



Finance ADVISORY ■

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Risk Retention Provisions: Final Implementation Rules Published

On October 21, 2014, the Board of Governors of the Federal Reserve System, the Securities and Exchange Commission, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Department of Housing and Urban Development, and the Federal Housing Finance Agency published final rules for implementing Section 941 of the Dodd-Frank Act as it relates to credit risk retention provisions.

Here are the impacts and compliance times most germane to commercial mortgage-backed securities (CMBS):

- Rules apply to both transactions registered under the Securities Act of 1933 (i.e., public deals) and those transactions exempt (i.e., private deals/Rule 144A deals).
- Compliance for CMBS is required two years after publication in the *Federal Register*.
- A 5 percent of fair value of all CMBS issued in a particular transaction in accordance with generally accepted accounting principles' risk retention rules was adopted with use of an eligible horizontal residual interest.
- A 5 percent of fair value vertical option was also adopted so that the sponsor (or a majority-affiliate) will need to hold 5 percent of each tranche, and if multiple sponsors, only one may hold to fulfill requirement.
- The B-piece buyer (or a majority-affiliate) may use the B-piece option to satisfy the above risk retention requirement under the following conditions:
 - The B-piece buyer pays for its B-piece in cash at the closing of the securitization transaction and does not obtain any financing from a related transaction party;
 - If multiple B-piece buyers are used, the B-piece buyers are *pari passu* with each other;
 - The B-piece buyer may be affiliated with the related special servicer;
 - The B-piece buyer is independent of originators of more than 10 percent of the securitized assets;
 - The B-piece shall not be transferred within the first five years of the transaction;
 - The transaction sponsor shall be responsible for monitoring compliance by the B-piece buyer; and
 - The B-piece buyer must disclose the price paid for the B-piece, the name and form of organization of each B-piece buyer, the B piece buyer's experience in CMBS, and the fair value of the B-piece.

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- If the B-piece option is used, an operating advisor must be appointed to the transaction.
 - An entity that is to be an operating advisor does not have specific regulatory requirements.
 - The operating advisor's authority is limited to consultation with the special servicer after B-piece control has ended (i.e., 75 percent or more of the B-piece's original principal balance has been eradicated).
 - Appraisal reductions and realized losses must be considered in determining the end of B-piece control.
 - The operating advisor reviews actions of the special servicer and reports to securities holders and may recommend termination.
 - If the operating advisor wishes to terminate the special servicer, it requires an affirmative majority vote of investors (with a 20 percent quorum) and the quorum must include at least three holders unaffiliated with each other.
- If the CMBS pool is solely a qualifying commercial real estate (CRE) loan, there are no risk retention rules if:
 - The loan is secured by a property with five or more single family units, or by non-farm, non-residential real property, the primary source (50 percent or more) of repayment for which is expected to be rental income associated with the property or the proceeds of the sale, refinancing, or permanent financing of the property.
 - The loan is secured by improved land if the obligor owns the fee interest in the land and the land is leased to a third party who owns all improvements on the land, and the improvements are nonresidential or residential with five or more single family units.
 - The loan has a debt service coverage ratio (DSCR) of 1.5x or greater, if the loan is a qualifying leased CRE loan, net of any income derived from tenants who are not qualified tenants.
 - The loan has a DSCR of 1.25x or greater, if the loan is a qualifying multifamily property loan.
 - The loan has a DSCR of 1.7x or greater, if the loan is any other type of CRE loan.
 - The loan has a maximum loan-to-value ratio of 65 percent and maximum combined loan-to-value ratio of 70 percent.
 - Loan may not be interest-only for any period or for the entirety of the loan term.

Should you have any questions about how this new rule impacts the way you do business, please contact **Robert Sullivan** or **Geoff Maibohm**.

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