American
SECURITIZATION
FORUM®

September 10, 2007

Board of Governors of the Federal Reserve System
Docket No. R-1261

Federal Deposit Insurance Corporation
RIN 3064-AC73

Office of the Comptroller of the Currency
Docket No. 06-09

Office of Thrift Supervision
Attn: 2006-33

Re: Risk-Based Capital Standards; Advanced Capital Adequacy Framework

Ladies and Gentlemen:

The American Securitization Forum[1] is writing to follow up on three topics raised in our July 24, 2007 meeting with representatives of your agencies (the "Agencies") relating to the securitization framework set out in the joint notice of proposed rulemaking (the "Basel II NPR") published on September 25, 2006. The three topics we discuss below are:

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- How risk-based capital should be determined for program-wide credit enhancement ("PWCE") if the Agencies applied the internal assessment approach (the "IAA") as suggested by comment 1(b) in our March 26, 2007 comment letter (the "ASF Letter") relating to the Basel II NPR……………………………….…………………………… 2

- Whether the credit risks of parallel purchase facilities are generally similar to those of liquidity facilities…………………………….……………………………………… 3

- To what extent comments 1, 5 and 6 in the ASF Letter are consistent with the mid-year text of Basel II and/or BIPRU 9, which is being adopted by the Financial Services Authority (the "FSA") to implement Basel II…………………………….... 3

[1] The American Securitization Forum (the "ASF") is a broadly-based professional forum of participants in the U.S. securitization market. Among other roles, the ASF members act as issuers, underwriters, dealers, investors, servicers and professional advisors working on securitization transactions. This comment letter was developed principally in consultation with the ASF's ABCP Conduit Sponsors Subforum and ASF Legal, Regulatory, Accounting and Tax Committee, with input from other ASF members, subforums and committees. More information about the ASF and its members and activities may be found at the ASF's website, located at www.americansecuritization.com.

References below to "banks" relate to depository institutions (and bank holding companies) that will be subject to the Agencies' final rules relating to the advanced internal ratings-based approach, whether on a core or opt-in basis.

Determining Risk-Based Capital for PWCE

Comment 1(b) in the ASF Letter stated that "A bank should be able to . . . exclude the bank's exposures to a conduit's ineligible transactions from the bank's IAA without affecting otherwise qualifying exposures to transactions funded through the conduit." In other words, a single conduit could include some transactions that were eligible for the IAA and some others that were ineligible. In that case, a bank's risk-based capital requirements for exposures to the eligible transactions would be determined using the IAA, and the bank's risk-based capital requirements for exposures to ineligible transactions would be determined using the ratings-based approach (the "RBA") or the supervisory formula approach (the "SFA"). If the bank was unable to calculate capital for an exposure using any of these methodologies, the exposure would be deducted from capital in accordance with Section 42(a)(4) of the proposed new rules.

The Agencies have asked for our suggestion as to how the risk-based capital requirement for PWCE provided by a bank should be calculated when some but not all of the related liquidity exposures are subject to the IAA. We suggest that banks should apply a method based on the weakest-link approach outlined in the Agencies' April 2005 guidance on the risk-based capital treatment of direct-credit substitutes issued in connection with asset-backed commercial paper ("ABCP") programs.[2] Our suggested approach would take into account the risk weight assigned to each underlying transaction in an ABCP program, whether or not the transaction was eligible for the IAA. These risk weights would be determined for each transaction using the applicable methodology, as described in the preceding paragraph. The transactions would then be rank ordered by their risk weights. The PWCE would be assigned a risk weight based upon the notional amount of transactions in each risk weighting.

Under the weakest-link approach, the risk weight for the PWCE would correspond first to the weakest transactions to which the PWCE is exposed. Banks should begin with the transactions with the highest risk-weighting and then move to the next lower risk weighting until the entire amount of the PWCE has been assigned. The assigned risk weights and their associated capital charges would then be aggregated. The aggregate capital charge for the PWCE and other exposures held by the same bank to conduit transactions would be subject to Section 42(d) of the proposed new rules.

The April 2005 guidance also permitted banks to use other methods to determine the risk weight for PWCE, so long as each bank could appropriately support its risk-based capital calculation.[3]

[2] See pp. 18-19 and 22-26 of the April 2005 guidance.

[3] See p. 23 of the April 2005 guidance: "Banking organizations that sponsor ABCP programs may have other methodologies to quantify risk across multiple exposures. For example, collateralized debt obligation (CDO) ratings methodology takes into account both the probability of loss on each underlying transaction and correlations between the underlying transactions. This and other methods may generate capital requirements equal to or more

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We propose that the Agencies permit similar flexibility in determining risk-based capital for PWCE in the circumstances under discussion here.

Treatment of Parallel Purchase Facilities

Comment 5 in the ASF Letter suggested that banks should be permitted to apply the IAA to parallel purchase facilities, which banks provide as a back-up to sellers in many programs where the same banks have provided a liquidity facility to the purchasing conduit. The Agencies have asked us to elaborate on our arguments in support of this suggestion. In particular, the Agencies asked whether parallel purchase facilities have credit risks similar to the credit risks of liquidity facilities.

Parallel purchase facilities are an integral, long-standing, traditional part of the documentation package for transactions funded in many of the largest ABCP programs. They relate directly to the ABCP programs. A bank's exposure under a parallel purchase facility is generally identical to the exposure the bank would have had if the same assets had first been purchased by an ABCP conduit and then purchased by the bank under a liquidity facility. The assets are the same, and in our experience the advance rates and exclusions of defaulted receivables are generally also identical. Since the resulting exposures are essentially identical, we believe the same methodology should be used to assess their respective risk-based capital requirements. If in some cases there are differences between the facilities, we do not think that is a reason for excluding parallel purchase facilities from the IAA. Those differences would be considered in assigning a rating/risk weight to each of them.

Also, draws on a parallel purchase facility and a related liquidity facility are mutually exclusive, so that the capital on the two facilities would be duplicative. If a purchase is made under a parallel purchase facility, then those purchased assets are not in the conduit and cannot be purchased under the liquidity facility. If the conduit purchases assets, creating the potential for a purchase under the liquidity facility, then those same assets cannot be purchased under the parallel purchase facility.

Consistency of Comments 1, 5 and 6 with the Mid-Year Text and the FSA's BIPRU 9

Comment 1 in the ASF letter had two comments, the second of which (comment 1(b)) is discussed and summarized above. Comment 1(a) requested that qualifying banks be permitted to apply the IAA to exposures to conduits administered by other banks or non-banks, as well as to exposures to conduits administered by the subject bank. Comment 5 is also discussed and summarized above. Comment 6 related to the IAA eligibility criteria and stated that those criteria should not flatly prohibit the purchase of assets that are significantly past due or defaulted. The Agencies have asked for our view as to whether these comments are consistent with the mid-year text and/or with the FSA's BIPRU 9.

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conservative than those arrived at via the weakest-link method. Regardless of the approach used, well-managed institutions should be able to support their risk-based capital calculations."

Comment 1

As indicated in the ASF Letter (p. 4), we believe that comment 1 is generally consistent with the approach being taken by the FSA. We also think that the mid-year text can be interpreted in a manner that is generally consistent with comment 1.

Focusing on the FSA's approach, as to comment 1(a), we understand that, as a result of discussions at a Securitisation Standing Group and expert group meetings, UK banks believe that the FSA intends to allow qualifying firms to apply the IAA to all ABCP-conduit related activity, whether sponsored by the bank itself or by a third-party, which might or might not be IAA eligible. Individual IAA applications, therefore, sought specifically to establish eligibility and to receive permission to apply the IAA in this matter. We understand the FSA is close to issuing its permissions to banks regarding their IAA applications.

As to comment 1(b), please refer to the attached excerpt from FSA's Policy Statement 06/6, item 16.3, which supports the position that the treatment applied to any individual transaction would not jeopardize the availability of the IAA to other transactions or the eligibility of any program.

Comment 5

We believe that the mid-year text can be interpreted to permit the application of the IAA to parallel purchase facilities. Although the mid-year text speaks in terms of securitisation exposures that a bank extends to ABCP programmes, it does not specifically indicate whether a parallel purchase facility should or should not be considered to be extended to an ABCP program. The language is sufficiently general to permit a favorable interpretation. We understand that at least some UK banks believe that the FSA's principles-based approach permits a favorable interpretation on this point.

Comment 6

Unfortunately, the mid-year text includes language similar to the language addressed by comment 4, which prohibits the purchase of assets that are significantly past due or defaulted. We understand this text has also been adopted by the FSA. Nevertheless, we cannot overstate the importance of providing reasonable flexibility on this point, as illustrated by the series of implementation issues that arose from the inclusion of similar language in the Agencies' current eligibility standards for ABCP liquidity facilities.

We believe that the mid-year text provides some flexibility on this point. Paragraph 620(j) of the mid-year text states:

> "The ABCP programme's underwriting policy must establish minimum asset eligibility criteria that, among other things,
>
> - exclude the purchase of assets that are significantly past due or defaulted . . . ."

One point to note about this language is that it does not specify particular periods of delinquency as being “significantly past due.” At a minimum, this would seem to permit the Agencies to use more flexible standards than the blanket 30 days past due standard that appears in the currently eligibility standards for ABCP liquidity facilities.

Also, it would be unusual for an ABCP conduit to make whole loan purchases of significantly past due or defaulted assets. The issues in this area arise because conduits often purchase interests in pools, where the pools include past due or defaulted assets. We believe it is consistent with the securitization framework in Basel II to view an exposure to such a pool as a separate asset, distinct from any of the underlying assets. Therefore, the exclusion quoted above could be read as not applying to a tranched investment in a pool that includes past due or defaulted assets, unless that tranched investment itself (as opposed to one or more of the underlying exposures) is significantly past due or defaulted.

* * *

The ASF appreciates the opportunity to provide the foregoing comments. Should you have any questions or desire any clarification concerning the matters addressed in this letter, please do not hesitate to contact Tom Deutsch, Associate Director of the ASF (646.637.9235), or Rob Hugi (312.701.7121) or Jason Kravitt (212.506.2622), each of Mayer Brown LLP, who have acted as special counsel to the ASF on this matter.

Sincerely,

Cameron L. Cowan
Chair
ASF Legal, Regulatory, Accounting and Tax Committee

Excerpt from FSA Policy Statement 06/6

Internal assessment approach

Q73: What are your views on our implementation of the internal assessment approach (IAA)?

16.1 The joint-industry response welcomed the re-ordering and grouping of the IAA requirements as it will make this part of the chapter easier to navigate.

16.2 Respondents disagreed with a hierarchy of approaches that required the application of the IAA or the supervisory formula method (SFM) 'consistently across transactions'.

16.3	**Our response:** The intention was to allow firms to choose between the two approaches for each individual transaction or position. Thereafter to 'stick with' that approach. We agree that the guidance was not clear. We also agree that there will be legitimate reasons for using one method then migrating to another for example a firm may begin using the SFM then migrate to the IAA once it has evidenced compliance with the IAA requirements. If the firm ceases to meet these requirements it would then return to the SFM. The policy will be changed to allow firms to choose the most appropriate approach for each transaction or exposure in accordance with the circumstances at the time. Switching between the two approaches simply to cherry pick the one with the lowest capital requirement will not be considered as an acceptable basis for choosing the most appropriate approach.