

Proposed Deal Agent Framework: Background and Introduction

Prior to the 2008 financial crisis, the US non-agency residential mortgage (RMBS) market had over \$2.5 trillion dollars outstanding and was a key source of private capital for the US mortgage system. The new origination RMBS market has remained effectively closed since 2008 and, while many factors may have contributed, numerous investors cite serious deficiencies within existing RMBS transactions for their lack of engagement in the new issue market. The “Deal Agent Framework” is a proposal to reform the securitization contracts for U.S. RMBS transactions in a manner that we believe would significantly enhance the governance protocols built into the current U.S. RMBS structures.

This proposal is based on over 18 months of discussions facilitated by the U.S. Department of Treasury (“Treasury”) under its “Private Label Securitization (PLS) Initiative”. The Treasury’s PLS Initiative provided a forum for a large number of industry participants (investors, mortgage originators and aggregators, mortgage servicers, trustees, potential Deal Agents and rating agencies) to address several topics, including: servicer oversight, representations & warranties enforcement and the role of the trustee. Over time, a substantial portion of the group’s conversations focused closely on the request by investor representatives for the inclusion in the trust of an independent party (the “Deal Agent”) that would represent the interests of all investors in the trust, subject to robust and continuous fiduciary duties of care and loyalty.

The resulting Deal Agent Framework, crafted and supported by many PLS Initiative participants, aims to improve RMBS transactions by ensuring that all parties to the securitization contracts fulfill their contractual obligations, and are subject to the oversight of an entity empowered with enforcement authority in the event such party determines events of non-compliance. This key new entity, the Deal Agent, would be a party to the securitization contracts, act in a fiduciary-like capacity to maximize the value of trust assets, and have the authority (either directly or through direction to the trustee) to enforce these contracts on behalf of all investors. While some of the Deal Agent’s functions were previously assigned to other entities within the trust, many investors have concluded that their interests would be best protected by entrusting the governance of the trust primarily to a party that is subject to fiduciary duties of care and loyalty.

In addition to enforcing the existing contractual responsibilities of the trust parties, the Deal Agent would be authorized to act on behalf of all investors to negotiate amendments to the securitization contracts. This would allow the trust to adapt to unforeseen events in order to protect the best interests of all investors. This is a major enhancement from current securitization structures, where the amendment process is extremely difficult and faces the

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hurdles of a special purpose vehicle that has historically been designed to be passive and is hampered by conflicts of interest and significant operational challenges posed by the requirement for bondholder voting. Various provisions were discussed to ensure that the Deal Agent performed its role in a balanced fashion.

We are publicly releasing the “Key Principles of the Deal Agent Framework” to explain the goals of the proposal, disseminate it to participants in the broader market, and solicit feedback from additional parties. The Key Principles attached should be viewed as the essential elements that Framework proponents believe are necessary for the Deal Agent construct to accomplish its intended goals:

- provide fair protections to all investors in the trust;
- allow trust parties to adapt to events not specifically contemplated in the securitization contracts;
- increase transparency into those actions.

On behalf of the Framework’s proponents, we hope that issuers and other transaction parties will consider these goals as they design new RMBS transactions. Should they incorporate the proposed Framework, we believe that many influential and impactful investors will be encouraged to re-engage in what would amount to a significantly reformed new issue U.S. RMBS market.

Thank you to Treasury for facilitating and encouraging open dialogue across many parties with sometimes diverging interests. Thank you to all the participants in the working group who have shared their deep and diverse experiences and put in countless hours of work toward the shared goal of improving and reforming the structure of RMBS. While the proposed Deal Agent Framework has been extensively debated and we believe it has gained acceptance among many active participants in the working group, particularly among investors, we do not represent that a unanimous consensus has yet been achieved. We expect the dialogue that gave rise to the proposed Framework will continue among proponents and those who are still considering or support alternative constructs.

In addition, we believe the proposed Deal Agent Framework is complementary to the efforts by Structured Finance Industry Group's RMBS 3.0 Task Force and to the fiduciary model advanced by the Association of Institutional INVESTORS. We therefore encourage RMBS 3.0 participants to evaluate the proposed Framework as they continue their work toward the goals we share.

Additional work is necessary toward the practical implementation of the Deal Agent Framework, particularly the enhancement of the underlying securitization contracts to allow the Deal Agent to perform its duties to the required standard of care and loyalty. Furthermore,

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securitization economics are impacted by factors that are beyond the control of securitization practitioners, and these challenges may delay the Framework's implementation. However, along with other proponents, we firmly believe that the eventual implementation of the proposed Deal Agent Framework is a condition necessary for meaningful, sustainable private funding returning to the U.S. RMBS market and for a gradual and responsible expansion of mortgage credit to U.S. consumers.

Sincerely,

Co-Chairs of the Deal Agent Committee¹

Alessandro Pagani
Head of Securitized Assets
Loomis Sayles & Company

James Callahan
Principal
Pentalpha Global

¹ The Deal Agent Committee refers to an informal working group of industry representatives, who have participated in a series of discussions facilitated by the US Treasury as part of its Private Label Securitization (PLS) Initiative. In facilitating discussions related to the PLS Initiative, Treasury did not and does not seek advice or recommendations for any federal government policy, decision, or activity. The proposed Deal Agent Framework and Key Principles may not represent the views of all the participants in the US Treasury's PLS Initiative.