# MEMORANDUM

**TO**: Public File - Notice of Public Rulemaking: Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring, (RIN 3064-AE04) ("Liquidity Coverage Ratio NPR")

**FROM**: Sue Dawley, Senior Attorney, Legal Division

**DATE**: January 23, 2014

**SUBJECT**: Meeting with Representatives from the Structured Finance Industry Group ("SFIG") and the Securities Industry and Financial Markets Association ("SIFMA")

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On January 10, 2014, FDIC staff, together with staff of the Board of Governors of the Federal Reserve System and the Office of the Comptroller of the Currency, met with representatives of SFIG and SIFMA (collectively, the "Associations").

Representatives from the Associations presented their concerns and views with regard to certain provisions of the Liquidity Coverage Ratio NPR, which was issued in the Federal Register of November 29, 2013 (78 FR 71818), including (1) the role of securitizations in the real economy, (2) treatment of mortgage backed securitized debt issued by government sponsored enterprises currently under conservatorship, (3) treatment of unfunded commitments, and (4) the definition of special purpose entities.

The FDIC representatives at this meeting were:

- Kyle Hadley, Section Chief for Examination Support, Capital Markets/RMS
- Eric Schatten, Policy Analyst, Capital Markets/RMS
- Greg Feder, Counsel, Legal Division
- Sue Dawley, Senior Attorney, Legal Division

The Associations' representatives in attendance at this meeting were:

- Sairah Burki, Director of Policy, SFIG
- Chris Killian, Managing Director, SIFMA
- Brian J. Wiele, Managing Director, Head of Securitized Products Syndicate, Barclays
- Sam Smith, Director of Funding and Securitization, Ford Motor Company
- Brad Welling, Director, Federal Affairs-International Trade & Finance, General Motors Company
- Susan Sheffield, Executive Vice President, Corporate Finance, GM Financial
- John M. Kuhns, Executive Director, Securitized Products, JPMorgan
- William Falcon, Senior Vice President, PNC Bank
- Eric Wise, Managing Director, Securitization, Capital Markets, Royal Bank of Canada
- Rachel George, Partner, Chapman and Cutler LLP
- Tim Mohan, Partner, Chapman and Cutler LLP

Materials provided by the Associations are attached.

# SFIG/SIFMA Joint Working Group:
# U.S. Proposed Liquidity Coverage Ratio

January 10, 2014

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# 1. Executive Summary

- On October 24, 2013, the Board of Governors of the Federal Reserve Board, in conjunction with the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency (collectively, the "***Agencies***") released a Notice of Proposed Rulemaking ("***NPR***") that proposes U.S. regulations introducing a liquidity coverage ratio ("***LCR***") requirement that will test a bank's ability to withstand "liquidity stress periods" (the "***Proposed Rule***")
- SFIG and SIFMA (collectively, the "***Associations***") believe that LCR regulations should recognize that securitization is (i) an essential source of core funding to the real economy and (ii) an important part of a bank's liquidity management strategy. Furthermore, the Associations believe that the Agencies have failed to sufficiently distinguish among types of securitizations in a manner that overstates the LCR requirement for certain securitization transactions

**The Denominator**

- Some securitization facilities act as substitutes for or complements to traditional revolving credit facilities provided by banks to their customers, which seek funding for financial assets. The outflow amount for **undrawn credit commitments** to bank customer securitization credit facilities should match the outflow amounts for credit commitments to those bank customers
- A **sponsored structured transaction** that meets the definition of "traditional securitization" under the Agencies' regulatory capital rules should not be treated as an outflow amount provided that the bank does not provide credit or liquidity support to the transaction

**The Numerator**

- For so long as they are in conservatorship, **Fannie Mae and Freddie Mac mortgage-backed securities** should be treated as Level 1 liquid assets or, at a minimum, the 40% cap should not apply
- Certain **RMBS, Covered Bonds**, and **ABS** should be treated as Level 2B liquid assets

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# 2. Assumed 100% Drawdown of Commitments to SPEs

## LCR Assumed Drawdown Percentages

- Consistent with the Basel Committee on Banking Supervision (“***BCBS***”) LCR, the Proposed Rule requires a bank to assume 100% drawdown of committed credit and liquidity facilities to special purpose entities, excluding liquidity facilities extended to SPEs consolidated with the bank
  - The only exceptions would be for commitments that could not be drawn within the next 30 days

- The Agencies cite the following rationale for this proposal:
  - Pg. 71838: “The agencies are proposing a 100 percent outflow rate for a covered company’s liquidity facilities with special purpose entities (SPEs), **given SPEs’ sensitivity to emergency cash and backstop needs in a short-term stress environment, such as those experienced with SPEs during the recent financial crisis.** During that period, many SPEs experienced severe cash shortfalls, as they could not rollover debt and had to rely on borrowing and backstop lines.”
  - Pg. 71837: “The agencies believe that the maximum potential amount that a covered company may be required to provide to support its sponsored structured transactions, including potential obligations arising out of commitments to an issuing entity, that arise from structured finance transactions should be fully included in outflows when calculating the proposed liquidity coverage ratio because **such transactions, whether issued directly or sponsored by covered companies, have caused severe liquidity demands at covered companies during stressed environments.”**

- The Agencies have requested feedback on the treatment of unfunded commitments under the proposal, as well as the appropriateness of the definition of SPE

- The definition of SPE set forth in the NPR is over-inclusive and should be modified to recognize the substantive differences between (i) transactions in which an SPE acts as a borrower under a securitized credit facility to finance the receivables owned by a corporate entity and (ii) the types of securitization transactions that raise the concerns the Agencies indicate they are attempting to address in the NPR

## SFIG/SIFMA Recommendation – Look-Through Approach

- The Bank Customer Securitization Credit Facility (***"BCSCF"***) 'look-through' recommendation is designed to balance the priorities of US regulators and the desire to preserve an important banking product for bank customers
  - **Bank Customers**: Bank customers value securitization facilities and the associated bank commitments for a variety of reasons and the Associations' recommendation would help to preserve many of the critical benefits:
    - Funding diversification
    - Lower-cost financing (as proposed, the 100% drawdown assumption is likely to materially increase the cost of a bank providing BCSCFs)
    - Targeted financing against eligible financial asset portfolios
    - Funding flexibility (i.e.. balances can increase and decrease based on seasonality or customer demand)
  - **Banks**: BCSCFs are a cornerstone banking product that offer a number of significant benefits:
    - BCSCFs act as substitutes for or complements to traditional revolving credit facilities provided by banks to their customers
    - Legally isolated asset exposure
    - Attractive risk/ return exposure
  - **Regulators**: The proposed BCSCF 'look-through' is designed to meet a number of regulatory priorities
    - The BCSCF framework reflects the contractual terms that start with the securitization customer
    - Designed to avoid unintended proliferation (i.e. cannot be utilized by SIVs, CDO issuers, arbitrage conduits, etc.)
    - Considers the economically equivalent substance of other comparable facilities extended to bank customers (i.e. unsecured and secured revolving credit facilities)
    - Substantiated by historical data and experience
  - **BCBS Coordination**: The contractual and economic substance of the Associations' recommendation is consistent with the January 2013 BCBS LCR release

# 2. Assumed 100% Drawdown of Commitments to SPEs

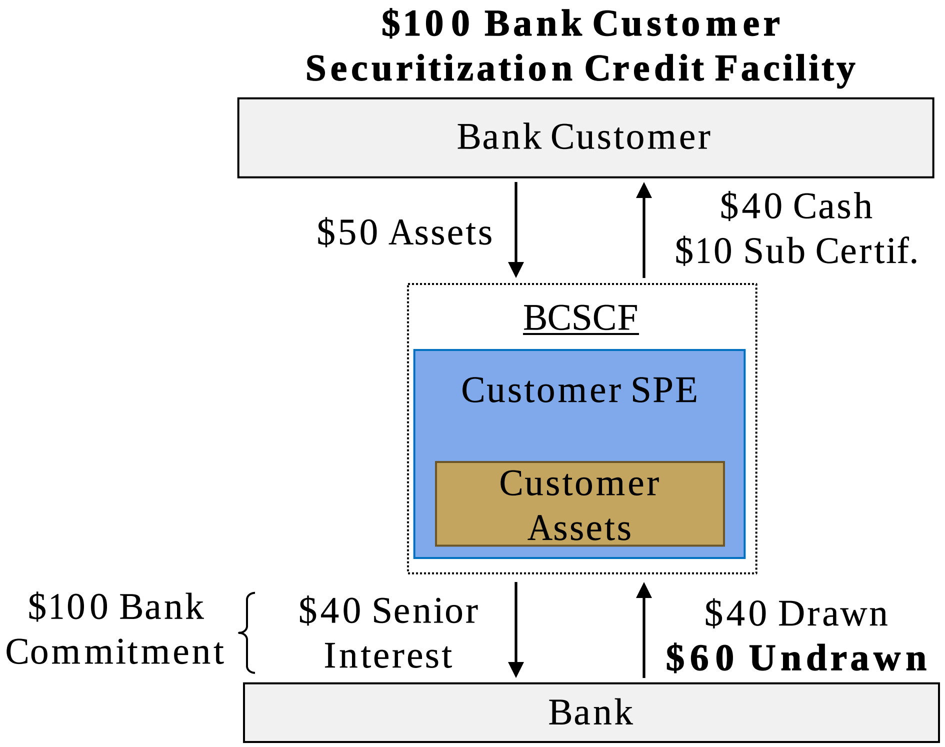
**Summary of SFIG/SIFMA Look-Through Approach Recommendation**

| | |
|---|---|
| **Securitizations that Substitute for Traditional Revolvers Receive Look-Through Treatment** | • The Associations propose the term "Bank Customer Securitization Credit Facilities" to capture securitization transactions that act as substitutes for or complements to traditional bank revolving credit facilities<br>• BCSCFs are provided to support bank customers' securitization transactions either directly by banks or through asset-backed commercial paper ("***ABCP***") conduit facilities<br>• BCSCF undrawn amounts should be assigned outflow amounts consistent with the undrawn amount of commitments made directly to the relevant bank customer under the Proposed Rule |
| **Strict Parameters Would Ensure SPEs with Liquidity Issues Would Not Qualify** | • Credit and liquidity commitments to SIVs, SIV-lites, credit arbitrage vehicles and CDO vehicles would not qualify for the proposed look-through treatment |
| **Only the Undrawn Amount of Credit Commitments to Customer SPEs Would Qualify for Look-Through Treatment** | • Only the undrawn amount of the credit commitment extended and available to an SPE sponsored by a bank customer in conjunction with a BCSCF would be eligible for look-through treatment (see pg. 9)<br>• If a BCSCF is provided to support a customer's securitization transaction via a bank administered ABCP conduit, only the undrawn amount of the BCSCF would be eligible for look-through treatment (see pg. 10) |

# 2. Assumed 100% Drawdown of Commitments to SPEs

## Fundamental BCSCF Structure – Direct Bank Funding to Customer SPE

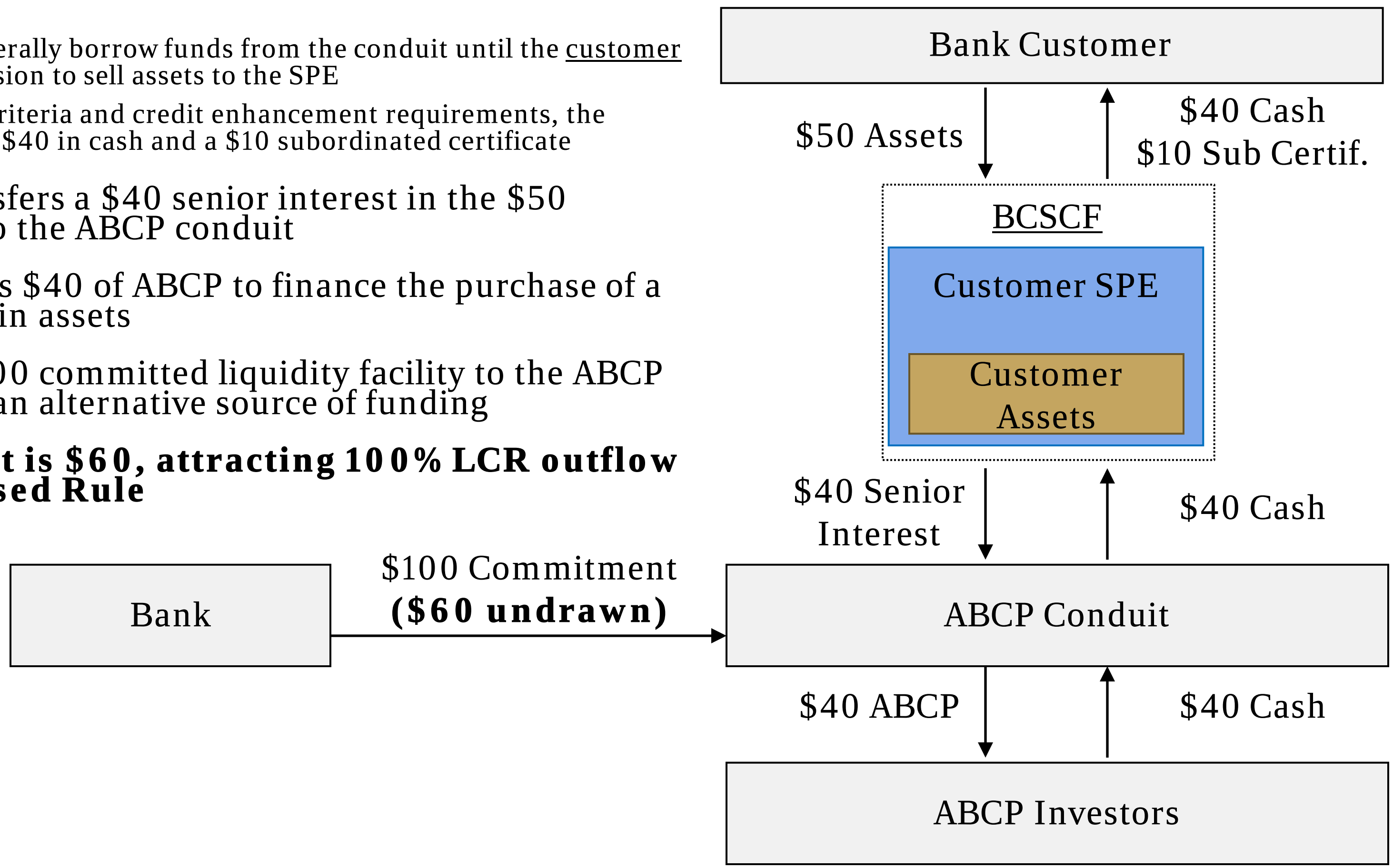
- Bank provides a $100 commitment to customer's SPE to fund assets as they are delivered, subject to a borrowing base
- Bank customer sells assets ($50) to an SPE ("***Customer SPE***") that it sponsors
  - Decision to borrow undrawn amounts starts with the customer, since the customer originates and holds the assets to be transferred to and financed by the SPE
  - SPE cannot unilaterally borrow funds from the bank until the customer has made the decision to sell assets to the SPE
  - Due to eligibility criteria and credit enhancement requirements, the customer receives $40 in cash and a $10 subordinated certificate
- Customer SPE transfers a $40 senior interest in the $50 portfolio of assets to the Bank
- **Undrawn amount is $60, attracting 100% LCR outflow under the Proposed Rule**



## Fundamental BCSCF Structure – ABCP Conduit

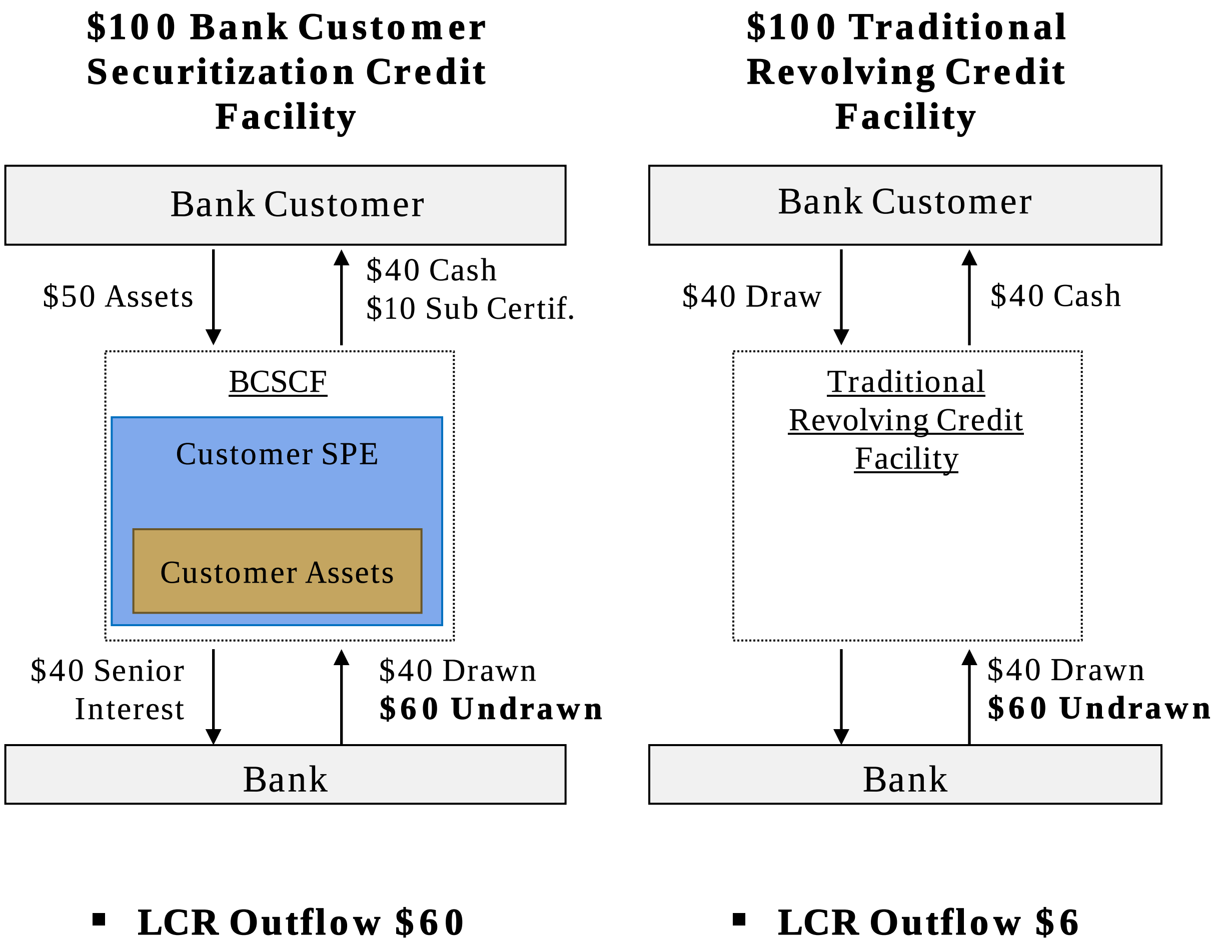
- Bank customer sells assets ($50) to a Customer SPE that it sponsors
  - Decision to borrow undrawn amounts starts with the customer, since the customer originates and holds the assets to be transferred to and financed by the SPE
  - SPE cannot unilaterally borrow funds from the conduit until the customer has made the decision to sell assets to the SPE
  - Due to eligibility criteria and credit enhancement requirements, the customer receives $40 in cash and a $10 subordinated certificate
- Customer SPE transfers a $40 senior interest in the $50 portfolio of assets to the ABCP conduit
- ABCP conduit issues $40 of ABCP to finance the purchase of a $40 senior interest in assets
- Bank provides a $100 committed liquidity facility to the ABCP conduit to serve as an alternative source of funding
- **Undrawn amount is $60, attracting 100% LCR outflow under the Proposed Rule**

**$100 Bank Customer Securitization Credit Facility**



## Comparison – BCSCF vs. Traditional Revolving Credit Facility

- Despite identical decision making and similar historical draw behavior, the LCR implications of the two facilities are very different
  - Undrawn credit commitments to wholesale customers attract a 10% LCR outflow, versus a 100% LCR outflow for BCSCFs
- See Appendix A for more detailed customer examples, including a BCSCF to a financial entity



## BCSCF Look-Through Approach - Applicable Only to Undrawn Credit Commitments

- The Associations recommend implementing a look-through mechanism for undrawn credit commitments to BCSCFs, which ensures consistent treatment in the LCR calculation for facilities to the same type of bank customer
- The assumed drawdown percentages for these undrawn credit commitments would be modified as set forth below:

| Commitment Type | Assumed Drawdown Percentage of Undrawn Amounts in Proposed Rule | Assumed Drawdown Percentage of Undrawn Amounts Proposed by the Associations |
|---|---|---|
| Undrawn credit commitments to wholesale BCSCFs | 100% | 10% |
| Undrawn credit commitments to certain banking organizations' BCSCFs | 100% | 50% |
| Undrawn credit commitments to financial entity BCSCFs | 100% | 40% |

- Please see Appendix A for examples of the application of our proposed look-through approach and Appendix B for proposed modifications to the NPR regarding the look-through approach

# 2. Assumed 100% Drawdown of Commitments to SPEs

## BCSCF Definition

- In recognition of the fact that this treatment is not appropriate for all transactions, the Associations have set forth the following criteria for inclusion in the definition of BCSCF:

| Definition | Rationale |
|---|---|
| A traditional securitization: | |
| (a) that is sponsored by a financial or wholesale customer of one or more banks; | *Ensures that the credit facility arises out of a bank customer relationship and not a market transaction.* |
| (b) through which the customer obtains financing either (i) directly from one or more such banks, or (ii) through one or more ABCP conduits that are supported with liquidity facilities from one or more such banks with commitment amounts (together with commitment amounts from other financial institutions, governmental Agencies and government-sponsored entities) that at least cover the face amount of the ABCP; | *Limits the sources of funding for the facilities to banks and ABCP conduits. This helps ensure that the transaction is the functional equivalent of a privately negotiated bank loan to the bank's customer.* |
| (c) where the customer is not one of such banks, or an affiliate of one of such banks, extending financing or providing a liquidity or credit facility to an ABCP conduit that is extending such funding; | *Ensures that the credit facility is truly a customer funding and not a source of funding to the bank that would otherwise be treated as an outflow amount under the proposed rule.* |
| (d) where one or more of such banks or ABCP conduits, or an agent on its or their behalf, negotiates and agrees to the terms of the financing directly with the customer or the special purpose entity sponsored by the customer; | *Ensures that the transaction is not a market purchase of a credit exposure. Bank customer securitization credit facilities, like the traditional revolving credit facilities they substitute for, must be privately negotiated loan transactions.* |
| (e) where the eligible primary underlying exposures have been originated or acquired by the customer to further a long-term business objective and proceeds of borrowings by the customer or its special purpose entity under the facility are used to finance such exposures; | *Ensures that the financed exposures are extensions of credit that the bank customer is making on its own customer base that is part of its core business. Proceeds of bank customer securitization credit facilities could not be used to purchase assets generated in the capital markets or that would otherwise be speculative ventures on the part of the bank customer, which could create volatility in commitment draws that would not exist for traditional revolving credit facilities.* |
| (f) where, for at least 95 percent of the eligible primary underlying exposures, the obligor is not a bank; | *Ensures that the securitization transaction is for a corporate customer of the bank rather than a transaction sponsored by the bank or an inter-bank transaction.* |
| (g) where the terms of the underlying transaction are not subject to market value triggers that require eligible primary underlying exposures to be sold; | *Traditional secured revolving credit facilities do not contain market triggers requiring asset sales. Bank customer securitization credit facilities would be similarly restricted.* |
| (h) that contains terms requiring compliance with any applicable laws and regulations governing credit risk retention by sponsors of traditional securitizations; and | *Ensures that a borrowing base of eligible assets exists to support any customer draw request. During times of financial stress, the financing needs of bank customers would generally decline as their needs for working capital, or to otherwise finance these receivables, decrease. The amount of receivables available to finance would also be likely to decline. As such, it is logical to expect that usage of bank customer securitization credit facilities, like the usage of traditional revolving credit facilities, would decline during times of economic stress.* |
| (i) where, after its initial financing is extended, none of such banks or ABCP conduits is required to fund any commitment to such customer or its special purpose entity unless eligible primary underlying exposures exist and are available to secure such additional funding as required by the terms of the financing. | *See explanation regarding clause (h) above.* |

- These criteria would exclude certain SPE entities that the Proposed Rule was designed to protect against:
  - Securities Arbitrage, Cash Flow ABS CDOs, Market Value ABS CDOs, SIVs, SIV-lites
- Please see Appendix C for an analysis of the types of facilities that would not qualify under the proposed definition of BCSCF

# 2. Assumed 100% Drawdown of Commitments to SPEs

## Guiding Principles

| | |
|---|---|
| **Mainstream Customer Funding Alternative** | • BCSCFs are used by bank customers for working capital, extensions of credit, and other general purposes, with borrowing decisions driven by customer needs<br>• BCSCFs complement or act as substitutes for traditional revolving credit facilities by providing alternative or complementary bank-committed financing capacity<br>• As such, LCR treatment for undrawn amounts should be consistent with traditional revolving credit facilities to the same bank customers |
| **Availability of Credit to the Real Economy** | • Isolating credit risk to pools of assets has typically allowed banks to diversify exposure, resulting in lower credit risk and complementary/incremental capacity available to corporate customers<br>• 100% draw assumption for undrawn amounts on BCSCFs may adversely impact these existing arrangements with corporate customers |
| **Safety and Soundness of the Banking System** | • High quality, well structured BCSCFs are consistent with stated policy objectives of broader financial system safety and soundness<br>• Isolation of receivables and required overcollateralization in BCSCFs provide protection to banking organizations in periods of financial stress |

# 2. Assumed 100% Drawdown of Commitments to SPEs

## Mainstream Customer Funding Alternative – BCSCF End-Users[1]

### Energy

Marathon
Phillips 66
Targa
Valero

### Medical

McKesson
UHS
Cardinal Health
Fresenius Medical Care

### Utilities

NiSource
Duke Energy
American Electric Power
Cincinnati Bell

### Consumer Products

Heinz
Dean Foods
American Greetings
Ball
Hanesbrands
Newell Rubbermaid Brands That Matter

### Transportation

Swift
Union Pacific
Norfolk Southern
ABF
CSX Transportation

### Auto/Equipment

Honda
Toyota
Ford | Ford Credit
Harley-Davidson Motor Cycles
John Deere

[1] Please refer to Appendix D for a more comprehensive list of recognizable BCSCF companies

## Availability of Credit to the Real Economy – Types of Bank-Provided Credit Facilities

- Through the normal course of business, companies (i.e. manufacturing and service companies) extend credit to their customers (for example: trade receivables arising from 30-day payment terms)
  - **Such companies rely on banks for committed credit to manage their working capital, for other general purposes, and to facilitate the extension of credit to their customers through the following credit facility types:**

### Unsecured Credit Facility

- Provided by banks on an unsecured basis
- Funded through bank balance sheets
- **Borrowing decisions are driven by customer borrowing needs**

### Secured Credit Facility

- Secured by collateral
- Funded through bank balance sheets
- May or may not use borrowing base mechanics to limit customer draw availability
- **Borrowing decisions are driven by customer borrowing needs**

### Securitized Credit Facility (BCSCF)

- Uses SPE structures to limit bank risk and isolate collateral
- SPEs are generally wholly-owned subsidiaries of a bank customer's corporate parent
- Uses borrowing base mechanics to limit customer draw availability
- Can be provided either (i) directly through a bank's balance sheet or (ii) through a bank's ABCP conduit
- **Borrowing decisions are driven by customer borrowing needs**

- **Working capital and other corporate needs, not the structure of the transaction, drive usage in unsecured, secured and securitized credit facilities**
  - As such, credit facilities to SPEs established by BCSCFs have not historically experienced cash shortfalls in times of economic stress, which is what the 100% drawdown assumption is designed to protect against

# 2. Assumed 100% Drawdown of Commitments to SPEs

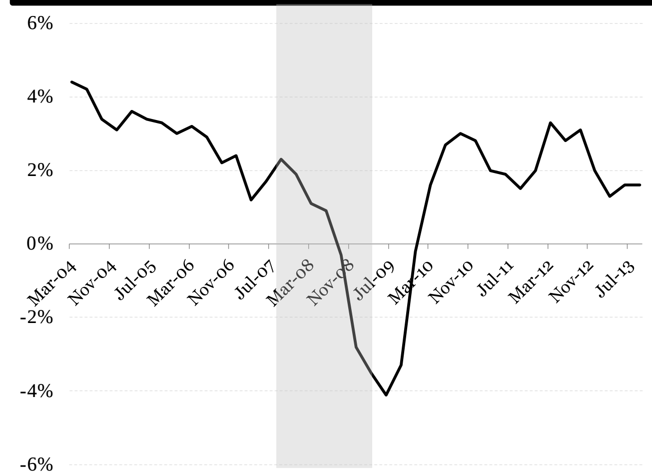
## Consistency

- Look-through treatment is more consistent with the economic substance of BCSCFs, and has been adopted, in part, by European regulators in CRD IV "Outflows from credit and liquidity facilities"
- CRD IV recognizes the distinction between the portion of liquidity facilities that support customer credit commitments and the portion of liquidity facilities that support outstanding ABCP
- Article 424, Section 4 provides:
  - "The committed amount of a liquidity facility that has been provided to an SSPE for the purpose of enabling such an SSPE to purchase assets other than securities from customers that are not financial customers shall be multiplied by 10% to the extent that it exceeds the amount of assets currently purchased from customers and where the maximum amount that can be drawn is limited to the amount of assets currently purchased."
    - According to Article 4, Section 66 a 'securitisation special purpose entity (SSPE)' means a corporation trust or other entity, other than an institution, organised for carrying on a securitisation or securitisations, the activities of which are limited to those appropriate to accomplishing that objective, the structure of which is intended to isolate the obligations of the SSPE from those of the originator institution, and the holders of the beneficial interests in which have the right to pledge or exchange those interests without restriction

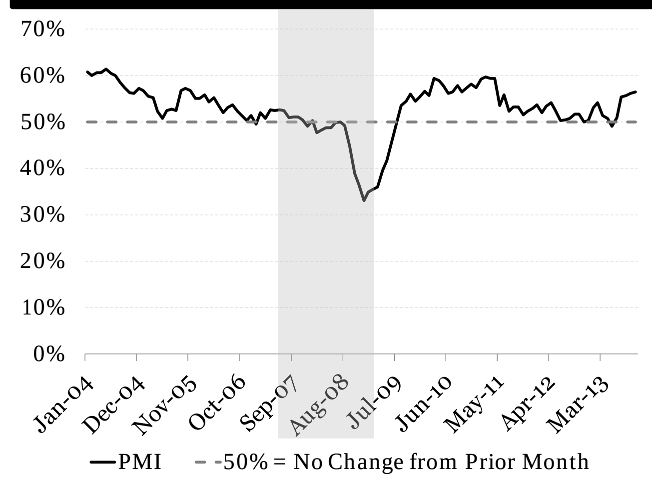
## Drivers of Historical Usage

- Both traditional revolving credit facilities and BCSCFs provide working capital and other general corporate financing for bank customers
  - Decision to utilize facilities largely dependent on working capital needs driven by business volume
  - Many companies fully fund BCSCFs against the borrowing base in the normal course of operations
- During the financial crisis, business origination slowed significantly
  - GDP growth steadily declined during the crisis, reaching a trough of 4.1% YoY contraction in 2Q 2009
  - Purchasing Managers' Index indicated a contraction in the manufacturing sector from February 2008 through July 2009
    - Metric based on new orders, inventory levels, production, supplier deliveries and employment
- In times of economic stress, draws on both traditional revolving credit facilities and BCSCFs would likely be lower, as they are generally used for working capital and other general corporate purposes
  - Utilization not tied to market based liquidity events
- Please refer to Appendix E for an analysis of the economic impact of the 100% drawdown assumption, including an IMF study detailing the effects of liquidity changes on lending rates

US GDP YoY Growth[1]




Purchasing Managers' Index (PMI)[1]



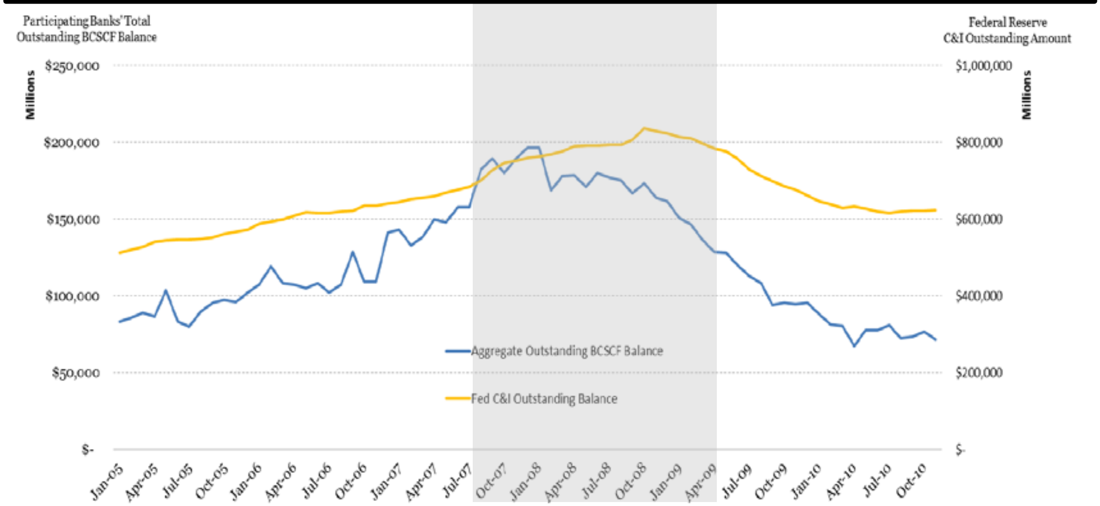

[1] Source: Bloomberg

# 2. Assumed 100% Drawdown of Commitments to SPEs

## Loan Balance Trends Demonstrate Reduced Bank Customer Borrowing Needs During Economic Downturn

- Decision to draw on BCSCFs driven by the same factors as under general C&I loans
  - Utilization dependent on the working capital needs of the bank customer
- Neither BCSCFs nor traditional corporate revolvers experienced a spike in outstandings during the financial crisis
  - Historical draw experience for BCSCFs demonstrates their similarity to traditional revolving credit facilities, supporting the Associations' recommendation for the look-through approach
  - Experience shows that 100% outflow rate for SPEs used in BCSCFs is overly conservative

**Total Outstanding Balances[1]**




- See Appendix F for additional detail on historical draw rates for BCSCFs, and Appendix G for additional supporting evidence for the look-through approach

[1] Source: Federal Reserve for outstanding C&I balance data and survey of 9 major banking organizations for BCSCF data

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# 3. Sponsored Structured Transaction Outflow Amount

## SFIG/SIFMA Recommendation

- The Associations believe that a sponsored structured transaction that meets the definition of "traditional securitization" under the Agencies' regulatory capital rules should not be treated as an outflow amount provided that the bank does not provide credit or liquidity support to the transaction

- Securitization transactions are structured such that the issued securities have maturities that are entirely (or at least primarily) dependent on the receipt of cash flow from underlying assets. If the issuing entity is not obligated to make a payment on a security due to the lack of sufficient cash flows from the underlying assets, then the sponsoring bank should not be required to assume that it will make such a payment when calculating its LCR

- One factor to consider in evaluating a sponsoring bank's obligation to repay a securitization exposure is whether the transaction meets the definition of a "traditional securitization" under the Agencies' regulatory capital rules
  - The fact that a securitization does not meet the definition of "traditional securitization" does not, in and of itself, necessitate the conclusion that the bank is responsible for repayment of the security. However, in any circumstance under which the sponsoring bank has satisfied the criteria for a transaction to be a "traditional securitization," it is clear that the sponsoring bank is not obligated for the repayment of the security

- Please see Appendix H for the Agencies' definition of "traditional securitization"

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# 4. Level 2 Treatment of GSE Securities

## More Favorable HQLA Treatment for Fannie Mae and Freddie Mac MBS

- Section __.20(b)(1) of the Proposed Rule treats GSE securities as Level 2A liquid assets, provided that such securities are (1) investment grade, and (2) are senior to preferred stock
- The Associations are of the view that, for so long as Fannie Mae and Freddie Mac are in conservatorship, their mortgage-backed securities should be treated as Level 1 liquid assets, or at a minimum the 40% cap that applies to other Level 2A liquid assets should not apply to Fannie Mae and Freddie Mac mortgage-backed securities

$$\frac{\text{Potential Stock of } \textbf{High Quality Liquid Assets}}{\text{Potential } \textbf{Net Cash outflows over a 30-day time period}} \geq \textbf{100\%}$$

**Level 1** (unlimited; full value)
- Cash
- US Treasurys
- GNMAs (explicit full faith & credit of US government)
- Certain marketable securities issued by IMF, BIS, ECB, EU
- Sovereign bonds that are 0% risk weight
- **GSE (FNMA, Freddie)**

**Level 2A** (capped; 15% haircut)
- **GSE (FNMA, Freddie)**
- Sovereign bonds (not Level 1 and < 20% risk weight)

**Level 2B** (capped; 50% haircut)
- Publicly traded corporate debt (Inv Grade, <20% mkt price decline or haircut, proven liquidity in stressed market)
- Publicly traded common shares (in S&P 500, $US, <40% decline mkt price or haircut, not from regulated financial company, not held to satisfy a debt obligation)

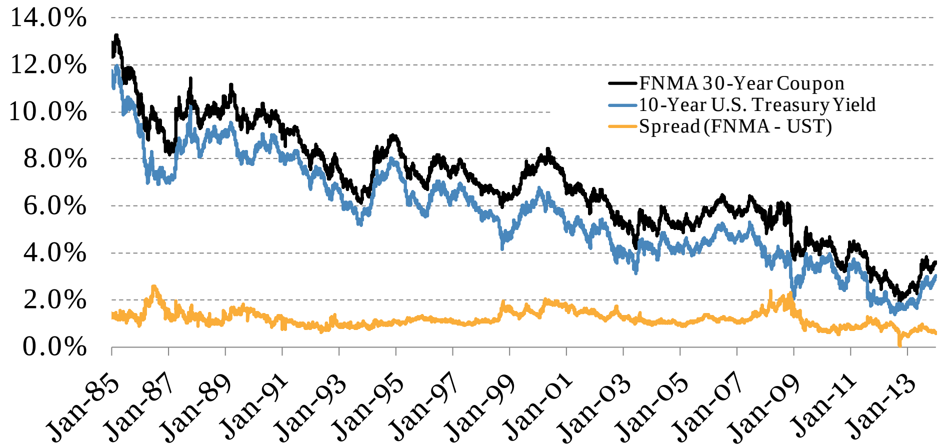
- Unsecured Retail Funding
- Structured Transaction Outflow Amount
- Net Derivative Cash Outflow Amount
- Mortgage Commitment Outflow Amount
- Commitment Outflow Amount
- Collateral Outflow Amount
- Brokered Deposit Outflow Amount
- Unsecured Wholesale Funding Outflow Amount
- Debt Security Outflow Amount
- Secured Funding and Asset Exchange Outflow Amount
- Foreign Central Bank Borrowing Outflow Amount
- Other Contractual Outflow Amount
- Excluded Amounts for Intragroup Transactions

# 4. Level 2 Treatment of GSE Securities

## More Favorable HQLA Treatment for Fannie Mae and Freddie Mac MBS

- GSE mortgage-backed securities are amongst the highest quality and most liquid assets in the world
  - Over $4 trillion of GSE mortgaged-backed securities are currently outstanding
  - Average 2013 trading volume of GSE MBS is approximately $212 billion per day, with pricing nearly perfectly correlated to treasury securities, compared to only $37 billion of GNMA MBS traded per day

FNMA and U.S. Treasury Yields[1]

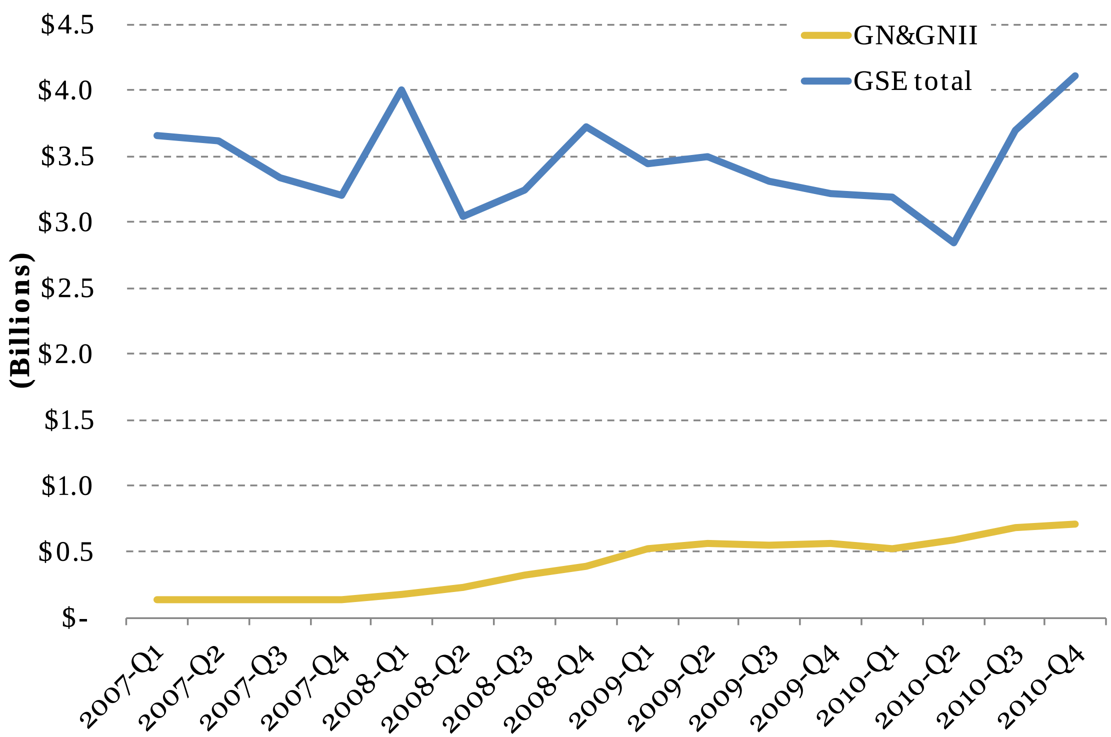



- Failure to more fully include Fannie and Freddie MBS as liquid securities could have significant negative consequences:
  1. GSE MBS currently comprises a significant portion of the liquid asset portfolios of U.S. banks
  2. Discouraging purchases of Fannie and Freddie MBS could have an adverse effect on the interest rates on such securities and therefore mortgage interest rates

[1] Source: Bloomberg

## Fannie Mae and Freddie Mac MBS Securities are More Liquid Than Ginnie Mae MBS

**Trading Volume Comparison – 30 Year GSE vs. Ginnie Mae MBS**




Source: leading MBS trading platform

- While Ginnie Mae MBS receives Level 1 liquid asset treatment under the Proposed Rule, Freddie and Fannie trading volumes are 9.75 times higher

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# 5. RMBS, ABS, and Covered Bonds not HQLA

## Certain RMBS and Covered Bonds Should be Treated as Level 2B Liquid Assets

- The Final BCBS LCR includes RMBS rated AA or better as Level 2B liquid assets with a 25% haircut and includes covered bonds rated AA- or better as Level 2A liquid assets with a 15% haircut
- The Associations would propose that certain high credit quality RMBS and covered bonds be treated as **Level 2B liquid assets** under the U.S. LCR provided certain requirements are met
- Failure to include these securities as HQLA could have an adverse impact on the return of the private U.S. mortgage market. The Agencies should include these securities as HQLA provided they meet general credit quality and market liquidity requirements

Potential Stock of **High Quality Liquid Assets**

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Potential **Net Cash outflows over a 30-day time period**

**≥ 100%**

**Level 1** (unlimited; full value)
- Cash
- US Treasurys
- GNMAs (explicit full faith & credit of US government)
- Certain marketable securities issued by IMF, BIS, ECB, EU
- Sovereign bonds that are 0% risk weight

**Level 2A** (capped; 15% haircut)
- GSE (FNMA, Freddie)
- Sovereign bonds (not Level 1 and < 20% risk weight)

**Level 2B** (capped; 50% haircut)
- Publicly traded corporate debt (Inv Grade, <20% mkt price decline or haircut, proven liquidity in stressed market)
- Publicly traded common shares (in S&P 500, $US, <40% decline mkt price or haircut, not from regulated financial company, not held to satisfy a debt obligation)
- **RMBS backed by Qualified Mortgages (25% haircut)**
- **RMBS not backed by Qualified Mortgages, ABS, and Covered Bonds (50% haircut)**

- Unsecured Retail Funding
- Structured Transaction Outflow Amount
- Net Derivative Cash Outflow Amount
- Mortgage Commitment Outflow Amount
- Commitment Outflow Amount
- Collateral Outflow Amount
- Brokered Deposit Outflow Amount
- Unsecured Wholesale Funding Outflow Amount
- Debt Security Outflow Amount
- Secured Funding and Asset Exchange Outflow Amount
- Foreign Central Bank Borrowing Outflow Amount
- Other Contractual Outflow Amount
- Excluded Amounts for Intragroup Transactions

## Proposed Liquid Asset Requirements for RMBS

1. The security is registered for offer and sale under the Securities Act of 1933 (***"Act"***) or, if exempt from such registration, is eligible for resale in reliance on Rule 144A under the Act;
2. The security is a senior security that has a risk-weight of 20% or less under the Agencies' standardized approach risk-based capital rules;
3. The security constitutes a "traditional securitization" exposure under the Agencies' risk-based capital rules; and
4. Proposed haircuts for RMBS:
   - RMBS backed exclusively by Qualified Mortgages would qualify as Level 2B liquid assets with a 25% haircut
   - All other RMBS meeting the requirements above would qualify as Level 2B liquid assets with the 50% haircut applicable to all other Level 2B liquid assets

## RMBS Backed by Qualified Mortgages is Expected to be Highly Liquid

- In January 2013 the CFPB issued rules (the "***ATR Rules***") requiring lenders to make a reasonable, good faith determination of a consumer's ability to repay any consumer credit transaction secured by a dwelling (other than certain open-ended credit plans, timeshare plans, reverse mortgages or temporary loans). These rules are effective January 10, 2014

- The ATR Rules also include a definition of "Qualified Mortgages". Qualified Mortgages are loans with low risk features and are presumed to comply with the ATR Rules. In order to fall within the Qualified Mortgage definition, loans must not have a negative amortization feature, an interest only period, a term longer than 30 years, or, in most cases, a balloon payment. Additionally, loans that are not eligible for purchase, guarantee or insurance by one of the GSEs, FHA, VA or USDA, generally require a borrower debt-to-income ratio of 43% or less in order to meet the definition

- In May 2013, the FHFA announced that it was directing FNMA and FHLMC to limit their future mortgages acquisitions to loans that meet the Qualified Mortgage standard, including those that meet the special or temporary qualified mortgage definition, and loans that are exempt from the "ability to repay" requirements under Dodd-Frank

- In addition, the Agencies, in the Risk Retention re-proposed rules, explicitly recognized the high quality of Qualified Mortgages when they proposed an exemption from the risk retention requirements for RMBS backed by these loans

- The requirement that FNMA/FHLMC purchase mortgages under the QM standard and that RMBS transactions backed back QM are exempt from the risk retention requirements represent an elevated status for QM based on the stringent underwriting standards and lower expected credit risk

- Investors reward securities that have lower credit risk expectations with broader market acceptance and greater liquidity

- Although most U.S. RMBS would not be backed solely by mortgage loans with full recourse to the borrower's assets, we believe, as a general matter, that a portfolio of Qualified Mortgages has far greater intrinsic value than a portfolio of mortgages which include the potential for an additional unsecured claim against the borrower and that therefore granting Level 2B liquid asset status to RMBS backed exclusively by QM with a 25% haircut would be consistent with granting full recourse RMBS the same status under the Basel LCR

## Proposed Liquid Asset Requirements for Covered Bonds

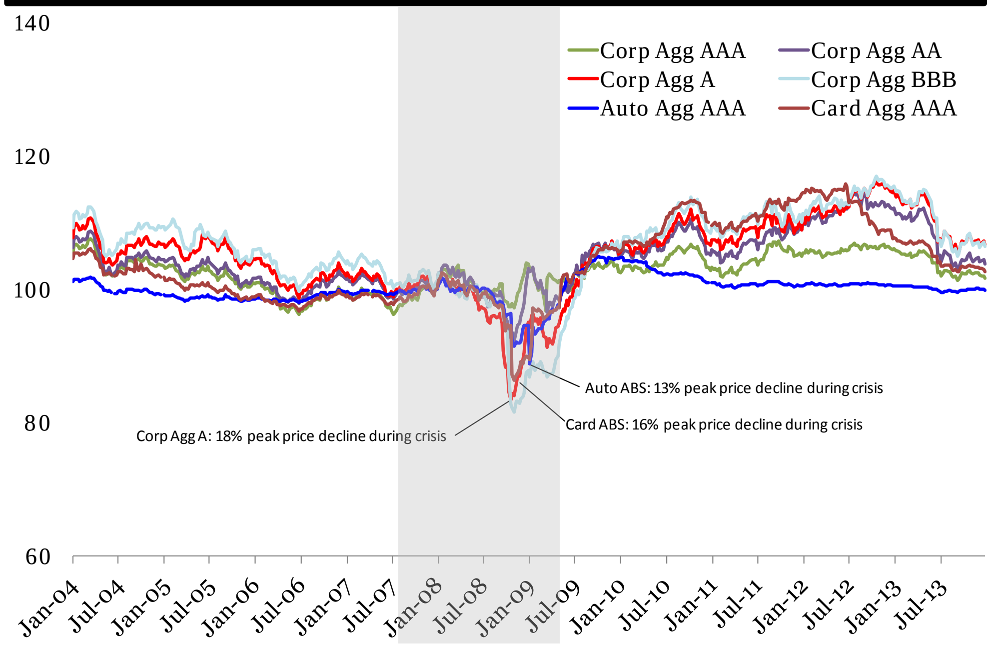
1. The security is registered for offer and sale under the Securities Act of 1933 or, if exempt from such registration, is eligible for resale in reliance on Rule 144A under the Act;
2. The security is a senior debt security issued by a regulated unaffiliated financial institution located in an OECD country;
3. The security is investment grade under the OCC's investment regulation; and
4. The transaction documents with respect to such security grant debtholders (or a trustee on their behalf) the right to sell the covered asset pool upon a payment default and such sale could not be stayed or otherwise delayed due to the insolvency of the issuing entity under applicable law

# 5. RMBS, ABS, and Covered Bonds not HQLA

## Certain ABS Should be Treated as Level 2B Assets

- The Associations propose that certain high credit quality ABS be treated as Level 2B liquid assets under the U.S. LCR regulations
  - AAA rated ABS in select asset classes has historically performed on par with or better than much of the investment grade corporate debt universe (as demonstrated by performance versus the single-A index below)
- The Associations believe that this subset of ABS should be granted HQLA status for two reasons:
  1. These securities demonstrate a high degree of liquidity consistent with corporate debt securities
  2. Granting HQLA status will promote the financing of financial asset pools that are essential to the economy

**Historical Bond Prices[1]**




[1] Source: Barclay's Indices

# 5. RMBS, ABS, and Covered Bonds not HQLA

## Proposed Liquid Asset Requirements for ABS

1. The security is registered for offer and sale under the Securities Act of 1933 or, if exempt from such registration, is eligible for resale in reliance on Rule 144A under the Act;
2. The security is a senior security that has a risk-weight of 20% or less under the Agencies' standardized approach risk-based capital rules;
3. The security constitutes a "traditional securitization" exposure under the Agencies' risk-based capital rules; and
4. The security is backed by an asset pool that was not originated or otherwise owned by the bank or any of its affiliates prior to the relevant securitization transaction

# 5. RMBS, ABS, and Covered Bonds not HQLA

SPEs That Are Consolidated Subsidiaries of Regulated Financial Companies Would not be Precluded from Issuing RMBS or ABS That Would Qualify as HQLA Under Our Proposal

- To qualify as HQLA under the Associations' proposal, RMBS and ABS must be "traditional securitization" exposures under the Agencies' regulatory capital rules
- To constitute a traditional securitization under these rules, (i) all or a portion of the credit risk of the exposures underlying the RMBS or ABS must be transferred to a third party, and (ii) performance of the RMBS or ABS must depend upon the performance of the exposures underlying the RMBS or ABS
- As a result, neither a regulated financial company nor its affiliates that originate the securitized assets or act as depositors or issuers in the relevant securitization transaction should be treated as being obligated on such securities for LCR purposes

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## Drawdown Rate Asymmetry – Customer Example 1

- The inclusion of an SPE to isolate credit risk does not change the true nature of the BCSCF, and does not impact customers' borrowing needs
  - Working capital and other general corporate purposes dictate activity
  - Proposed look-though approach ensures that facilities to the same customer are treated the same in the LCR calculation

| Wholesale Customer | Unsecured Revolving Credit Facility | BCSCF | Comments |
|---|---|---|---|
| Borrower | Wholesale Bank Customer | Wholesale Bank Customer's SPE | Borrowing decisions are driven by customer borrowing needs |
| Commitment | $100MM | $100MM | |
| Borrowed Amount | $40MM | $40MM | |
| Undrawn Amount | $60MM | $60MM | |
| Available Borrowing Base | N/A | $45MM | Required to borrow under a securitization |
| Available Borrowing Capacity | $60MM | $5MM | Available capacity is constrained to the borrowing base |
| Current LCR Draw | 10% = $6MM | **100% = $60MM** | Current drawdown included in the LCR calculation for a wholesale customer increases by $54MM when funded through a BCSCF |
| Proposed LCR Look-Through Approach | 10% = $6MM | **10% = $6MM** | Proposed LCR definition modification to avoid disparate treatment for similar facility types |

The current LCR outflow calculation is **$54MM** greater than a standard corporate exposure, while the substance of the transaction remains unchanged

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## Drawdown Rate Asymmetry – Customer Example 2

- The asymmetry is still present in the case of a financial entity

| **Financial Entity** | **Unsecured Revolving Credit Facility** | **BCSCF** | **Comments** |
|---|---|---|---|
| Borrower | Financial Entity Bank Client | Financial Entity Bank Client's SPE | Borrowing decisions are driven by customer borrowing needs |
| Commitment | $100MM | $100MM | |
| Borrowed Amount | $40MM | $40MM | |
| Undrawn Amount | $60MM | $60MM | |
| Available Borrowing Base | N/A | $45MM | Required to borrow under a securitization |
| Available Borrowing Capacity | $60MM | $5MM | Available capacity is constrained to the borrowing base |
| Current LCR Draw | 40% = $24MM | **100% = $60MM** | Current drawdown included in the LCR calculation for a financial entity increases by $36MM when funded through a BCSCF |
| Proposed LCR Look-Through Approach | 40% = $24MM | **40% = $24MM** | Proposed LCR definition modification to avoid disparate treatment for similar facility types |

The current LCR outflow calculation is **$36MM** greater than a standard corporate exposure, while the substance of the transaction remains unchanged

- Both Section __.32(b) and Section __.32(e)(vi) of the NPR would need to be modified to address this issue
  - Under Section __.32(b) as currently drafted, both the commitment made by a sponsored issuing entity to purchase assets and the maximum amount of funding a bank may be required to provide to the issuing entity within 30 days or less of the relevant calculation date through a liquidity facility must be included as outflow amounts. Because as described previously "unfunded credit commitments" in BCSCFs are often funded through ABCP conduits, our proposed look through treatment would need to be provided for in Section __.32(b)
  - Section __.32(e)(vi) would require corresponding modifications
- Section __.32(e)(vi) of the NPR should be modified to exclude commitments covered by Section __.32(b)(2) of the NPR
  - As drafted, Section __.32(e)(vi) only excludes liquidity facilities extended to SPEs consolidated with a bank
  - Section __.32(b)(2) of the proposed rule, however, would include liquidity facilities to SPEs sponsored by the bank, which SPEs may or may not also be consolidated
  - To avoid double counting, Section __.32(e)(vi) should be modified to exclude any credit and liquidity facilities that would be covered by Section __.32(b)
  - These modifications to Section __.32(e)(vi) should operate to exclude both credit and liquidity facilities

# Appendix C: BCSCF Versus Other Securitization Structures

| Proposed Bank Customer Securitization Credit Facility Criteria | Bank Customer Securitization Credit Facility | | Securities Arbitrage | Cash Flow ABS CDO | Market Value ABS CDO | SIV | SIV-lite |
|---|---|---|---|---|---|---|---|
| | Bank Sponsored Multi-Seller Conduit Facility | Direct Bank Funded | | | | | |
| Does it have unfunded exposure? | YES | YES | DEPENDS | NO | YES | NO | NO |
| (A) Sponsored by a Bank Customer | PASS | PASS | FAIL | FAIL - Not Bank | FAIL | FAIL | FAIL |
| (B) Financed directly through bank or ABCP conduit(s) supported with liquidity facility covering face amount of ABCP | PASS | PASS | PASS | FAIL | FAIL | FAIL | FAIL |
| (C) Not financing bank's own assets | PASS | PASS | DEPENDS | PASS | PASS | PASS | PASS |
| (D) Individually negotiated customer transactions | PASS | PASS | FAIL | FAIL | FAIL | FAIL | FAIL |
| (E) Underlying exposures acquired by customer for long term business objective, not market arbitrage | PASS | PASS | FAIL | FAIL | FAIL | FAIL | FAIL |
| (F) Obligor not a bank for at least 95% of underlying exposures | PASS | PASS | PASS | PASS | PASS | PASS | PASS |
| (G) No market value triggers forcing liquidation | PASS | PASS | PASS | PASS | FAIL | FAIL | FAIL |
| (H) Requires compliance with applicable credit risk retention laws | PASS | PASS | PASS | PASS | PASS | PASS | PASS |
| (I) Available borrowing base required for additional funding against unused commitment | PASS | PASS | DEPENDS | FAIL | PASS | FAIL | FAIL |
| **Passes all categories?** | **PASS** | **PASS** | **FAIL** | **FAIL** | **FAIL** | **FAIL** | **FAIL** |

# Appendix D: Select Recognizable BCSCF Companies

| Sample Bank Client Securitization Listing[1,2] | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Bank Client** | **Bank Client Industry** | **Year Established** | **Facility Size** | **Bank Client** | **Bank Client Industry** | **Year Established** | **Facility Size** |
| Valero Energy Corporation | Oil & Gas Refining & Marketing | 1999 | $1,500,000,000 | Eastman Chemical Company | Chemicals - Major Diversified | 2008 | $250,000,000 |
| McKesson Corporation | Drugs Wholesale | 1999 | $1,350,000,000 | TransDigm Group Inc. | Aerospace and Defense | 2013 | $225,000,000 |
| Marathon Petroleum Corporation | Oil & Gas Refining & Marketing | 2011 | $1,300,000,000 | Hanesbrands, Inc. | Textile - Apparel Clothing | 2007 | $225,000,000 |
| LyondellBasell Industries NV | Specialty Chemicals | 2007 | $1,000,000,000 | Exelon Corporation | Diversified Utilities | 2001 | $210,000,000 |
| AmerisourceBergen Corporation | Drugs Wholesale | 2003 | $950,000,000 | Ball Corporation | Packaging & Containers | 2003 | $210,000,000 |
| Avnet, Inc. | Electronics Wholesale | 2001 | $800,000,000 | NiSource Inc. | Diversified Utilities | 2009 | $200,000,000 |
| Fresenius Medical Care Holdings | Healthcare Facilities | 1997 | $800,000,000 | United Stationers Inc. | Wholesale, Other | 1998 | $200,000,000 |
| Arrow Electronics, Inc. | Electronics Wholesale | 2001 | $775,000,000 | Consol Energy Inc. | Industry Metals & Minerals | 2003 | $200,000,000 |
| American Electric Power Compan | Electric Utilities | 2000 | $700,000,000 | Volt Information Sciences, Inc. | Business Services | 2002 | $200,000,000 |
| Cardinal Health, Inc. | Drugs Wholesale | 2002 | $700,000,000 | Insight Enterprises, Inc. | Application Software | 2008 | $200,000,000 |
| Rock-Tenn Company | Packaging & Containers | 2000 | $700,000,000 | Perrigo Company | Pharmaceutical Manufacturing | 2009 | $200,000,000 |
| Phillips 66 | Oil & Gas Refining & Marketing | 2012 | $696,000,000 | Commercial Metals Company | Metal Products Manufacturing | 2011 | $200,000,000 |
| Ingram Micro Inc. | Computers Wholesale | 1993 | $675,000,000 | VWR International, LLC | Medical Equipment & Supplies | 2011 | $175,000,000 |
| United States Steel | Iron & Steel Mills | 2001 | $625,000,000 | Cooper Tire & Rubber Company | Rubber & Plastics | 2006 | $175,000,000 |
| Union Pacific Corporation | Railroads | 1993 | $600,000,000 | Triumph Group Inc | Aerospace/Defense Products & Services | 2008 | $175,000,000 |
| Ferguson Enterprises, Inc. | Plumbing & Heating Supplies Wholesaling | 2013 | $600,000,000 | H.J. Heinz Company | Food and Beverage | 2009 | $175,000,000 |
| Dean Foods Company | Dairy Products | 2000 | $550,000,000 | Greif Inc. | Packaging & Containers | 2008 | $170,000,000 |
| United Rentals Inc. | Rental & Leasing Services | 2001 | $550,000,000 | Lennox International, Inc. | Diversified Machinery | 2000 | $160,000,000 |
| Quest Diagnostics Inc. | Medical Laboratories & Research | 2000 | $525,000,000 | The Manitowoc Company, Inc. | Construction of Machinery & Equipment | 2000 | $150,000,000 |
| WESCO International, Inc. | Industrial Equipment Wholesale | 2003 | $500,000,000 | Convergys Corporation | Business Software & Services | 2009 | $150,000,000 |
| Jarden Corporation | Housewares & Accessories | 2006 | $500,000,000 | Flowers Foods | Consumer Products | 2013 | $150,000,000 |
| Synnex Corporation | Computer and Computer Peripheral Equipment | 2003 | $500,000,000 | Kelly Services, Inc. | Staffing & Outsourcing Services | 2009 | $150,000,000 |
| Fleetcor Technologies | Credit Card Processing | 2004 | $500,000,000 | UGI Energy Services, LLC | Energy Marketing and Distribution | 2001 | $150,000,000 |
| Community Health Systems, Inc. | Hospitals | 2012 | $500,000,000 | Martin Marietta Materials, Inc. | Non-Metallic Minerals Mining | 2013 | $150,000,000 |
| Mylan Inc. | Drugs - Generic | 2012 | $400,000,000 | Celanese Corporation | Basic Chemical Manufacturing | 2013 | $135,000,000 |
| Duke Energy Corporation | Electric Utilities | 2008 | $400,000,000 | SPX Corporation | Diversified Machinery | 2000 | $130,000,000 |
| Tech Data Corporation | Computers Wholesale | 1995 | $400,000,000 | Lexmark International Inc. | Computer Peripheral Equipment | 2004 | $125,000,000 |
| Newell Rubbermaid Inc. | Housewares & Accessories | 2001 | $350,000,000 | Cincinnati Bell Inc. | Telecom Services - Domestic | 2006 | $120,000,000 |
| Norfolk Southern Corporation | Railroads | 2000 | $350,000,000 | Great Plains Energy Inc. | Electric Utilities | 1999 | $110,000,000 |
| Sungard Data Systems Inc. | Data Processing | 2009 | $350,000,000 | TriMas Corporation | Industrial Equipment & Components | 2002 | $105,000,000 |
| Ashland Inc. | Chemicals - Major Diversified | 2008 | $350,000,000 | Armstrong World Industries, Inc. | General Building Materials | 2010 | $100,000,000 |
| Swift Transportation Company | Trucking | 1999 | $325,000,000 | Meritor, Inc. | Auto Parts | 2001 | $100,000,000 |
| Boston Scientific Corporation | Medical Appliances & Equipment | 2002 | $300,000,000 | Moog Inc. | Aerospace/Defense Products & Services | 2012 | $100,000,000 |
| Anixter Inc. | Industrial Equipment Wholesale | 2000 | $300,000,000 | Worthington Industries, Inc. | Steel Processing | 2000 | $100,000,000 |
| Targa Resources Partners LP | Oil & Gas Pipelines | 2012 | $300,000,000 | LKQ Corporation | Motor Vehicle Parts | 2012 | $80,000,000 |
| Peabody Energy Corporation | Industry Metals & Minerals | 2002 | $275,000,000 | Arkansas Best Corporation | General Freight Trucking | 2009 | $75,000,000 |
| Universal Health Services | Hospitals and Behavioral Health Centers | 1993 | $275,000,000 | Cloud Peak Energy Inc. | Coal Mining | 2013 | $75,000,000 |
| CSX Corporation | Railroads | 2009 | $250,000,000 | American Greetings Corporation | Printing and Publishing | 2001 | $50,000,000 |
| Huntsman Corporation | Chemicals - Major Diversified | 2000 | $250,000,000 | Teleflex Inc. | Medical Instruments & Supplies | 2001 | $50,000,000 |
| Arch Coal Inc. | Industry Metals & Minerals | 2006 | $250,000,000 | Ferro Corporation | Specialty Chemicals | 2000 | $50,000,000 |
| Owens Corning Corporation | Building Products Manufacturing | 2011 | $250,000,000 | G&K Services, Inc. | Personal Services | 2010 | $50,000,000 |

[1] Represents a sample list of companies that maintain a trade receivables securitization and, therefore, is not a complete list of companies that utilize this form of financing

[2] All BCSCFs presented herein are publicly disclosed

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# Appendix E: Economic Impact of 100% Drawdown Assumption

- The drawdown rate asymmetry and punitive LCR treatment for BCSCFs have several negative consequences:
  - Reduce companies' access to credit
    - Unsecured and secured credit facilities are significantly smaller than securitized credit facilities
  - Create incentives for banks to extend higher risk forms of other types credit (unsecured and secured)
    - Unsecured and secured credit facilities expose banks to corporate customers' bankruptcy risk
    - In contrast, securitized credit legally isolates banks from such bankruptcy risk, hence reducing risk to banks
    - Higher cost of other types of credit also increases a company's weighted average costs of capital, resulting in reduced free cash flow
  - Contradict policy objectives of broader financial system safety and soundness
    - The bankruptcy-remote nature of BCSCF transactions protects financial institutions against loss in a liquidation scenario, further safeguarding the financial system in a period of stress

- Increased bank costs associated with holding additional HQLA against securitized credit facilities may be passed on to bank customers
  - Negatively impacts certain bank financial metrics and potentially shareholder value
  - Increased costs hinder the customer's ability to invest in its business and spur innovation and job growth
    - Limits the ability to invest locally, negatively impacting the real economy

## IMF Study - Estimating the Costs of Financial Regulation

- Recent studies estimate the current LCR shortfall in the US financial system at approximately $700 billion
  - The 100% drawdown assumption exacerbates the shortfall with an additional 10 times draw assumption for BCSCFs versus traditional revolving credit facilities
- For banks that are experiencing a shortfall versus the LCR requirement, there are several actions that can be taken in order to become compliant, including:
  - Increasing the length of liabilities
  - Raising capital
  - Shortening the maturity of assets
  - Switching to higher quality assets
- All of the aforementioned actions would result in higher costs to the banks, which will likely be passed on to the banks' customers in the form of increased borrowing costs and reduced liquidity, potentially resulting in reduced annual growth and GDP
  - The IMF analyzed the impact of liquidity changes on lending rates, with the US suffering a marked increase in pre-tax funding costs

***Estimated Effects of Liquidity Changes on Lending Rates***

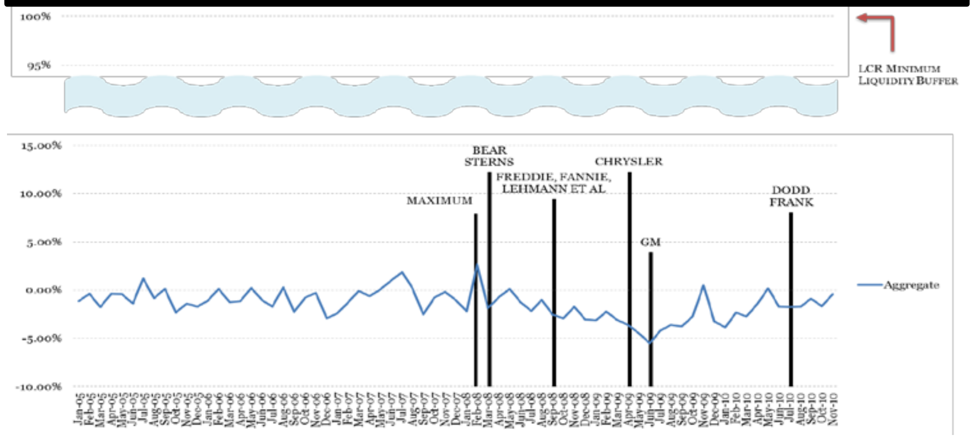
| Effect | Region | | |
|---|---|---|---|
| | Europe | Japan | U.S. |
| Liquid assets needed for a 100% LCR (in US$ billion) | 1,434.66 | 54.21 | 700.00 |
| Reduction in liquid assets from capital increases (in US$ billion) | 128.23 | 27.93 | 92.20 |
| Net liquid assets needed (in US$ billion) | 1,306.43 | 26.27 | 607.80 |
| Increase in pre-tax funding cost or reduction in investment income (in percent) | 2.00 | 1.25 | 2.00 |
| Reduction in pre-tax interest margin (in US$ billion) | 26.13 | 0.33 | 12.16 |
| Reduction in pre-tax interest margin (in percentage of total assets) | 0.08 | 0.01 | 0.11 |

[1] "Estimating the Costs of Financial Regulation" – International Monetary Fund (September 11, 2012)

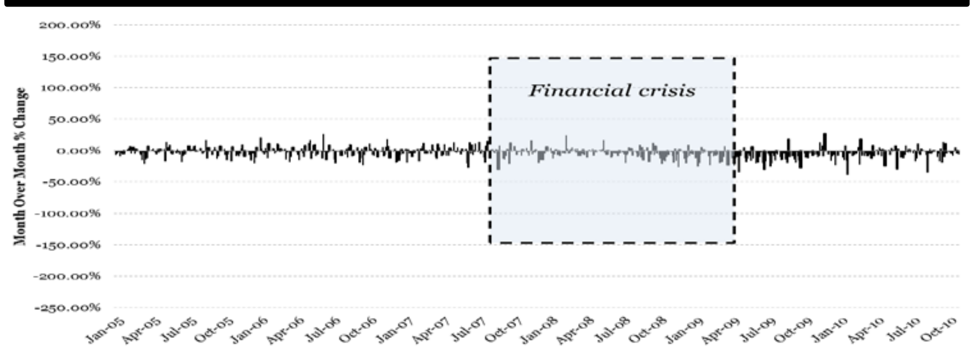
# Appendix F: BCSCF Historical Usage

- 100% utilization assumption for BCSCFs is overly conservative, as these facilities did not experience a spike in usage during the financial crisis
- Peak usage in each case occurred at a time outside of the financial crisis, providing further evidence that the decision to draw is not tied to market liquidity events

**Change in Usage as % of Total Commitments[1]**




**Usage as % of Average Undrawn Commitments[1]**

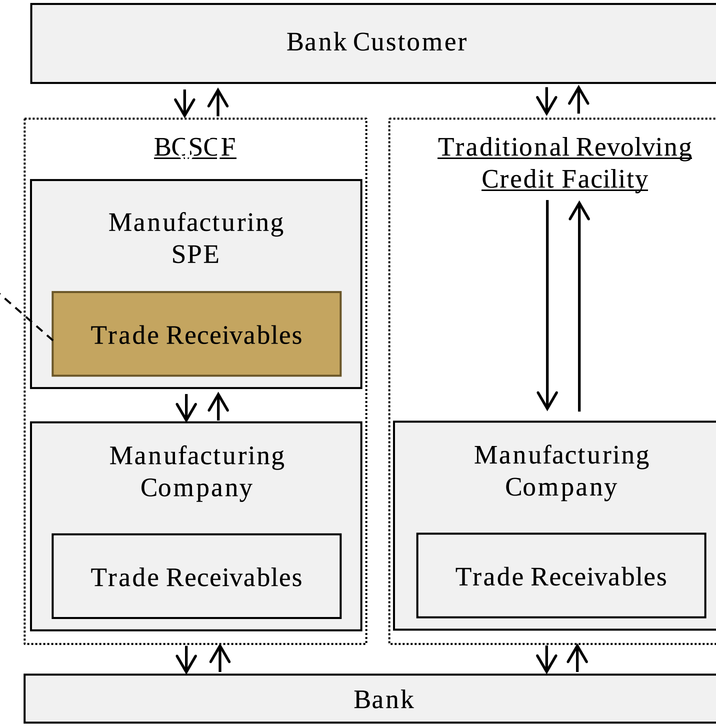



[1] Source: Survey of 9 major banking organizations

## Availability of Credit to the Real Economy – Benefits of BCSCFs

- In the normal course of business, companies extend credit to their clients in order to facilitate transactions
- Credit extension terms can vary from several days to several months for trade receivables, and much longer for consumer receivables such as auto loans
  - The longer the terms the more working capital a company needs to invest in to finance the extension of credit to their customers
- BCSCFs leverage these extensions of credit, or receivables on the company's balance sheet, into an efficient form of financing
  - Securitization credit facilities allow banks to extend credit to their customers on the most efficient terms, resulting in decreased costs to the BCSCF
  - Decreased costs could ultimately be passed on to the BCSCF's customer, resulting in reduced credit costs for the entire supply chain, and increased capital available for investment in the real economy
- **Working capital and other financing needs of the bank customer dictate draw decisions**

## Comparison – BCSCF vs. Traditional Revolving Credit Facility

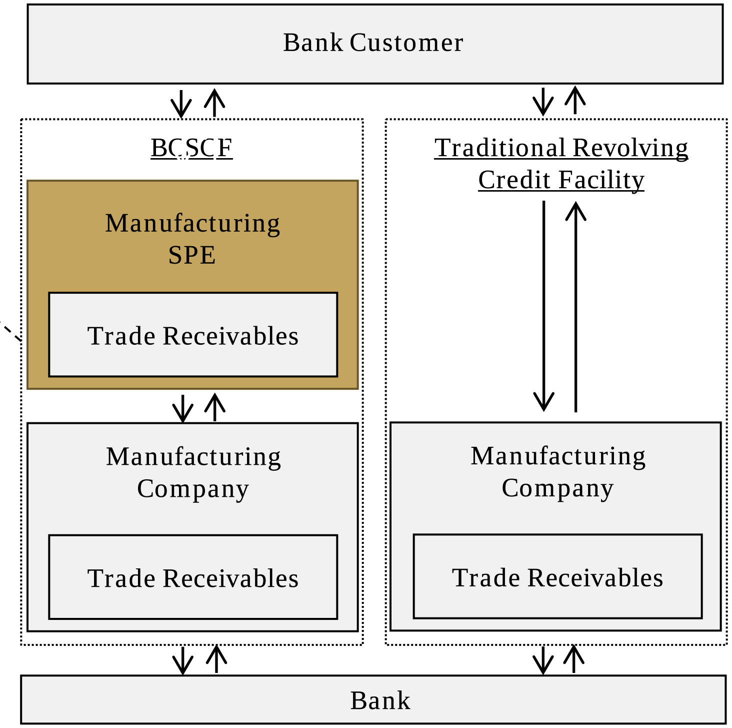



| | BCSCF | | Traditional Revolving Credit Facility |
|---|---|---|---|
| ✓ | Leverages existing assets into the most efficient form of financing | ✗ | Leverages existing assets into the most efficient form of financing |
| ✓ | Working Capital and General Corporate Financing | ✓ | Working Capital and General Corporate Financing |

## Safety and Soundness – Benefits of BCSCFs

- Isolates the underlying assets (e.g., receivables) from the customer's bankruptcy and credit risk
  - Securitized credit facilities require overcollateralization (a first loss exposure retained by the SPE)
- Excess receivables are required to provide the available borrowing base to support the customer's credit needs
  - In an economic downturn, slowing sales generate fewer receivables to support funding
  - Borrowing base adjusts to reflect decreased receivables
  - Customer draws on securitized credit facilities are therefore constrained during periods of economic stress
- Obligations are repaid by the cashflows generated from collections on a diversified pool of receivables that exceed the amount financed
  - Only residual receivables collections are returned to the bank customer once all outstandings have been paid
- Isolating credit risk allows banks to provide lower cost capital and larger amounts of overall credit capacity to corporate customers

### Comparison – BCSCF vs. Traditional Revolving Credit Facility

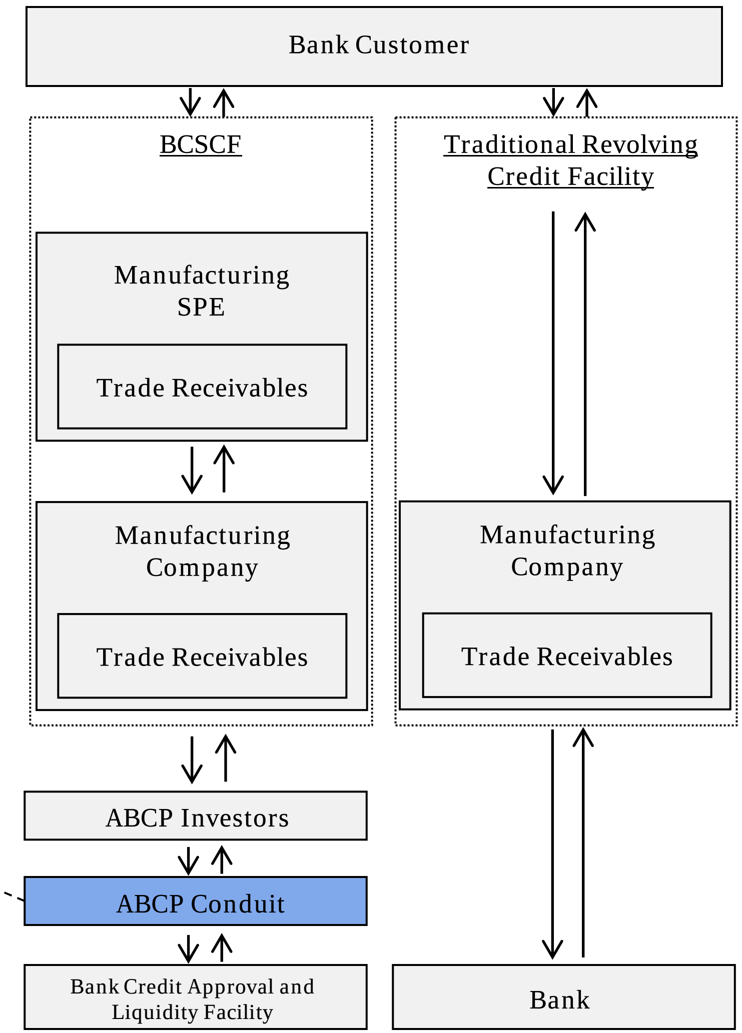



| BCSCF | | Traditional Revolving Credit Facility | |
|---|---|---|---|
| ✓ | Bankruptcy-Remote Isolation of Assets | ✗ | Bankruptcy-Remote Isolation of Assets |
| ✓ | Required Overcollateralization | ✗ | Required Overcollateralization |
| ✓ | Borrowing Base Requirement | ✓ | Borrowing Base ***May Be*** Required if Secured |

## ABCP Conduits

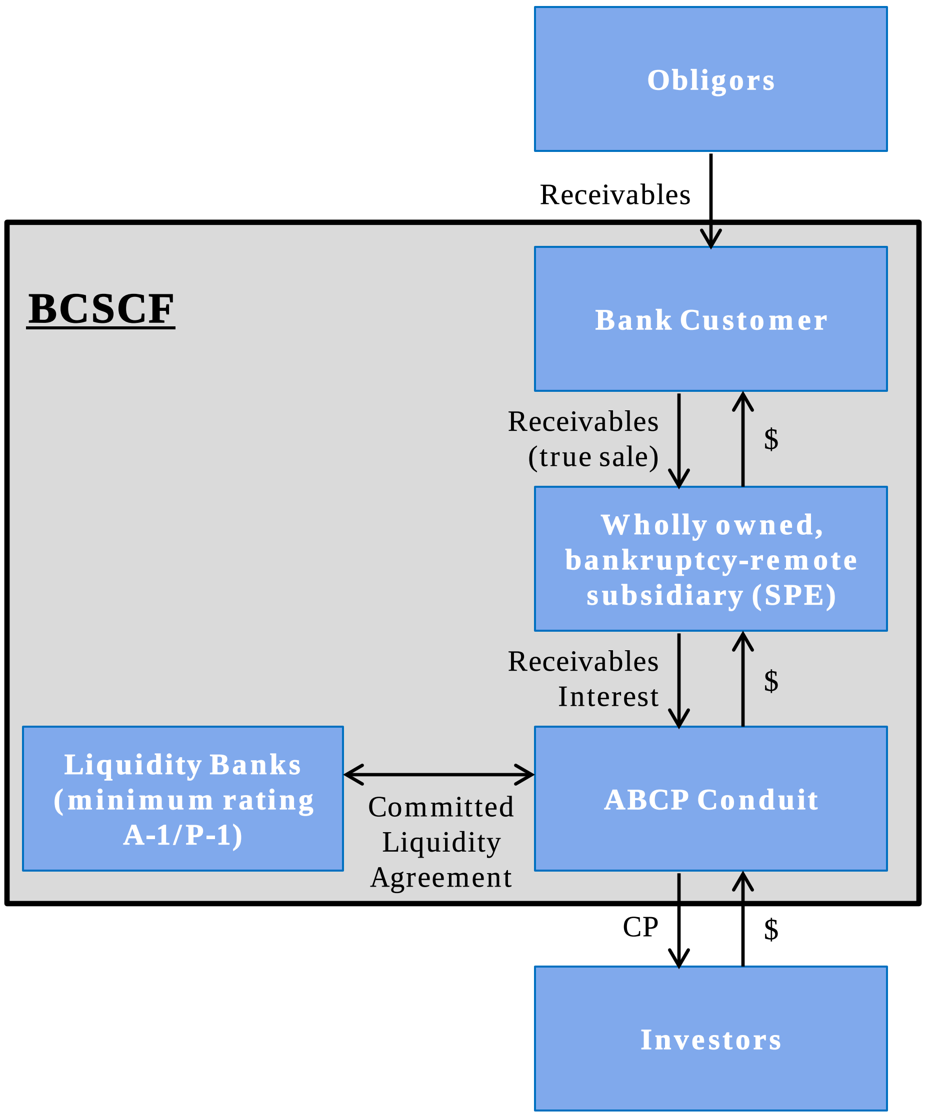
- As an alternative to direct bank funding, shown in the previous two examples, BCSCFs may also be funded through an ABCP conduit, while the substance of the transaction to the bank customer remains the same
- The isolation of receivables and the borrowing base limitation, which restricts borrowing availability to a dynamic borrowing base, are also present in transactions funded directly by ABCP conduits
  - ABCP conduits issue commercial paper backed by a pool of BCSCFs to fund customer commitments, in lieu of direct bank funding
  - These conduits are often highly rated, with many carrying agency ratings of A-1/P-1/F1
- Transactions funded by ABCP conduits, which are SPEs, also receive a 100% LCR draw for any CP that matures within 30 days and is used to fund customer borrowings
  - The Associations recognize that ABCP conduits are more susceptible to capital markets liquidity issues in a crisis and do not object to this treatment for CP that matures within 30 days

**Comparison – BCSCF vs. Traditional Revolving Credit Facility**



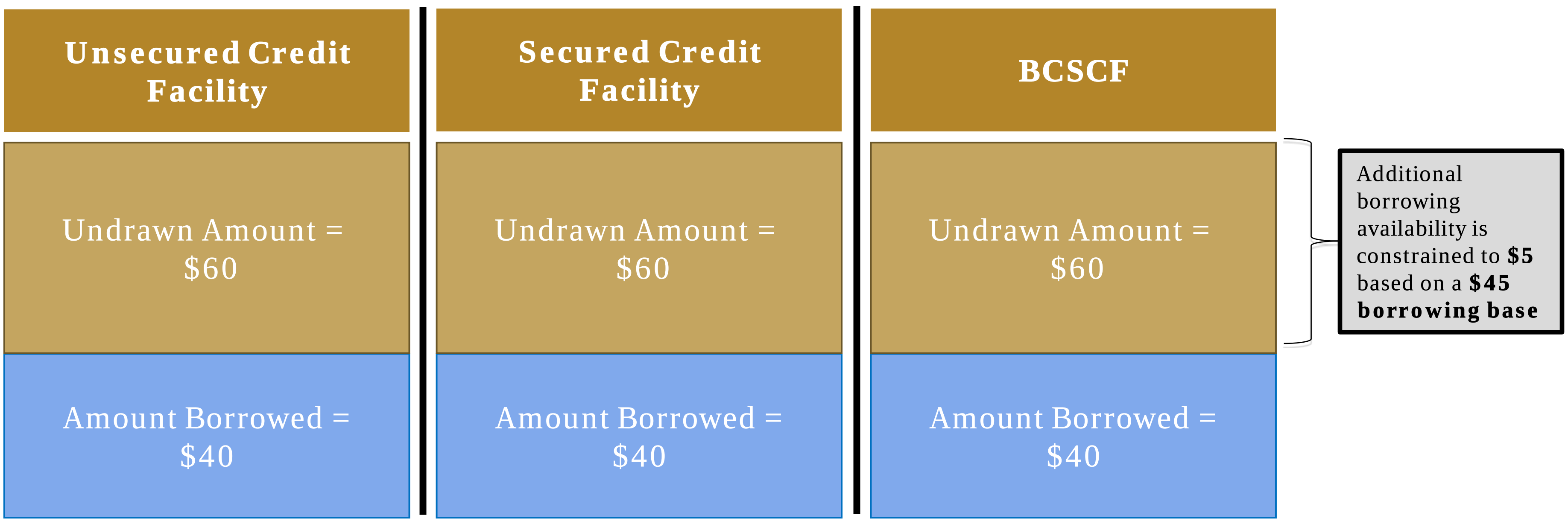
## ABCP Conduit Example

- A bank customer establishes a wholly owned, bankruptcy-remote, SPE for the purpose of conducting a securitization
- The bank customer and/or certain of its subsidiaries will transfer all of their rights, title, and interest in a defined pool of receivables to the SPE. In certain transactions, the SPE may also purchase new receivables on a revolving basis as collections are received on existing receivables
- Transfer of receivables from the bank customer to the SPE is deemed a "true sale" for legal purposes, and is opined on as such by outside counsel
- The SPE will fund its purchases of receivables by selling or pledging interests in the receivables to an ABCP conduit
- The conduit funds purchases by issuing on an offering basis, in its own name, commercial paper
- The bank customer will have a committed source of funding from the liquidity banks if the conduit is unable or unwilling to issue commercial paper



## Undrawn Credit Commitments

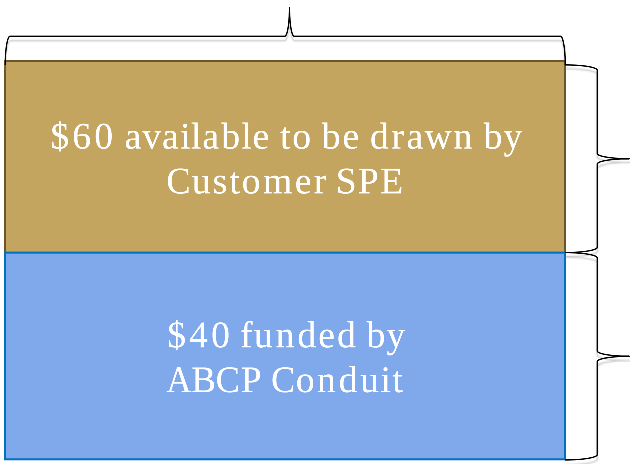
- The NPR utilizes an undrawn concept in determining the drawdown assumption and calculation of LCR
  - Borrowing availability is often constrained to a borrowing base
  - Borrowing base availability may differ from the undrawn amount
- Please see below for an illustration detailing the difference between these concepts, assuming:
  - Credit Commitment to the Bank Customer= $100
  - Amount Borrowed by the Bank Customer= $40
  - Borrowing Base Availability (applicable in BCSCF example only) = $45



## Undrawn Credit Commitment – ABCP Conduit Example

$100 total bank commitment to BCSCF transaction in the form of an undrawn liquidity facility
<u>$40 funded by ABCP conduit</u>
$60 undrawn credit commitment

$100 total commitment




**$60 of the $100 undrawn liquidity facility supports the undrawn commitment to the customer SPE**
This portion of the bank commitment would be entitled to the look-through treatment that the Associations are proposing

**$40 of the $100 undrawn liquidity facility supports outstanding ABCP**
Under Section __.32(e)(2)(ii)(B) of the Proposed Rule the portion of this $40 that supports ABCP with maturities of 30 days or less is a 100% outflow amount. The remaining portion of this $40 is a 0% outflow amount

**NOTE:** Look-through treatment should apply to the relevant undrawn credit commitment regardless of whether the outflow amount applies under Section __.32(b) or Section __.32(e) of the Proposed Rule

# Appendix H: Agencies' Definition of "Traditional Securitization"

- According to the Agencies' regulatory capital rules, traditional securitization means a transaction in which:

  (1) All or a portion of the credit risk of one or more underlying exposures is transferred to one or more third parties other than through the use of credit derivatives or guarantees;

  (2) The credit risk associated with the underlying exposures has been separated into at least two tranches reflecting different levels of seniority;

  (3) Performance of the securitization exposures depends upon the performance of the underlying exposures;

  (4) All or substantially all of the underlying exposures are financial exposures (such as loans, commitments, credit derivatives, guarantees, receivables, asset-backed securities, mortgage-backed securities, other debt securities, or equity securities);

  (5) The underlying exposures are not owned by an operating company;

  (6) The underlying exposures are not owned by a small business investment company defined in section 302 of the Small Business Investment Act;

  (7) The underlying exposures are not owned by a firm an investment in which qualifies as a community development investment under section 24(Eleventh) of the National Bank Act;

  (8) The [AGENCY] may determine that a transaction in which the underlying exposures are owned by an investment firm that exercises substantially unfettered control over the size and composition of its assets, liabilities, and off-balance sheet exposures is not a traditional securitization based on the transaction's leverage, risk profile, or economic substance;

  (9) The [AGENCY] may deem a transaction that meets the definition of a traditional securitization, notwithstanding paragraph (5), (6), or (7) of this definition, to be a traditional securitization based on the transaction's leverage, risk profile, or economic substance; and

  (10) The transaction is not:

    (i) An investment fund;

    (ii) A collective investment fund (as defined in [12 CFR 9.18 (national bank) and 12 CFR 151.40 (Federal saving association) (OCC); 12 CFR 208.34 (Board); and 12 CFR 344.3 (state nonmember bank) and 12 CFR 390.203 (state savings association) (FDIC)];

    (iii) An employee benefit plan (as defined in paragraphs (3) and (32) of section 3 of ERISA), a "governmental plan" (as defined in 29 U.S.C. 1002(32)) that complies with the tax deferral qualification requirements provided in the Internal Revenue Code, or any similar employee benefit plan established under the laws of a foreign jurisdiction;

    (iv) A synthetic exposure to the capital of a financial institution to the extent deducted from capital under §__.22; or

    (v) Registered with the SEC under the Investment Company Act of 1940 (15 U.S.C. 80a-1) or foreign equivalents thereof.