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October 15, 2009

Office of the Comptroller of the Currency
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Washington, DC 20219
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Docket No. OCC-2009-0012

Jennifer J. Johnson
Board of Governors of the
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Docket No. R-1368

Mr. Robert E. Feldman
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Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
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Attention: OTS-2009-0015

Re: Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance: Impact of Modifications to Generally Accepted Accounting Principles; Consolidation of Asset-Backed Commercial Paper Programs; and Other Related Issues

Wells Fargo & Company ("Wells Fargo") welcomes the opportunity to comment on the recent notice of proposed rulemaking (NPR) regarding the above topics.

Introduction

We understand the need for the agencies to consider the recent adoption of Financial Accounting Statements No. 166 and No.167 by the FASB, which resulted in certain very significant modifications to generally accepted accounting principles (the "2009 GAAP modifications"). We also understand the need for the agencies to evaluate whether regulatory capital standards should be revised in response to the 2009 GAAP modifications and recent economic turmoil. The NPR stated in its Summary paragraph that the "agencies are issuing this proposal and request

for comment to better align capital requirements with the actual risk of certain exposures…" However, the primary conceptual basis articulated by FASB for the 2009 GAAP modifications focuses on an entity's retained control or ability to obtain benefits rather than focusing on the actual economic risk exposures owned in a securitization. We agree with and applaud the agencies for recognizing that the 2009 GAAP modifications may not directly align with the economic risks and related increased capital needed from newly consolidated assets and liabilities. We believe that there is a compelling basis upon which to modify regulatory capital requirements to alter the adverse effect of the 2009 GAAP modifications, and we present our rationale below in our Overall Comments as well as in our answers to the specific questions raised in the NPR.

Overall Comments

The 2009 GAAP modifications require consolidation of gross assets and liabilities of entities based on a qualitative analysis of control. However, for many securitizations, consolidation will be the result for GAAP purposes even though a bank may have effectively transferred the economic risk of loss on a substantial portion of the assets underlying the securitization. Accordingly, since it is only the portion of the securitization that a sponsoring entity retains that exposes such entity to contractual potential loss, we believe that regulatory risk-based capital requirements should be based only on such contractual exposure. We realize that the agencies have a concern that goes beyond contractual risk, namely, that some sponsors of securitizations may have voluntarily "supported" their outstanding securitizations without any contractual obligation to do so and that some additional level of regulatory capital should be held to reflect the potential risk of loss related to such implicit recourse. However, the agencies correctly recognize that only "some" of the unconsolidated securitizations present actual risk of implicit recourse.

Specifically, in the sentence immediately preceding Question 2 of the NPR, the following appears: "it is the agencies' view that the capital treatment of *some* previously unconsolidated VIE's does not reflect the actual risk to which the banking organization may be exposed." [Emphasis added] We agree with this statement and believe that it would be inappropriate to require additional regulatory capital for *all* securitizations, irrespective of whether the characteristics of such securitizations could result in implicit recourse. Specifically, and as explained below, we do not believe that sponsors of self-liquidating securitizations backed by amortizing asset pools, including residential mortgage-backed securitization ("RMBS") transactions, should be required to hold any additional risk-based capital to reflect implicit recourse, as such implicit recourse is absent from these transactions.

In order to illustrate our view that risk-based capital requirements should be focused primarily on the amount of actual economic risk exposure rather than the 2009 GAAP modifications, which primarily focus on a qualitative analysis of control, we would like to highlight characteristics of a typical RMBS transaction. This should assist the agencies in fully recognizing that a final rule that automatically follows the 2009 GAAP modifications would result in a misalignment of capital treatment and the actual economic risk exposure for many securitizations.

In a typical RMBS transaction, an entity (the "sponsor") that owns and often services mortgage loans will sell such loans into a trust, which will in turn issue debt (bonds) to investors. This debt is generally non-recourse to the sponsor since only the cash flows from the loans in the trust and any collateral securing the loans are available to pay the bonds. Because the sponsor typically services the loans, if it also retains a threshold portion of the bonds, the sponsor would be required to consolidate the trust assets and liabilities under the 2009 GAAP modifications. As a result, the sponsor will have to recognize the debt of the bonds on its balance sheet while the liability to make payments on such bonds is not a liability of the sponsor; rather, it is a liability of the issuing trust. GAAP consolidation would be based on a qualitative analysis of control, but would not recognize the economic relationship between the assets and liabilities; i.e., that third-parties bear the risk of economic loss. Furthermore, the typical RMBS transaction prohibits the sponsor from enhancing the cash flow in the issuing trust, resulting in the *inability* of the sponsor to assume the payment obligation on the RMBS bonds or the loss on the underlying assets of the trust.

It should be stressed that the implementation of the 2009 GAAP modification will not create or diminish the economic reality of the securitization trust, as the accounting rules will not affect the cash flows of the transactions. Conversely, while the economics of the transaction are not affected by 2009 GAAP modifications, the accounting treatment of the sponsoring entity is greatly affected by such modifications, misaligning actual assumed liability and economic reality.

As an example, assume a $1 billion securitized pool of residential mortgage loans in which the sponsor owns the $30 million most subordinated bond and where the remaining $970 million is sold to third-party investors and is non-recourse to the sponsor. If a $50 million allowance for credit losses is required to be established, then the sponsor would be required to record an additional $20 million of loan loss reserves to reflect risk that would actually be held by third-party bondholders. In other words, assuming the $30 million bond held by the sponsor is completely worthless, the $50 million allowance would be $20 million in excess of the sponsor's total economic exposure ($50 million allowance minus $30 million first loss subordinated bond equals $20 million recorded loss in excess of economic risk). By extension, the sponsor would have $20 million of reserves on its books related to third-party debt that it is not obligated to repay. However, under GAAP the remaining non-recourse debt can only be defeased once the debt is legally terminated, which typically occurs at a much later date (up to 30 years for the typical RMBS transaction). This causes a current reduction in profit that will be recovered in a future period, creating a significant mismatch in period earnings.

Absent any modification of regulatory capital requirements to alter the effect of the 2009 GAAP modifications, Tier 1 Capital and the Leverage Ratio will be calculated as if the capital of a sponsor is at risk for the vast majority of the assets of the entities that will be consolidated, even though the debt of the variable interest entity ("VIE") has all of the economic risk of loss. In other words, the accounting impact of the 2009 GAAP modifications suggests that more capital is at risk than is actually the case, which from an economic perspective is artificial and could lead to the result that every $1 billion dollars of additional capital held from newly consolidated assets "crowds out" more than $15 billion of loans in order to maintain regulatory capital ratios. Given

the current state of the economy, any actions that inhibit the flow of credit to creditworthy consumers and businesses should be avoided.

We believe that in order to accurately determine the capital requirements for the newly consolidated assets and liabilities of entities impacted by the proposed changes, the extent to which economic risk has been permanently transferred to third-parties must be acknowledged. In this regard, we recommend that the agencies adopt an approach similar to an already existing model previously approved by the agencies for the regulatory capital treatment of synthetic securitizations that meet certain basic criteria. In that model, the agencies provided for the modification of regulatory capital requirements such that the GAAP treatment was no longer the basis for the capital calculation. Allowing sponsors to similarly evaluate capital required for newly consolidated assets would align the impact of the 2009 GAAP modifications with the economic reality of the transaction. We discuss this in detail in our answer to Question 7 below.

Absent any modification of regulatory capital requirements, we will be required to hold capital for assets for which we will never incur future economic losses and in respect of debt for which we have no obligation to pay. As a matter of public policy, this makes stand-alone financial evaluation of banks and consistency of comparison to peers extremely difficult.

Questions and Responses

Question 1: Which types of VIEs will banking organizations have to consolidate onto their balance sheets due to the 2009 GAAP modifications, which types are not expected to be subject to consolidation, and why? Which types are likely to be restructured to avoid consolidation?

> **Response**: We expect banks will consolidate VIEs in which they are both the principal servicer or manager and own a potentially significant variable interest. These VIEs may include formerly qualifying special purpose entities (the assets of which typically include private label residential mortgages, commercial mortgages, auto loans, student loans and credit cards), bank-sponsored asset backed commercial paper conduits, bank-managed collateralized debt obligation securitizations, and certain alternative investment funds with incentive fee structures. In addition, unless interpretive guidance is issued by the accounting regulators, it is also possible that banks may be required to consolidate previously supported money market and similar funds.
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> We do not expect any broad based asset class restructurings to avoid consolidation, as exposures can instead be sold to reduce continuing involvement in a VIE to an insignificant level. Instead, banks may simply decide to exit certain business lines rather than tie up capital for accounting reasons in respect of risk exposures for which they are neither “on the hook” nor compensated.

Question 2: Are there features and characteristics of securitization transactions or other transactions with VIEs, other SPEs, or other entities that are more or less likely to elicit banking

organizations' provision of non-contractual (implicit) support under stressed or other circumstances due to reputational risk, business model, or other reasons? Commenters should describe such features and characteristics and the methods of support that may be provided. The agencies are particularly interested in comments regarding credit card securitizations, structured investment vehicles, money market funds, hedge funds, and other entities that are likely beneficiaries of non-contractual support.

Response: We acknowledge non-contractual support has been provided to such transactions in the past. Recently, this has largely been confined to revolving credit card securitizations sponsored by the largest issuers in that industry. By contrast, even during the recent period of significant deterioration in real estate and the related lending markets, we are not aware of any provision of non-contractual support within the private-label RMBS universe including those issued by Wells Fargo.

Question 3: What effect will the 2009 GAAP modifications have on banking organizations' financial positions, lending, and activities? How will the modifications impact lending typically financed by securitization and lending in general? How may the modifications affect the financial markets? What proportion of the impact is related to regulatory capital requirements? Commenters should provide specific responses and supporting data.

Response: As noted in our Overall Comments, the 2009 GAAP modifications will result, in many cases, in the consolidation of assets for which the risk of future economic loss is substantially contractually limited and debt for which there is no obligation to repay. Absent any modification of regulatory capital requirements, we strongly believe this will create an artificial capital need that crowds out new lending and will lead to higher pricing as banks ration scarce capital. For example, there is currently a clear focus on maintenance of capital ratios; a bank impacted by the 2009 GAAP modifications such that an additional $5 billion of capital is required will be forced to manage down their balance sheet more than $80 billion in order to maintain a consistent Leverage Ratio (assuming a 6% target). The 2009 GAAP modifications and the related impacts will also likely delay re-emergence of all securitization markets, which also adversely impacts the borrowers needing consumer financing and, potentially, the U.S. taxpayer. For example, the FHA or other government agencies may need to expand their underwriting criteria to provide mortgages to consumers no longer served by the private-label RMBS market, a market that met the needs of individuals not eligible for loans qualifying for inclusion in GNMA, FNMA or FHLMC securitized pools. The effect of this would be transferring risk from the private market to the U.S. taxpayer.

The impact of the 2009 GAAP modifications specific to ABCP conduits is very unclear given the uncertainty of the ultimate regulatory capital outcome. Our responses to Questions 5 and 7 below address this further.

Question 4: As is generally the case with respect to changes in accounting rules, the 2009 GAAP modifications would immediately affect banking organizations' capital requirements. The agencies specifically request comment on the impact of immediate application of the 2009 GAAP modifications on the regulatory capital requirements of banking organizations that were not included in the SCAP. In light of the potential impact at this point in the economic cycle of the 2009 GAAP modifications on regulatory capital requirements, the agencies solicit comment on whether there are significant costs and burdens (or benefits) associated with immediate application of the 2009 GAAP modifications to regulatory capital requirements. If there are significant costs and burdens, or other relevant considerations, should the agencies consider a phase-in of the capital requirements that would result from the 2009 GAAP modifications? Commenters should provide specific and detailed rationales and supporting evidence and data to support their positions.

> **Response**: Wells Fargo was included in the SCAP and estimated the impact of the 2009 GAAP modifications during that process. We update our analysis as new information becomes available, and provide disclosure quarterly.
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> We believe that the implementation of FAS 166 and FAS 167 will be very expensive for the industry because of the operational and administrative requirements to support the new accounting. For example, systems that may currently be unable to distinguish between and track assets that are on versus off balance sheet will require significant enhancement to support the 2009 GAAP modifications and additional human resources in technology, accounting, operations, etc. roles will be required. As we noted in our answer to Question 3, there will also be an incremental burden absorbed by consumers and businesses resulting from reductions in available lending capacity and higher pricing.
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> The implementation date for the 2009 GAAP modifications is fast approaching, while material interpretive guidance remains outstanding. Given this, in combination with the fact that the resulting regulatory capital treatment will presumably not be certain until the agencies have been provided the opportunity to analyze these and similar comments on this NPR, we recommend a moratorium on any increased capital requirements at least through calendar year 2010.

Question 5: The agencies request comment on all aspects of this proposed rule, including the proposal to remove the exclusion of consolidated ABCP program assets from risk-weighted assets under the risk-based capital rules, the proposed reservation of authority provisions, and the regulatory capital treatment that would result from the 2009 GAAP modifications absent changes to the agencies' regulatory capital requirements.

> **Response:** We believe that the only reasonable basis on which to remove the exclusion of ABCP program assets from risk-weighted assets is in a scenario that provides for application of internal ratings-based risk weights to conduit exposures based on the bank's own application of publicly available rating criteria, in advance of full approval of the Internal Assessment Approach (IAA).

Consistent with our answer to Question 4 above, we recommend no change in capital rules with respect to ABCP programs during the calendar year 2010, and an expectation that IAA methodology for related banks be approved in time to be implemented for regulatory capital calculations beginning in calendar year 2011.

Absent such an approach, non-rated exposures that are very high credit quality could be assessed unreasonable capital requirements. For example, assume an unrated $100 million security investment by a conduit, supported by an eligible 364-day liquidity facility with a notional amount of $102 million, which the sponsor/liquidity bank determines has a AAA credit risk.

a) Under the current capital rules, the capital held against such assets is $816,000, which is determined by multiplying the notional amount of the commitment times a credit conversion factor of 10%, a risk weight of 100% and the minimum capital requirement of 8%.
b) IAA capital for the hypothetical transaction above would be $605,472, determined by multiplying the notional amount of the commitment times a risk weight of 7%, a minimum capital requirement of 8% and the scaling factor of 1.06.
c) Our understanding of current rules, with the removal of the current ABCP exclusion and without IAA, is that this position would require <u>$8 million</u> of capital, which is determined by multiplying the investment amount times a risk weight of 100% and the minimum capital requirement of 8%.

This outcome is unreasonable and seems unintended but will occur absent clarification from the agencies.

<u>Question 6</u>: Does this proposal raise competitive equity concerns with respect to accounting and regulatory capital treatments in other jurisdictions or with respect to international accounting standards?

<u>Response</u>: Yes, we believe the proposal raises serious competitive issues with respect to banks in other jurisdictions, as well as unregulated competitors in the United States. We join and fully support the comments regarding the potential anti-competitive effects of the proposal set forth in the comment letter submitted by the American Securitization Forum.

<u>Question 7</u>: Among the structures that likely will be consolidated under the 2009 GAAP modifications, for which types, if any, should the agencies consider assessing a different risk-based capital requirement than the capital treatment that will result from the implementation of the modifications? How are commenters' views influenced by proposals for reforming the securitization markets that require securitizers to retain a percentage of the credit risk on any asset that is transferred, sold or conveyed through a securitization? Commenters should provide a detailed explanation and supporting empirical analysis of why the features and characteristics

of these structure types merit an alternative treatment, how the risks of the structures should be measured, and what an appropriate alternative capital treatment would be. Responses should also discuss in detail with supporting evidence how such different capital treatment may or may not give rise to capital arbitrage opportunities.

> **Response:** We believe that the agencies should assess different risk-based capital requirements than the capital treatment that would result from the implementation of the 2009 GAAP modifications. Our specific suggestion is to use an approach similar to the approach set forth in Interpretive Letter #988 dated July 28, 2003 from the OCC and the Federal Reserve. In this letter, the OCC and Federal Reserve provided precedent for modifying regulatory capital requirements where GAAP treatment is for the basis for the capital calculation. This approach outlined the capital treatment for "synthetic securitizations", which are similar to many of the securitizations that would be required to be consolidated after the implementation of 2009 GAAP modifications. However, the capital treatment of these synthetic securitizations not only recognized the transference of economic risk, but also resulted in regulatory capital being required only for the economic risk associated with the owned positions. The interpretive letter supports consideration of modifying regulatory capital requirements to alter the impact of the 2009 GAAP modifications.
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> We propose that regulatory capital for securitizations that are required to be consolidated be calculated based 1) on the Ratings Based Approach (RBA) of owned banking book securities, and 2) reduced by capital already provided for (i.e. recognized as allowance for credit losses ("ACL")). In order to qualify for our proposed treatment, the transaction would have to meet the following conditions in Annex 1 of Interpretive Letter #988:
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> > Condition 1 – Demonstrate risk transference has been achieved
> > Condition 2 – Demonstrate the ability to evaluate the remaining banking book risk exposures and provide adequate capital support
> > Condition 3 – Provide adequate public disclosures of such transactions
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> If the above conditions are met, as well as legal isolation with respect to the securitized assets, we believe the sponsor should compare the assets and liabilities of the VIE on its books, where any excess of assets would correspond to a position not held by third-parties. Then the sponsor should calculate risk weighted assets only on that owned position using existing RBA rules based on the nature of such position (AAA/AA securities at 20% risk weighting, A at 50%, BBB at 100%, BB at 200% and anything below BB at dollar for dollar). Further, the ACL related to the loans in the securitizations should be included in Tier 1 capital.
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> Please see our answer to Question 10 below for further discussion.

Question 8: Servicers of securitized residential mortgages who participate in the Treasury's Making Home Affordable Program (MHAP) receive certain incentive payments in connection

with loans modified under the program. If a structure must be consolidated solely due to loan modifications under MHAP, should these assets be included in the leverage and risk-based capital requirements? Commenters should specify the rationale for an alternative treatment and what an appropriate alternative capital requirement would be.

> **Response**: We do not believe such structures will be consolidated for this reason exclusively.

Question 9: Which features and characteristics of transactions that may not be subject to consolidation after the 2009 GAAP modifications become effective should be subject to risk-based capital requirements as if consolidated in order to more appropriately reflect risk?

> **Response**: Given the broad scope of the 2009 GAAP modifications, we do not believe any material structures will avoid consolidation that nonetheless would require risk-based capital.

Question 10: Will securitized loans that remain on the balance sheet be subjected to the same ALLL provisioning process, including applicable loss rates, as similar loans that are not securitized? If the answer is no, please explain. If the answer is yes, how would banking organizations reflect the benefits of risk sharing if investors in securitized, on-balance sheet loans absorb realized credit losses? Commenters should provide quantification of such benefits, and any other effects of loss sharing, wherever possible. Additionally, are there policy alternatives to address any unique challenges the pending change in accounting standards present with regard to the ALLL provisioning process including, for example, the current constraint on the amount of provisions that are includible in tier 2 capital? Commenters should provide quantification of the effects of the current limits on the includibility of provisions in tier 2 capital and the extent to which the 2009 GAAP modifications and the changes in regulatory capital requirements proposed in this NPR effect those limits.

> **Response**: An allowance for credit losses (ACL) must be provided for assets consolidated under FAS 167, unless the reporting entity elects the fair value option. The process for calculating this allowance will be the same as for similar loans that are not securitized. Similarly, the calculation of the credit loss portion of other-than-temporary impairment for newly consolidated securities will be the same as for similar securities that are not securitized.
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> Generally accepted accounting principles do not support reducing the allowance for credit losses or other-than-temporary impairment based upon the expectation that actual economic losses will be ultimately absorbed by a securitization entity's investors. These economic losses do not result in an extinguishment of debt until the securitization entity is legally released from its obligation, which generally does not occur until an actual loss on the debt instrument has been incurred, which can be as late as the termination of the

entire structure. Accordingly, loss provision by the reporting entity will generally occur prior to the extinguishment of the related debt.

Because the generally accepted accounting principles governing the calculation of the ACL do not take into account the transfer of economic risk of loss on securitized assets to holders of the related debt, the sponsor's ACL then accounts for economic risks of loss that are contractually borne by third-party debt holders. We believe 1) that such assets should be excluded from the risk-weighting calculation, and 2) that the related portion of ACL should be included in Tier 1 capital.

Please feel free to contact the undersigned if you have any questions regarding the above comments.

Sincerely,

Paul Ackerman
Treasurer