis points if the loan is fully amortizing over its term, and the actual interest rate (the greater of pay or accrual rate) is used if it is higher than the assumed interest rate. Because floating-rate loans may be affected by rising interest rates, the lesser of the ceiling rate, if any, and a stress rate is used for floating-rate loans. In a pool transaction, each borrower may or may not be required to fund a replacement reserve for capital expenditures, depending on the practice of the loan originator. Regardless of whether replacement reserves are required, it is assumed that each borrower in a pool will find it necessary to make some amount of capital expenditures each year to preserve the value of its investment. Third-party appraisals of the underlying real estate assets are

considered, but they generally use such reports only for the information that they contain regarding conditions in local markets rather than for their specific property value conclusions.

Estimates of loss frequency and loss severity are further adjusted for the following types of qualitative factors: certain types of property will tend to lose tenants in economic stress periods (*e.g.*, hotels and restaurants) and will have more volatile cash flows (*e.g.*, seasonal industries); environmental risks, such as asbestos; climate risks (*e.g.*, earthquakes and floods) and economic trends (*e.g.*, some states are slow in paying nursing home reimbursements). Extensive default regression analysis has also been performed to isolate which asset types have higher default rates and higher loss severity percentages. The more geographically diversified the loans are, the lower the loss frequency. Loan size does not clearly correlate to loss frequency so is it minimized as a factor, but loan size can affect severity as the larger the loan the more severe its effect can be on the pool as a whole. Fixed interest rate loans have lower default and severity rates than floating, and the lower the interest rate, the lower the default rate. Balloon mortgage loans have a higher rate of default than amortizing loans. Loans with subordinated liens, loans underwritten by lenders with non-typical underwriting standards and loans characterized by prior defaults or workouts all require greater credit support.

Environmental reports for each property are generally required. A reserve is usually required for any reported remediation costs, and any actions covenanted must be completed within a specified period. Risks that cannot be quantified or that have not been mitigated through either remediation or reserves are assumed to pose a risk to the Trust and are reflected in the credit enhancement requirements. Properties with certain types of asbestos problems, or those that are assumed to have such problems given their date of construction, are assumed to have higher losses due to the clean-up costs and increased difficulty or cost in leasing or selling the asset. Seasoned or acquired pools that may not have current reports for each property are also assumed to have higher environmental losses.

(d) CMBS—Selecting the Type of Credit Support—In general, although there are other types of credit support available, subordination is the only type of credit support used in CMBS. However, protection is also provided to subordinated classes through the concept of a ''directing class'' which has evolved to give those holders of rated subordinated Securities in the first loss position some control over the servicing and realization on defaulted mortgage loans. In a typical transaction, the Servicer might be required to obtain the consent of the directing class before proceeding with any of the following: any modification, consent or forgiveness of principal or interest with respect to a defaulted mortgage loan; any proposed foreclosure or acquisition of a mortgaged property by deed-in-lieu of foreclosure; any proposed sale of a defaulted mortgage loan and any decision to conduct environmental clean up or remediation. The directing class might also have the right to remove a Servicer, with or without cause, subject to the Rating Agency's confirmation that appointment of the successor Servicer would not result in a qualification, withdrawal or downgrade of the then-applicable rating assigned to the rated Securities, compliance with the terms and conditions of the Pooling and Servicing Agreement and payment by the directing class of any and all termination or other fees relating to such removal. Holders of CMBS enjoy additional protection, in that the Master Servicer or Servicer occupies a first-loss position and usually holds an equity stake in the offering, which gives it an incentive to maximize recoveries on defaulted loans. The Master Servicer and Servicer are in a first loss position because they hold the most subordinated equity position interest(s) in the Issuer. Accordingly, they absorb losses before any other classes of securityholders.

Additional cash flow stability is created through call protection features on the commercial mortgages held in the Issuer. Call protection prevents the borrowers from prepaying the mortgage loans during a fixed ''lock-out period.'' In certain transactions, under the terms of the mortgage agreement, the borrower is only allowed to prepay the loan at the end of the lock-out period if it provides ''yield maintenance'' [36] whereby it is required to contribute a cash payment derived from a formula which is calculated based on current interest rates and is intended to offset the borrower's refinancing incentive. This amount also effectively compensates the Issuer for the loss of interest payable on the mortgage loan.

Another mechanism, referred to as ''defeasance'', assures stability of cash flow and operates as follows. If a borrower wishes to have the mortgage lien released on the property (for example, where it is being sold), the original obligation either remains an asset of the Issuer and is assumed by a third party, or a new obligation with the same outstanding principal balance, interest rate, periodic payment dates, maturity date and default provisions is entered into with such third party. The new obligation replicates the cash flows over the remaining term of the original obligor's obligation. In either case, the property or assets originally collateralizing the obligation are replaced by collateral consisting of United States Treasury securities or any other security guaranteed as to principal and interest by the United States, or by a person controlled or supervised by and acting as an instrumentality of the Government of the United States; for any of the foregoing (Government Securities). Defeasance generally operates so that, pursuant to an assumption and release or similar arrangement valid under applicable state law, the original obligor is replaced with a new obligor.

The new obligor is generally a bankruptcy-remote special purpose entity (SPE), the assets of which consist of Government Securities. In the defeasance of a mortgage loan held in a CMBS pool, a new entity must be created (the SPE) which becomes the obligor on the mortgage loan and holds the Government Securities being substituted for the original collateral securing the mortgage loan. This newly formed entity is required by the Rating Agencies to be an SPE in order to assure that the owner of the securities to be pledged has no liabilities or creditors other than the CMBS pool trustee, has no assets or business other than the ownership of the Government Securities and is not susceptible to substantive consolidation with the original mortgage borrower in the event of the original mortgage borrower's bankruptcy. Such an SPE is purely passive and does not engage in any activities other than the ownership of securities. Although there is no prescribed market requirement as to ownership of the SPE, the securitization sponsor (*e.g.*, the original mortgage lender) is usually its owner, except that in certain circumstances the original mortgage borrower may own the SPE for a variety of reasons; *e.g.*, to be entitled to any excess value of securities pledged as collateral at maturity of the new defeasance note over the amount due at such time. As a condition to

[36] The Applicant represents that the yield maintenance provision in the mortgage agreement would meet the definition of a ''yield supplement agreement'' currently permitted under section III.B.(3)(b) of the Underwriter Exemptions.

defeasance, all fees and expenses are paid at the substitution of the Government Securities for the mortgage lien. Mechanically, the Government Securities are transferred to a custodian which holds then as collateral for the securitization trust. The payments on the Government Securities are actually made directly to the Issuer so that the SPE does not receive any payments or make any payments.

Whether the original mortgage obligation is replaced with a new securitized obligation or the original obligation remains an asset of the Issuer, is usually dictated by how the transaction is treated for mortgage recording tax purposes under state law. Both call protection and defeasance are intended to protect investors from the risk of prepayments of the loans.

5. Corollary Effects of Requesting Relief for Subordinated and Investment Grade-Securities.

The Applicant wishes to note that the extension of exemptive relief to the Designated Transactions described in this Section V. has a corollary effect on other provisions of the Underwriter Exemptions which will be discussed here.

First, the current ''seasoning requirement'' contained in the last paragraph of section III.B. of the text of the current Underwriter Exemptions provides that Certificates which have been issued in other pools containing the same asset types must have been rated in one of the three highest generic rating categories for at least one year prior to the plan's acquisition of securities pursuant to the Underwriter Exemptions. The Applicant believes that it is consistent with the extension of exemptive relief to Designated Transactions to have this seasoning requirement expanded to cover securities issued in Designated Transactions which have been rated in one of the highest four generic rating categories.

Second, the current Underwriter Exemptions provide in footnote 9 that the term ''Trust'' includes a two-tier structure, provided that the securities held by the second Trust are not subordinated to the rights and interests evidenced by the first Trust. This restriction was based on the premise that the Underwriter Exemptions did not afford relief for any subordinated securities. The Applicant believes that it would be appropriate and consistent with the relief requested in Section I. of this application for this non-subordination restriction to be removed where the securities of the first Trust are issued in Designated Transactions, even if they are subordinated to other classes of securities issued by the first Trust.

VI. Remaining Provisions

A. Disclosure

In connection with the original issuance of Securities, the prospectus or private placement memorandum will be furnished to investing plans. The prospectus or private placement memorandum will contain information material to a fiduciary's decision to invest in the Securities, including:

1. Information concerning the payment terms of the Securities, the rating of the Securities, any material risk factors with respect to the Securities and the fact that principal amounts left in the Pre-Funding Account at the end of the Pre-Funding Period will be paid to securityholders as a repayment of principal.

2. A description of the Issuer as a legal entity and a description of how the Issuer was formed by the seller/Servicer or other Sponsor of the transaction;

3. Identification of the independent Trustee;

4. A description of the receivables contained in the Issuer, including the types of receivables, the diversification of the receivables, their principal terms and their material legal aspects, and a description of any Pre-Funding Account used or Capitalized Interest Account used in connection with a Pre-Funding Account;

5. A description of the Sponsor and Servicer;

6. A description of the Pooling and Servicing Agreement, including a description of the Sponsor's principal representations and warranties as to the Issuer's assets, including the terms and conditions for eligibility of any receivables transferred during the Pre-Funding Period and the Trustee's remedy for any breach thereof; a description of the procedures for collection of payments on receivables and for making distributions to investors, and a description of the accounts into which such payments are deposited and from which such distributions are made; a description of permitted investments for any Pre-Funding Account or Capitalized Interest Account; identification of the servicing compensation and a description of any fees for credit enhancement that are deducted from payments on receivables before distributions are made to investors; a description of periodic statements provided to the Trustee, and provided or made available to investors by the Issuer; and a description of the events that constitute events of default under the pooling and servicing contract and a description of the Trustee's and the investors' remedies incident thereto;

7. A description of the credit support;

8. A general discussion of the principal federal income tax consequences of the purchase, ownership and disposition of the Securities by a typical investor;

9. A description of the Underwriter's plan for distributing the Securities to investors;

10. Information about the scope and nature of the secondary market, if any, for the Securities; and

11. A statement as to the duration of any Pre-Funding Period and the Pre-Funding Limit for the Issuer.

Reports indicating the amount of payments of principal and interest are provided to securityholders at least as frequently as distributions are made to securityholders. Securityholders will also be provided with periodic information statements setting forth material information concerning the underlying assets, including, where applicable, information as to the amount and number of delinquent and defaulted loans or receivables.

In the case of an Issuer that offers and sells Securities in a registered public offering, the Issuer, the Servicer or the Sponsor will file such periodic reports as may be required to be filed under the Securities Exchange Act of 1934. Although some Issuers that offer Securities in a public offering will file quarterly reports on Form 10–Q and Annual Reports on Form 10–K, many Issuers obtain, by application to the Securities and Exchange Commission, relief from the requirement to file quarterly reports on Form 10–Q and a modification of the disclosure requirements for annual reports on Form 10–K. If such relief is obtained, these Issuers normally would continue to have the obligation to file current reports on Form 8–K to report material developments concerning the Issuer and the Securities and copies of the statements sent to securityholders. While the Securities and Exchange Commission's interpretation of the periodic reporting requirements is subject to change, periodic reports concerning an Issuer will be filed to the extent required under the Securities Exchange Act of 1934.

At or about the time distributions are made to securityholders, a report will be delivered to the Trustee as to the status of the Issuer and its assets, including underlying obligations. Such report will typically contain information regarding the Issuer's assets (including those purchased by the Issuer from any Pre-Funding Account), payments received or collected by the Servicer, the amount

of prepayments, delinquencies, Servicer advances, defaults and foreclosures, the amount of any payments made pursuant to any credit support, and the amount of compensation payable to the Servicer. Such report also will be delivered to or made available to the Rating Agency or Agencies that have rated the Securities.

In addition, promptly after each distribution date, securityholders will receive a statement prepared by the Servicer, paying agent or Trustee summarizing information regarding the Issuer and its assets. Such statement will include information regarding the Issuer and its assets, including underlying receivables. Such statement will typically contain information regarding payments and prepayments, delinquencies, the remaining amount of the guaranty or other credit support and a breakdown of payments between principal and interest.

B. Secondary Market Transactions

It is the Applicant's normal policy to attempt to make a market for Securities for which it is lead or co-managing Underwriter, and it is the Applicant's intention to make a market for any Securities for which the Applicant is a lead or co-managing Underwriter. At times the Applicant will facilitate sales by investors who purchase Securities if the Applicant has acted as agent or principal in the original private placement of the Securities and if such investors request the Applicant's assistance.

VII. Summary

In summary, the Applicant represents that the transactions for which exemptive relief is requested satisfy the statutory criteria of section 408(a) of the Act due to the following:

A. The Issuers contain ''fixed pools'' of assets. There is little discretion on the part of the Sponsor to substitute receivables contained in the Issuer once the Issuer has been formed;

B. In the case where a Pre-Funding Account is used, the characteristics of the receivables to be transferred to the Issuer during the Pre-Funding Period must be substantially similar to the characteristics of those transferred to the Issuer on the Closing Date thereby giving the Sponsor and/or originator little discretion over the selection process, and compliance with this requirement will be assured by the specificity of the characteristics and the monitoring mechanisms contemplated under the amended exemptive relief proposed. In addition, certain cash accounts will be established to support the Security interest rate and such cash accounts will be invested in short-term, conservative investments; the Pre-Funding Period will be of a reasonably short duration; a pre-funding limit will be imposed; and any Internal Revenue Service requirements with respect to pre-funding intended to preserve the passive income character of the Issuer will be met. The fiduciary of the plans making the decision to invest in Securities is thus fully apprised of the nature of the receivables which will be held in the Issuer and has sufficient information to make a prudent investment decision;

C. Securities in which plans invest will have been rated in one of the three highest generic rating categories (or four in the case of Designated Transactions) by a Rating Agency. The Rating Agency, in assigning a rating to such Securities, will take into account the fact that Issuers may hold interest rate swaps or yield supplement agreements with notional principal amounts or, in Designated Transactions, Securities may be issued by Issuers holding residential and home equity loans with LTV ratios in excess of 100%. Credit support will be obtained to the extent necessary to attain the desired rating;

D. Securities will be issued by Issuers whose assets will be protected from the claims of the Sponsor's creditors in the event of bankruptcy or other insolvency of the Sponsor, and both equity and debt securityholders will have a beneficial or security interest in the receivables held by the Issuer. In addition, an independent Trustee will represent the securityholders' interests in dealing with other parties to the transaction;

E. All transactions for which the Underwriter seeks exemptive relief will be governed by the Pooling and Servicing Agreement, the principal provisions of which are described in the prospectus or private placement memorandum and which is made available to plan fiduciaries for their review prior to the plan's investment in Securities;

F. Exemptive relief from sections 406(b) and 407 for sales to plans is substantially limited; and

G. The Underwriter has made, and anticipates that it will continue to make, a secondary market in Securities.

Notice to Interested Persons

The applicant represents that because those potentially interested participants and beneficiaries cannot all be identified, the only practical means of notifying such participants and beneficiaries of this proposed exemption is by the publication of this notice in the **Federal Register**. Comments and requests for a hearing must be received by the Department not later than 45 days from the date of publication of this notice of proposed exemption in the **Federal Register**.

General Information

The attention of interested persons is directed to the following:

1. The fact that a transaction is the subject of an exemption under section 408(a) of the Act and section 4975(c)(2) of the Code does not relieve a fiduciary or other party in interest or disqualified person from certain other provisions of the Act and the Code, including any prohibited transaction provisions to which the exemption does not apply and the general fiduciary responsibility provisions of section 404 of the Act, which require, among other things, a fiduciary to discharge his or her duties respecting the plan solely in the interest of the participants and beneficiaries of the plan and in a prudent fashion in accordance with section 404(a)(1)(B) of the Act; nor does it affect the requirements of section 401(a) of the Code that the plan operate for the exclusive benefit of the employees of the employer maintaining the plan and their beneficiaries;

2. Before an exemption can be granted under section 408(a) of the Act and section 4975(c)(2) of the Code, the Department must find that the exemption is administratively feasible, in the interest of the plans and of their participants and beneficiaries and protective of the rights of participants and beneficiaries of the plans;

3. The proposed amendment, if granted, will be supplemental to, and not in derogation of, any other provisions of the Act and/or the Code, including statutory or administrative exemptions and transitional rules. Furthermore, the fact that a transaction is subject to an administrative or statutory exemption is not dispositive of whether the transaction is in fact a prohibited transaction; and

4. The proposed amendment, if granted, will be subject to the express condition that the material facts and representations contained in each application are true and complete and accurately describe all material terms of the transaction which is the subject of the exemption.

Written Comments and Hearing Requests

All interested persons are invited to submit written comments or requests for a hearing on the proposed amendment to the address above, within the time period set forth above. All comments will be made a part of the record. Comments and requests for a hearing

should state the reasons for the writer's interest in the proposed amendment. Comments received will be available for public inspection with the referenced applications at the address set forth above.

Proposed Exemption

Under section 408(a) of ERISA and section 4975(c)(2) of the Code and in accordance with the procedures set forth in 29 CFR Part 2570, subpart B (55 FR 32836, August 10, 1990), the Department proposes to amend the following individual Prohibited Transaction Exemptions (PTEs): PTE 89–88, 54 FR 42582 (October 17, 1989); PTE 89–89, 54 FR 42569 (October 17, 1989); PTE 89–90, 54 FR 42597 (October 17, 1989); PTE 90–22, 55 FR 20542 (May 17, 1990); PTE 90–23, 55 FR 20545 (May 17, 1990); PTE 90–24, 55 FR 20548 (May 17, 1990); PTE 90–28, 55 FR 21456 (May 24, 1990); PTE 90–29, 55 FR 21459 (May 24, 1990); PTE 90–30, 55 FR 21461 (May 24, 1990); PTE 90–31, 55 FR 23144 (June 6, 1990); PTE 90–32, 55 FR 23147 (June 6, 1990); PTE 90–33, 55 FR 23151 (June 6, 1990); PTE 90–36, 55 FR 25903 (June 25, 1990); PTE 90–39, 55 FR 27713 (July 5, 1990); PTE 90–59, 55 FR 36724 (September 6, 1990); PTE 90–83, 55 FR 50250 (December 5, 1990); PTE 90–84, 55 FR 50252 (December 5, 1990); PTE 90–88, 55 FR 52899 (December 24, 1990); PTE 91–14, 55 FR 48178 (February 22, 1991); PTE 91–22, 56 FR 03277 (April 18, 1991); PTE 91–23, 56 FR 15936 (April 18, 1991); PTE 91–30, 56 FR 22452 (May 15, 1991); PTE 91–62, 56 FR 51406 (October 11, 1991); PTE 93–31, 58 FR 28620 (May 5, 1993); PTE 93–32, 58 FR 28623 (May 14, 1993); PTE 94–29, 59 FR 14675 (March 29, 1994); PTE 94–64, 59 FR 42312 (August 17, 1994); PTE 94–70, 59 FR 50014 (September 30, 1994); PTE 94–73, 59 FR 51213 (October 7, 1994); PTE 94–84, 59 FR 65400 (December 19, 1994); PTE 95–26, 60 FR 17586 (April 6, 1995); PTE 95–59, 60 FR 35938 (July 12, 1995); PTE 95–89, 60 FR 49011 (September 21, 1995); PTE 96–22, 61 FR 14828 (April 3, 1996); PTE 96–84, 61 FR 58234 (November 13, 1996); PTE 96–92, 61 FR 66334 (December 17, 1996); PTE 96–94, 61 FR 68787 (December 30, 1996); PTE 97–05, 62 FR 1926 (January 14, 1997); PTE 97–28, 62 FR 28515 (May 23, 1997); PTE 97–34, 62 FR 39021 (July 21, 1997); PTE 98–08, 63 FR 8498 (February 19, 1998); PTE 99–11, 64 FR 11046 (March 8, 1999); PTE 2000–19, 65 FR 25950 (May 4, 2000); PTE 2000–33, 65 FR 37171 (June 13, 2000); and PTE 2000–41, First Tennessee National Corporation (August, 2000).

In addition, the Department notes that it is also proposing individual exemptive relief for: Deutsche Bank AG, New York Branch and Deutsche Morgan Grenfell/C.J. Lawrence Inc., FAN 97–03E (December 9, 1996); Credit Lyonnais Securities (USA) Inc., FAN 97–21E (September 10, 1997); ABN AMRO Inc., FAN 98–08E (April 27, 1998); and Ironwood Capital Partners Ltd., FAN 99–31E (December 20, 1999). They have received the approval of the Department to engage in transactions substantially similar to the transactions described in the Underwriter Exemptions pursuant to PTE 96–62. Finally, the Department notes that it is proposing relief for Countrywide Securities Corporation (Application No. D–10863).

I. Transactions

A. Effective for transactions occurring on or after the date of publication of this notice in the **Federal Register**, the restrictions of sections 406(a) and 407(a) of the Act, and the taxes imposed by sections 4975(a) and (b) of the Code, by reason of section 4975(c)(1)(A) through (D) of the Code shall not apply to the following transactions involving Issuers and Securities evidencing interests therein:

(1) The direct or indirect sale, exchange or transfer of Securities in the initial issuance of Securities between the Sponsor or Underwriter and an employee benefit plan when the Sponsor, Servicer, Trustee or Insurer of an Issuer, the Underwriter of the Securities representing an interest in the Issuer, or an Obligor is a party in interest with respect to such plan;

(2) The direct or indirect acquisition or disposition of Securities by a plan in the secondary market for such Securities; and

(3) The continued holding of Securities acquired by a plan pursuant to subsection I.A.(1) or (2).

Notwithstanding the foregoing, section I.A. does not provide an exemption from the restrictions of sections 406(a)(1)(E), 406(a)(2) and 407 of the Act for the acquisition or holding of a Security on behalf of an Excluded Plan by any person who has discretionary authority or renders investment advice with respect to the assets of that Excluded Plan.[37]

B. Effective for transactions occurring on or after the date of publication of this notice in the **Federal Register**, the restrictions of sections 406(b)(1) and 406(b)(2) of the Act and the taxes imposed by sections 4975(a) and (b) of the Code, by reason of section 4975(c)(1)(E) of the Code, shall not apply to:

(1) The direct or indirect sale, exchange or transfer of Securities in the initial issuance of Securities between the Sponsor or Underwriter and a plan when the person who has discretionary authority or renders investment advice with respect to the investment of plan assets in the Securities is (a) an Obligor with respect to 5 percent or less of the fair market value of obligations or receivables contained in the Issuer, or (b) an Affiliate of a person described in (a); if:

(i) The plan is not an Excluded Plan;

(ii) Solely in the case of an acquisition of Securities in connection with the initial issuance of the Securities, at least 50 percent of each class of Securities in which plans have invested is acquired by persons independent of the members of the Restricted Group and at least 50 percent of the aggregate interest in the Issuer is acquired by persons independent of the Restricted Group;

(iii) A plan's investment in each class of Securities does not exceed 25 percent of all of the Securities of that class outstanding at the time of the acquisition; and

(iv) Immediately after the acquisition of the Securities, no more than 25 percent of the assets of a plan with respect to which the person has discretionary authority or renders investment advice are invested in Securities representing an interest in an Issuer containing assets sold or serviced by the same entity.[38] For purposes of this paragraph (iv) only, an entity will not be considered to service assets contained in a Issuer if it is merely a Subservicer of that Issuer;

(2) The direct or indirect acquisition or disposition of Securities by a plan in the secondary market for such Securities, provided that the conditions set forth in paragraphs (i), (iii) and (iv) of subsection I.B.(1) are met; and

(3) The continued holding of Securities acquired by a plan pursuant to subsection I.B.(1) or (2).

C. Effective for transaction occurring on or after the date of publication of this notice in the **Federal Register**, the restrictions of sections 406(a), 406(b) and 407(a) of the Act, and the taxes imposed by section 4975(a) and (b) of

[37] Section I.A. provides no relief from sections 406(a)(1)(E), 406(a)(2) and 407 of the Act for any person rendering investment advice to an Excluded Plan within the meaning of section 3(21)(A)(ii) of the Act, and regulation 29 CFR 2510.3–21(c).

[38] For purposes of this Underwriter Exemption, each plan participating in a commingled fund (such as a bank collective trust fund or insurance company pooled separate account) shall be considered to own the same proportionate undivided interest in each asset of the commingled fund as its proportionate interest in the total assets of the commingled fund as calculated on the most recent preceding valuation date of the fund.

the Code by reason of section 4975(c) of the Code, shall not apply to transactions in connection with the servicing, management and operation of an Issuer, including the use of any Eligible Swap Transaction; or, effective January 1, 1999, the defeasance of a mortgage obligation held as an asset of the Issuer through the substitution of a new mortgage obligation in a commercial mortgage-backed Designated Transaction, provided:

(1) Such transactions are carried out in accordance with the terms of a binding Pooling and Servicing Agreement;

(2) The Pooling and Servicing Agreement is provided to, or described in all material respects in the prospectus or private placement memorandum provided to, investing plans before they purchase Securities issued by the Issuer; [39] and

(3) The defeasance of a mortgage obligation and the substitution of a new mortgage obligation in a commercial mortgage-backed Designated Transaction meet the terms and conditions for such defeasance and substitution as are described in the prospectus or private placement memorandum for such Securities, which terms and conditions have been approved by a Rating Agency and does not result in the Securities receiving a lower credit rating from the Rating Agency than the current rating of the Securities.

Notwithstanding the foregoing, section I.C. does not provide an exemption from the restrictions of section 406(b) of the Act or from the taxes imposed by reason of section 4975(c) of the Code for the receipt of a fee by a Servicer of the Issuer from a person other than the Trustee or Sponsor, unless such fee constitutes a Qualified Administrative Fee.

D. Effective for transactions occurring on or after the date of publication of this notice in the **Federal Register**, the restrictions of sections 406(a) and 407(a) of the Act, and the taxes imposed by section 4975(a) and (b) of the Code by reason of section 4975(c)(1)(A) through (D) of the Code, shall not apply to any transactions to which those restrictions or taxes would otherwise apply merely because a person is deemed to be a party in interest or disqualified person (including a fiduciary) with respect to a plan by virtue of providing services to the plan (or by virtue of having a relationship to such service provider described in section 3(14)(F), (G), (H) or (I) of the Act or section 4975(e)(2)(F), (G), (H) or (I) of the Code), solely because of the plan's ownership of Securities.

[39] In the case of a private placement memorandum, such memorandum must contain substantially the same information that would be disclosed in a prospectus if the offering of the securities were made in a registered public offering under the Securities Act of 1933. In the Department's view, the private placement memorandum must contain sufficient information to permit plan fiduciaries to make informed investment decisions. For purposes of this exemption, references to ''prospectus'' include any related prospectus supplement thereto, pursuant to which Securities are offered to investors.

II. General Conditions

A. The relief provided under section I. is available only if the following conditions are met:

(1) The acquisition of Securities by a plan is on terms (including the Security price) that are at least as favorable to the plan as they would be in an arm's-length transaction with an unrelated party;

(2) The rights and interests evidenced by the Securities are not subordinated to the rights and interests evidenced by other Securities of the same Issuer, unless the Securities are issued in a Designated Transaction;

(3) The Securities acquired by the plan have received a rating from a Rating Agency at the time of such acquisition that is in one of the three (or in the case of Designated Transactions, four) highest generic rating categories;

(4) The Trustee is not an Affiliate of any member of the Restricted Group. For purposes of this requirement:

(a) The Trustee shall not be considered to be an Affiliate of a Servicer solely because the Trustee has succeeded to the rights and responsibilities of the Servicer pursuant to the terms of a Pooling and Servicing Agreement providing for such succession upon the occurrence of one or more events of default by the Servicer; and

(b) Effective for transactions occurring on or after January 1, 1998, subsection II.A.(4) will be deemed satisfied notwithstanding a Servicer becoming an Affiliate of the Trustee as the result of a merger or acquisition involving the Trustee, such Servicer and/or their Affiliates which occurs after the initial issuance of the Securities, provided that:

(i) such Servicer ceases to be an Affiliate of the Trustee no later than six months after the later of August 23, 2000, or the date such Servicer became an Affiliate of the Trustee; and

(ii) such Servicer did not breach any of its obligations under the Pooling and Servicing Agreement, unless such breach was immaterial and timely cured in accordance with the terms of such agreement, during the period from the closing date of such merger or acquisition transaction through the date the Servicer ceased to be an Affiliate of the Trustee;

(5) The sum of all payments made to and retained by the Underwriters in connection with the distribution or placement of Securities represents not more than Reasonable Compensation for underwriting or placing the Securities; the sum of all payments made to and retained by the Sponsor pursuant to the assignment of obligations (or interests therein) to the Issuer represents not more than the fair market value of such obligations (or interests); and the sum of all payments made to and retained by the Servicer represents not more than Reasonable Compensation for the Servicer's services under the Pooling and Servicing Agreement and reimbursement of the Servicer's reasonable expenses in connection therewith;

(6) The plan investing in such Securities is an ''accredited investor'' as defined in Rule 501(a)(1) of Regulation D of the Securities and Exchange Commission under the Securities Act of 1933; and

(7) In the event that the obligations used to fund a Issuer have not all been transferred to the Issuer on the Closing Date, additional obligations of the types specified in subsection III.B.(1) may be transferred to the Issuer during the Pre-Funding Period in exchange for amounts credited to the Pre-Funding Account, provided that:

(a) The Pre-Funding Limit is not exceeded;

(b) All such additional obligations meet the same terms and conditions for determining the eligibility of the original obligations used to create the Issuer (as described in the prospectus or private placement memorandum and/or Pooling and Servicing Agreement for such Securities), which terms and conditions have been approved by a Rating Agency. Notwithstanding the foregoing, the terms and conditions for determining the eligibility of an obligation may be changed if such changes receive prior approval either by a majority vote of the outstanding securityholders or by a Rating Agency;

(c) The transfer of such additional obligations to the Issuer during the Pre-Funding Period does not result in the Securities receiving a lower credit rating from a Rating Agency upon termination of the Pre-Funding Period than the rating that was obtained at the time of the initial issuance of the Securities by the Issuer;

(d) The weighted average annual percentage interest rate (the average interest rate) for all of the obligations

held by the Issuer at the end of the Pre-Funding Period will not be more than 100 basis points lower than the average interest rate for the obligations which were transferred to the Issuer on the Closing Date;

(e) In order to ensure that the characteristics of the receivables actually acquired during the Pre-Funding Period are substantially similar to those which were acquired as of the Closing Date, the characteristics of the additional obligations will either be monitored by a credit support provider or other insurance provider which is independent of the Sponsor or an independent accountant retained by the Sponsor will provide the Sponsor with a letter (with copies provided to the Rating Agency, the Underwriter and the Trustee) stating whether or not the characteristics of the additional obligations conform to the characteristics of such obligations described in the prospectus, private placement memorandum and/or Pooling and Servicing Agreement. In preparing such letter, the independent accountant will use the same type of procedures as were applicable to the obligations which were transferred as of the Closing Date;

(f) The Pre-Funding Period shall be described in the prospectus or private placement memorandum provided to investing plans; and

(g) The Trustee of the Trust (or any agent with which the Trustee contracts to provide Trust services) will be a substantial financial institution or trust company experienced in trust activities and familiar with its duties, responsibilities and liabilities as a fiduciary under the Act. The Trustee, as the legal owner of the obligations in the Trust or the holder of a security interest in the obligations held by the Issuer, will enforce all the rights created in favor of securityholders of the Issuer, including employee benefit plans subject to the Act;

(8) In order to insure that the assets of the Issuer may not be reached by creditors of the Sponsor in the event of bankruptcy or other insolvency of the Sponsor:

(a) The legal documents establishing the Issuer will contain:

(i) Restrictions on the Issuer's ability to borrow money or issue debt other than in connection with the securitization;

(ii) Restrictions on the Issuer merging with another entity, reorganizing, liquidating or selling assets (other than in connection with the securitization);

(iii) Restrictions limiting the authorized activities of the Issuer to activities relating to the securitization;

(iv) If the Issuer is not a Trust, provisions for the election of at least one independent director/partner/member whose affirmative consent is required before a voluntary bankruptcy petition can be filed by the Issuer; and

(v) If the Issuer is not a Trust, requirements that each independent director/partner/member must be an individual that does not have a significant interest in, or other relationships with, the Sponsor or any of its Affiliates; and

(b) The Pooling and Servicing Agreement and/or other agreements establishing the contractual relationships between the parties to the securitization transaction will contain covenants prohibiting all parties thereto from filing an involuntary bankruptcy petition against the Issuer or initiating any other form of insolvency proceeding until after the Securities have been paid; and

(c) Prior to the issuance by the Issuer of any Securities, a legal opinion is received which states that either:

(i) A ''true sale'' of the assets being transferred to the Issuer by the Sponsor has occurred and that such transfer is not being made pursuant to a financing of the assets by the Sponsor; or

(ii) In the event of insolvency or receivership of the Sponsor, the assets transferred to the Issuer will not be part of the estate of the Sponsor;

(9) If a particular class of Securities held by any plan involves a Ratings Dependent or Non-Ratings Dependent Swap entered into by the Issuer, then each particular swap transaction relating to such Securities:

(a) Shall be an Eligible Swap;

(b) Shall be with an Eligible Swap Counterparty;

(c) In the case of a Ratings Dependent Swap, shall provide that if the credit rating of the counterparty is withdrawn or reduced by any Rating Agency below a level specified by the Rating Agency, the Servicer (as agent for the Trustee) shall, within the period specified under the Pooling and Servicing Agreement:

(i) Obtain a replacement swap agreement with an Eligible Swap Counterparty which is acceptable to the Rating Agency and the terms of which are substantially the same as the current swap agreement (at which time the earlier swap agreement shall terminate); or

(ii) Cause the swap counterparty to establish any collateralization or other arrangement satisfactory to the Rating Agency such that the then current rating by the Rating Agency of the particular class of Securities will not be withdrawn or reduced.

In the event that the Servicer fails to meet its obligations under this subsection II.A.(9)(c), plan securityholders will be notified in the immediately following Trustee's periodic report which is provided to securityholders, and sixty days after the receipt of such report, the exemptive relief provided under section I.C. will prospectively cease to be applicable to any class of Securities held by a plan which involves such Ratings Dependent Swap; provided that in no event will such plan securityholders be notified any later than the end of the second month that begins after the date on which such failure occurs.

(d) In the case of a Non-Ratings Dependent Swap, shall provide that, if the credit rating of the counterparty is withdrawn or reduced below the lowest level specified in section III.GG., the Servicer (as agent for the Trustee) shall within a specified period after such rating withdrawal or reduction:

(i) Obtain a replacement swap agreement with an Eligible Swap Counterparty, the terms of which are substantially the same as the current swap agreement (at which time the earlier swap agreement shall terminate); or

(ii) Cause the swap counterparty to post collateral with the Trustee in an amount equal to all payments owed by the counterparty if the swap transaction were terminated; or

(iii) Terminate the swap agreement in accordance with its terms; and

(e) Shall not require the Issuer to make any termination payments to the counterparty (other than a currently scheduled payment under the swap agreement) except from Excess Spread or other amounts that would otherwise be payable to the Servicer or the Sponsor;

(10) Any class of Securities, to which one or more swap agreements entered into by the Issuer applies, may be acquired or held in reliance upon this Underwriter Exemption only by Qualified Plan Investors; and

(11) Prior to the issuance of any debt securities, a legal opinion is received which states that the debt holders have a perfected security interest in the Issuer's assets.

B. Neither any Underwriter, Sponsor, Trustee, Servicer, Insurer or any Obligor, unless it or any of its Affiliates has discretionary authority or renders investment advice with respect to the plan assets used by a plan to acquire Securities, shall be denied the relief provided under section I., if the provision of subsection II.A.(6) is not satisfied with respect to acquisition or holding by a plan of such Securities,

provided that (1) such condition is disclosed in the prospectus or private placement memorandum; and (2) in the case of a private placement of Securities, the Trustee obtains a representation from each initial purchaser which is a plan that it is in compliance with such condition, and obtains a covenant from each initial purchaser to the effect that, so long as such initial purchaser (or any transferee of such initial purchaser's Securities) is required to obtain from its transferee a representation regarding compliance with the Securities Act of 1933, any such transferees will be required to make a written representation regarding compliance with the condition set forth in subsection II.A.(6).

III. Definitions

For purposes of this exemption:

A. ''Security'' means:

(1) A pass-through certificate or trust certificate that represents a beneficial ownership interest in the assets of an Issuer which is a Trust and which entitles the holder to payments of principal, interest and/or other payments made with respect to the assets of such Trust; or

(2) A security which is denominated as a debt instrument that is issued by, and is an obligation of, an Issuer; with respect to which the Underwriter is either (i) the sole underwriter or the manager or co-manager of the underwriting syndicate, or (ii) a selling or placement agent.

B. ''Issuer'' means an investment pool, the corpus or assets of which are held in trust (including a grantor or owner Trust) or whose assets are held by a partnership, special purpose corporation or limited liability company (which Issuer may be a Real Estate Mortgage Investment Conduit (REMIC) or a Financial Asset Securitization Investment Trust (FASIT) within the meaning of section 860D(a) or section 860L, respectively, of the Code); and the corpus or assets of which consist solely of:

(1)(a) Secured consumer receivables that bear interest or are purchased at a discount (including, but not limited to, home equity loans and obligations secured by shares issued by a cooperative housing association); and/or

(b) Secured credit instruments that bear interest or are purchased at a discount in transactions by or between business entities (including, but not limited to, Qualified Equipment Notes Secured by Leases); and/or

(c) Obligations that bear interest or are purchased at a discount and which are secured by single-family residential, multi-family residential and/or commercial real property (including obligations secured by leasehold interests on residential or commercial real property); and/or

(d) Obligations that bear interest or are purchased at a discount and which are secured by motor vehicles or equipment, or Qualified Motor Vehicle Leases; and/or

(e) Guaranteed governmental mortgage pool certificates, as defined in 29 CFR 2510.3–101(i)(2);[40] and/or

(f) Fractional undivided interests in any of the obligations described in clauses (a)-(e) of this subsection B.(1).[41]

Notwithstanding the foregoing, residential and home equity loan receivables issued in Designated Transactions may be less than fully secured, provided that: (i) the rights and interests evidenced by the Securities issued in such Designated Transactions (as defined in section III.DD.) are not subordinated to the rights and interests evidenced by Securities of the same Issuer; (ii) such Securities acquired by the plan have received a rating from a Rating Agency at the time of such acquisition that is in one of the two highest generic rating categories; and (iii) any obligation included in the corpus or assets of the Issuer must be secured by collateral whose fair market value on the Closing Date of the Designated Transaction is at least equal to 80% of the sum of: (I) the outstanding principal balance due under the obligation which is held by the Issuer and (II) the outstanding principal balance(s) of any other obligation(s) of higher priority (whether or not held by the Issuer) which are secured by the same collateral.

(2) Property which had secured any of the obligations described in subsection III.B.(1);

(3)(a) Undistributed cash or temporary investments made therewith maturing no later than the next date on which distributions are made to securityholders; and/or

(b) Cash or investments made therewith which are credited to an account to provide payments to securityholders pursuant to any Eligible Swap Agreement meeting the conditions of subsection II.A.(9) or pursuant to any Eligible Yield Supplement Agreement; and/or

(c) Cash transferred to the Issuer on the Closing Date and permitted investments made therewith which:

(i) Are credited to a Pre-Funding Account established to purchase additional obligations with respect to which the conditions set forth in paragraphs (a)-(g) of subsection II.A.(7) are met; and/or

(ii) Are credited to a Capitalized Interest Account; and

(iii) Are held by the Issuer for a period ending no later than the first distribution date to securityholders occurring after the end of the Pre-Funding Period.

For purposes of this paragraph (c) of subsection III.B.(3), the term ''permitted investments'' means investments which: (i) Are either: (x) direct obligations of, or obligations fully guaranteed as to timely payment of principal and interest by, the United States or any agency or instrumentality thereof, provided that such obligations are backed by the full faith and credit of the United States or (y) have been rated (or the Obligor has been rated) in one of the three highest generic rating categories by a Rating Agency; (ii) are described in the Pooling and Servicing Agreement; and (iii) are permitted by the Rating Agency.

(4) Rights of the Trustee under the Pooling and Servicing Agreement, and rights under any insurance policies, third-party guarantees, contracts of suretyship, Eligible Yield Supplement Agreements, Eligible Swap Agreements meeting the conditions of subsection II.A.(9) or other credit support arrangements with respect to any obligations described in subsection III.B.(1).

Notwithstanding the foregoing, the term ''Issuer'' does not include any investment pool unless: (i) The assets of the type described in paragraphs (a)-(f) of subsection III.B.(1) which are contained in the investment pool have been included in other investment pools, (ii) Securities evidencing interests in such other investment pools have been rated in one of the three (or in the case of Designated Transactions, four) highest generic rating categories by a Rating Agency for at least one year prior to the plan's acquisition of Securities pursuant to this Underwriter

[40] In Advisory Opinion 99–05A (Feb. 22, 1999), the Department expressed its view that mortgage pool certificates guaranteed and issued by the Federal Agricultural Mortgage Corporation (''Farmer Mac'') meet the definition of a guaranteed governmental mortgage pool certificate as defined in 29 CFR 2510.3–101(i)(2).

[41] The Department wishes to take the opportunity to clarify its view that the definition of Issuer contained in subsection III.B. includes a two-tier structure under which Securities issued by the first Issuer, which contains a pool of receivables described above, are transferred to a second Issuer which issues Securities that are sold to plans. However, the Department is of the further view that, since the Underwriter Exemption generally provides relief only for the direct or indirect acquisition or disposition of Securities that are not subordinated, no relief would be available if the Securities held by the second Issuer were subordinated to the rights and interests evidenced by other Securities issued by the first Issuer, unless such Securities were issued in a Designated Transaction.

Exemption, and (iii) Securities evidencing interests in such other investment pools have been purchased by investors other than plans for at least one year prior to the plan's acquisition of Securities pursuant to this Underwriter Exemption.

C. ''Underwriter'' means:

(1) An entity defined as an Underwriter in subsection III.C.(1) of each of the Underwriter Exemptions that are being amended by this proposed exemption. In addition, the term Underwriter includes Deutsche Bank AG, New York Branch and Deutsche Morgan Grenfell/C.J. Lawrence Inc, Credit Lyonnais Securities (USA) Inc., ABN AMRO Inc. and Ironwood Capital Partners Ltd. (which received the approval of the Department to engage in transactions substantially similar to the transactions described in the Underwriter Exemptions pursuant to PTE 96–62);

(2) Any person directly or indirectly, through one or more intermediaries, controlling, controlled by or under common control with such entity; or

(3) Any member of an underwriting syndicate or selling group of which a person described in subsections III.C.(1) or (2) is a manager or co-manager with respect to the Securities.

D. ''Sponsor'' means the entity that organizes an Issuer by depositing obligations therein in exchange for Securities.

E. ''Master Servicer'' means the entity that is a party to the Pooling and Servicing Agreement relating to assets of the Issuer and is fully responsible for servicing, directly or through Subservicers, the assets of the Issuer.

F. ''Subservicer'' means an entity which, under the supervision of and on behalf of the Master Servicer, services loans contained in the Issuer, but is not a party to the Pooling and Servicing Agreement.

G. ''Servicer'' means any entity which services loans contained in the Issuer, including the Master Servicer and any Subservicer.

H. ''Trust'' means an Issuer which is a trust (including an owner trust, grantor trust or a REMIC or FASIT which is organized as a Trust).

I. ''Trustee'' means the Trustee of any Trust which issues Securities and also includes an Indenture Trustee. ''Indenture Trustee'' means the Trustee appointed under the indenture pursuant to which the subject Securities are issued, the rights of holders of the Securities are set forth and a security interest in the Trust assets in favor of the holders of the Securities is created. The Trustee or the Indenture Trustee is also a party to or beneficiary of all the documents and instruments transferred to the Issuer, and as such, has both the authority to, and the responsibility for, enforcing all the rights created thereby in favor of holders of the Securities, including those rights arising in the event of default by the servicer.

J. ''Insurer'' means the insurer or guarantor of, or provider of other credit support for, an Issuer. Notwithstanding the foregoing, a person is not an insurer solely because it holds Securities representing an interest in an Issuer which are of a class subordinated to Securities representing an interest in the same Issuer.

K. ''Obligor'' means any person, other than the Insurer, that is obligated to make payments with respect to any obligation or receivable included in the Issuer. Where an Issuer contains Qualified Motor Vehicle Leases or Qualified Equipment Notes Secured by Leases, ''Obligor'' shall also include any owner of property subject to any lease included in the Issuer, or subject to any lease securing an obligation included in the Issuer.

L. ''Excluded Plan'' means any plan with respect to which any member of the Restricted Group is a ''plan sponsor'' within the meaning of section 3(16)(B) of the Act.

M. ''Restricted Group'' with respect to a class of Securities means:

(1) Each Underwriter;

(2) Each Insurer;

(3) The Sponsor;

(4) The Trustee;

(5) Each Servicer;

(6) Any Obligor with respect to obligations or receivables included in the Issuer constituting more than 5 percent of the aggregate unamortized principal balance of the assets in the Issuer, determined on the date of the initial issuance of Securities by the Issuer;

(7) Each counterparty in an Eligible Swap Agreement; or

(8) Any Affiliate of a person described in subsections III.M.(1)-(7).

N. ''Affiliate'' of another person includes:

(1) Any person directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with such other person;

(2) Any officer, director, partner, employee, relative (as defined in section 3(15) of the Act), a brother, a sister, or a spouse of a brother or sister of such other person; and

(3) Any corporation or partnership of which such other person is an officer, director or partner.

O. ''Control'' means the power to exercise a controlling influence over the management or policies of a person other than an individual.

P. A person will be ''independent'' of another person only if:

(1) Such person is not an Affiliate of that other person; and

(2) The other person, or an Affiliate thereof, is not a fiduciary who has investment management authority or renders investment advice with respect to any assets of such person.

Q. ''Sale'' includes the entrance into a Forward Delivery Commitment, provided:

(1) The terms of the Forward Delivery Commitment (including any fee paid to the investing plan) are no less favorable to the plan than they would be in an arm's-length transaction with an unrelated party;

(2) The prospectus or private placement memorandum is provided to an investing plan prior to the time the plan enters into the Forward Delivery Commitment; and

(3) At the time of the delivery, all conditions of this Underwriter Exemption applicable to sales are met.

R. ''Forward Delivery Commitment'' means a contract for the purchase or sale of one or more Securities to be delivered at an agreed future settlement date. The term includes both mandatory contracts (which contemplate obligatory delivery and acceptance of the Securities) and optional contracts (which give one party the right but not the obligation to deliver Securities to, or demand delivery of Securities from, the other party).

S. ''Reasonable Compensation'' has the same meaning as that term is defined in 29 CFR 2550.408c–2.

T. ''Qualified Administrative Fee'' means a fee which meets the following criteria:

(1) The fee is triggered by an act or failure to act by the Obligor other than the normal timely payment of amounts owing in respect of the obligations;

(2) The Servicer may not charge the fee absent the act or failure to act referred to in subsection III.T.(1);

(3) The ability to charge the fee, the circumstances in which the fee may be charged, and an explanation of how the fee is calculated are set forth in the Pooling and Servicing Agreement; and

(4) The amount paid to investors in the Issuer will not be reduced by the amount of any such fee waived by the Servicer.

U. ''Qualified Equipment Note Secured By A Lease'' means an equipment note:

(1) Which is secured by equipment which is leased;

(2) Which is secured by the obligation of the lessee to pay rent under the equipment lease; and

(3) With respect to which the Issuer's security interest in the equipment is at least as protective of the rights of the Issuer as the Issuer would have if the equipment note were secured only by the equipment and not the lease.

V. ''Qualified Motor Vehicle Lease'' means a lease of a motor vehicle where:

(1) The Issuer owns or holds a security interest in the lease;

(2) The Issuer owns or holds a security interest in the leased motor vehicle; and

(3) The Issuer's security interest in the leased motor vehicle is at least as protective of the Issuer's rights as the Issuer would receive under a motor vehicle installment loan contract.

W. ''Pooling and Servicing Agreement'' means the agreement or agreements among a Sponsor, a Servicer and the Trustee establishing a Trust. ''Pooling and Servicing Agreement'' also includes the indenture entered into by the Issuer and the Indenture Trustee.

X. ''Rating Agency'' means Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies Inc., Moody's Investors Service, Inc., Duff & Phelps Credit Rating Co., Fitch ICBA, Inc. or any successors thereto.

Y. ''Capitalized Interest Account'' means an Issuer account:

(i) which is established to compensate securityholders for shortfalls, if any, between investment earnings on the Pre-Funding Account and the interest rate payable under the Securities; and (ii) which meets the requirements of paragraph (c) of subsection III.B.(3).

Z. ''Closing Date'' means the date the Issuer is formed, the Securities are first issued and the Issuer's assets (other than those additional obligations which are to be funded from the Pre-Funding Account pursuant to subsection II.A.(7)) are transferred to the Issuer.

AA. ''Pre-Funding Account'' means an Issuer account: (i) which is established to purchase additional obligations, which obligations meet the conditions set forth in paragraph (a)–(g) of subsection II.A.(7); and (ii) which meets the requirements of paragraph (c) of subsection III.B.(3).

BB. ''Pre-Funding Limit'' means a percentage or ratio of the amount allocated to the Pre-Funding Account, as compared to the total principal amount of the Securities being offered, which is less than or equal to: (i) 40 percent, effective for transactions occurring on or after January 1, 1992, but prior to May 23, 1997; and (ii) 25 percent, for transactions occurring on or after May 23, 1997.

CC. ''Pre-Funding Period'' means the period commencing on the Closing Date and ending no later than the earliest to occur of: (i) the date the amount on deposit in the Pre-Funding Account is less than the minimum dollar amount specified in the Pooling and Servicing Agreement; (ii) the date on which an event of default occurs under the Pooling and Servicing Agreement or (iii) the date which is the later of three months or ninety days after the Closing Date.

DD. ''Designated Transaction'' means a securitization transaction in which the assets of the Issuer consist of secured consumer receivables, secured credit instruments or secured obligations that bear interest or are purchased at a discount and are: (i) Motor vehicle, home equity and/or manufactured housing consumer receivables; and/or (ii) motor vehicle credit instruments in transactions by or between business entities; and/or (iii) single-family residential, multi-family residential, home equity, manufactured housing and/or commercial mortgage obligations that are secured by single-family residential, multi-family residential, commercial real property or leasehold interests therein. For purposes of this section III.DD., the collateral securing motor vehicle consumer receivables or motor vehicle credit instruments may include motor vehicles and/or Qualified Motor Vehicle Leases.

EE. ''Ratings Dependent Swap'' means an interest rate swap, or (if purchased by or on behalf of the Issuer) an interest rate cap contract, that is part of the structure of a class of Securities where the rating assigned by the Rating Agency to any class of Securities held by any plan is dependent on the terms and conditions of the swap and the rating of the counterparty, and if such Security rating is not dependent on the existence of the swap and rating of the counterparty, such swap or cap shall be referred to as a ''Non-Ratings Dependent Swap''. With respect to a Non-Ratings Dependent Swap, each Rating Agency rating the Securities must confirm, as of the date of issuance of the Securities by the Issuer, that entering into an Eligible Swap with such counterparty will not affect the rating of the Securities.

FF. ''Eligible Swap'' means a Ratings Dependent or Non-Ratings Dependent Swap:

(1) Which is denominated in U.S. dollars;

(2) Pursuant to which the Issuer pays or receives, on or immediately prior to the respective payment or distribution date for the class of Securities to which the swap relates, a fixed rate of interest, or a floating rate of interest based on a publicly available index (*e.g.,* LIBOR or the U.S. Federal Reserve's Cost of Funds Index (COFI)), with the Issuer receiving such payments on at least a quarterly basis and obligated to make separate payments no more frequently than the counterparty, with all simultaneous payments being netted;

(3) Which has a notional amount that does not exceed either: (i) The principal balance of the class of Securities to which the swap relates, or (ii) the portion of the principal balance of such class represented solely by those types of corpus or assets of the Issuer referred to in subsections III.B.(1), (2) and (3);

(4) Which is not leveraged (*i.e.,* payments are based on the applicable notional amount, the day count fractions, the fixed or floating rates designated in subsection III.FF.(2), and the difference between the products thereof, calculated on a one to one ratio and not on a multiplier of such difference);

(5) Which has a final termination date that is either the earlier of the date on which the Issuer terminates or the related class of securities is fully repaid; and

(6) Which does not incorporate any provision which could cause a unilateral alteration in any provision described in subsections III.FF.(1) through (4) without the consent of the Trustee.

GG. ''Eligible Swap Counterparty'' means a bank or other financial institution which has a rating, at the date of issuance of the Securities by the Issuer, which is in one of the three highest long-term credit rating categories, or one of the two highest short-term credit rating categories, utilized by at least one of the Rating Agencies rating the Securities; provided that, if a swap counterparty is relying on its short-term rating to establish eligibility under the Underwriter Exemption, such swap counterparty must either have a long-term rating in one of the three highest long-term rating categories or not have a long-term rating from the applicable Rating Agency, and provided further that if the class of Securities with which the swap is associated has a final maturity date of more than one year from the date of issuance of the Securities, and such swap is a Ratings Dependent Swap, the swap counterparty is required by the terms of the swap agreement to establish any collateralization or other arrangement satisfactory to the Rating Agencies in the event of a ratings downgrade of the swap counterparty.

HH. ''Qualified Plan Investor'' means a plan investor or group of plan investors on whose behalf the decision to purchase Securities is made by an appropriate independent fiduciary that is qualified to analyze and understand

the terms and conditions of any swap transaction or Eligible Yield Supplement Agreement used by the Issuer and the effect such swap or Agreement would have upon the credit ratings of the Securities. For purposes of the Underwriter Exemption, such a fiduciary is either:

(1) A ''qualified professional asset manager'' (QPAM),[42] as defined under Part V(a) of PTE 84–14, 49 FR 9494, 9506 (March 13, 1984);

(2) An ''in-house asset manager'' (INHAM),[43] as defined under Part IV(a) of PTE 96–23, 61 FR 15975, 15982 (April 10, 1996); or

(3) A plan fiduciary with total assets under management of at least $100 million at the time of the acquisition of such Securities.

II. ''Excess Spread'' means, as of any day funds are distributed from the Issuer, the amount by which the interest allocated to Securities exceeds the amount necessary to pay interest to securityholders, servicing fees and expenses.

JJ. ''Eligible Yield Supplement Agreement'' means any yield supplement agreement, similar yield maintenance arrangement or, if purchased by or on behalf of the Issuer, an interest rate cap contract to supplement the interest rates otherwise payable on obligations described in subsection III.B.(1). Effective for transactions occurring on or after April 7, 1998, such an agreement or arrangement may involve a notional principal contract provided that:

(1) It is denominated in U.S. dollars;

(2) The Issuer receives on, or immediately prior to the respective payment date for the Securities covered by such agreement or arrangement, a fixed rate of interest or a floating rate of interest based on a publicly available index (e.g., LIBOR or COFI), with the Issuer receiving such payments on at least a quarterly basis;

(3) It is not ''leveraged'' as described in subsection III.FF.(4);

(4) It does not incorporate any provision which would cause a unilateral alteration in any provision described in subsections III.JJ.(1)–(3) without the consent of the Trustee;

(5) It is entered into by the Issuer with an Eligible Swap Counterparty; and

(6) It has a notional amount that does not exceed either: (i) the principal balance of the class of Securities to which such agreement or arrangement relates, or (ii) the portion of the principal balance of such class represented solely by those types of corpus or assets of the Issuer referred to in subsections III.B.(1), (2) and (3).

[42] PTE 84–14 provides a class exemption for transactions between a party in interest with respect to an employee benefit plan and an investment fund (including either a single customer or pooled separate account) in which the plan has an interest, and which is managed by a QPAM, provided certain conditions are met. QPAMs (e.g., banks, insurance companies, registered investment advisers with total client assets under management in excess of $50 million) are considered to be experienced investment managers for plan investors that are aware of their fiduciary duties under ERISA.

[43] PTE 96–23 permits various transactions involving employee benefit plans whose assets are managed by an INHAM, an entity which is generally a subsidiary of an employer sponsoring the plan which is a registered investment adviser with management and control of total assets attributable to plans maintained by the employer and its affiliates which are in excess of $50 million.

IV. Modifications

For the Underwriter Exemptions provided to Residential Funding Corporation, Residential Funding Mortgage Securities, Inc., *et al.* and GE Capital Mortgage Services, Inc. and GECC Capital Markets (the Applicants) (PTEs 94–29 and 94–73, respectively);

A. Section III.A. of this proposed exemption is modified to read as follows:

A. ''Security'' means:

(1) A pass-through certificate or trust certificate that represents a beneficial ownership interest in the assets of an Issuer which is a Trust and which entitles the holder to payments of principal, interest and/or other payments made with respect to the assets of such Trust; or

(2) A security which is denominated as a debt instrument that is issued by, and is an obligation of, an Issuer; with respect to which (i) one of the Applicants or any of its Affiliates is the Sponsor, [and] an entity which has received from the Department an individual prohibited transaction exemption relating to Securities which is similar to this proposed exemption, is the sole underwriter or the manager or co-manager of the underwriting syndicate or a selling or placement agent or (ii) one of the Applicants or any of its Affiliates is the sole underwriter or the manager or co-manager of the underwriting syndicate, or a selling or placement agent.

B. Section III.C. of this proposed exemption is modified to read as follows:

C. Underwriter means:

(1) An entity defined as an Underwriter in subsection III.C.(1) of each of the Underwriter Exemptions that are being amended by this proposed exemption. In addition, the term Underwriter includes Ironwood Capital Partners Ltd., Deutsche Bank AG, New York Branch and Deutsche Morgan Grenfell/C.J. Lawrence Inc.; ABN AMRO and Credit Lyonnais Securities, Inc. (which received the approval of the Department to engage in transactions substantially similar to the transactions described in the Underwriter Exemptions pursuant to PTE 96–62);

(2) Any person directly or indirectly, through one or more intermediaries, controlling, controlled by or under common control with such entity;

(3) Any member of an underwriting syndicate or selling group of which a person described in subsections III.C.(1) or (2) above is a manger or co-manager with respect to the Securities; or

(4) Any entity which has received from the Department an individual prohibited transaction exemption relating to Securities which is similar to this proposed exemption.

V. Effective Date

If adopted, this proposed exemption would be effective for transactions occurring on or after the date the proposed exemption is published in the **Federal Register**, except as otherwise provided in section I.C., subsection II.A.(4)(b), and section III.JJ. of the proposed exemption. Section I.C., relating to the defeasance of mortgage obligations, would be applicable to transactions occurring on or after January 1, 1999; subsection II.A.(4)(b) would be applicable to transactions occurring on or after January 1, 1998; and section III.JJ., relating to Eligible Yield Supplement Agreements involving notional principal contracts, would be applicable to transactions occurring on or after April 7, 1998.

Signed at Washington, DC this 16th day of August, 2000.

Ivan L. Strasfeld,

Director of Exemption Determinations, Pension and Welfare Benefits Administration, Department of Labor.

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