October 15, 2009

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Docket No. OCC-2009-0012

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Docket No. R-1368

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Regulation Comments
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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

Ladies and Gentlemen:

The American Securitization Forum (ASF)[1] is writing to comment on the agencies' recent notice of proposed rulemaking[2] (NPR) on the topics referenced above.

Recent events have demonstrated that some securitization exposures involve greater risk for banks than previously appeared to be the case. However, some other securitization exposures have weathered these severe tests well, either in the sense of their relative credit performance

[1] The American Securitization Forum is a broad-based professional forum through which participants in the US securitization market advocate their common interests on important legal, regulatory and market practice issues. ASF members include over 330 firms, including issuers, investors, servicers, financial intermediaries, rating agencies, financial guarantors, legal and accounting firms, and other professional organizations involved in securitization transactions. The ASF also provides information, education and training on a range of securitization market issues and topics through industry conferences, seminars and similar initiatives. For more information about ASF, its members and activities, please go to www.americansecuritization.com. The ASF is an affiliate of the Securities Industry and Financial Markets Association.
[2] Federal Register, Vol. 74, p. 47138 (September 15, 2009).

or in the sense that banks have benefited from having transferred risk and have not increased their support when investors suffered losses. Consequently, we do not believe that recent experience supports a blanket increase in capital requirements for all securitization exposures.

We support increased capital requirements where they are justified by new information about bank risks, but we believe strongly that the risk-based capital system should be truly risk-based. While we understand that the agencies believe that the revised, control-based consolidation standard for variable interest entities (VIEs) provides a reasonable starting point for a more cautious risk-based capital framework, it is in the best interests of all constituents if that starting point is refined by other more explicitly risk-focused considerations. The over-all level of capital that the agencies want banks to maintain is a separate question from how the capital requirements are allocated among various exposures. The rules should be sensitive to the relative risk of different types of exposures so as to provide appropriate incentives for risk management.

Our detailed comments below deal separately with asset-backed commercial paper (ABCP) conduits and term market structures, since they are affected by different parts of the NPR and also vary in important business and economic respects. In each case, we have presented our comments as answers to the questions posed in the NPR from the perspective of the particular market segment, although the ABCP conduit section begins with an introduction that sets out our main concerns relating to that market segment. Each NPR question is *italicized* below and followed by our response. We precede those detailed responses with an executive summary, which highlights our main concerns and key proposals relating to the NPR.

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Executive Summary

We are extremely concerned about the potential consequences of relying on a control-based accounting consolidation standard for risk-based capital purposes to the extent proposed in the NPR. The approach taken in the NPR threatens to:

- Decrease the availability and/or increase the price of credit to consumers and businesses, since banks may have to raise equity capital and/or curtail lending to adjust to the capital impacts from consolidation of previously unconsolidated VIEs. As noted in the NPR, these impacts come at a sensitive time in the economic cycle.

- Place US banks at a competitive disadvantage to foreign banks, since Basel II as adopted elsewhere permits (a) conduit sponsors to use an internal assessment approach to determine risk weights for consolidated conduit assets and (b) reductions of capital if significant risk is transferred, regardless of the accounting treatment of a securitization.

- Undermine incentives for banks to transfer risk. If the regulatory capital treatment is the same regardless of the amount of contractual risk transfer, then a bank will, at the margin, be more likely to decide among funding alternatives based on pricing or other considerations, with less consideration of risk transfer benefits.

- Create perverse incentives for banks to provide implicit support, since the experience of the NPR suggests that the agencies will treat all banks the same, regardless of whether any particular bank provides implicit support or not.

To maintain and enhance the risk-sensitivity of the risk-based capital rules and maintain and restore the viability of the securitization markets as a source of funding, liquidity and risk transfer for US banking organizations, we request that the proposals set out in the NPR be modified as follows:

- With respect to ABCP conduits, the agencies should:

    - continue to permit banks to elect to disregard consolidation of Customer Conduits (as we define that term on Attachment A) for risk-based capital purposes under the general risk-based capital rules and apply the current credit conversion factors (10% for up to one year and 50% for longer term commitments) to eligible liquidity facilities, at least while core banks are transitioning to the advanced approaches; and

    - confirm availability of the internal assessment approach for consolidated Customer Conduit assets under the advanced approaches.

- With respect to the term ABS markets, the agencies should:

    - address not only the increase in risk-weighted assets (the denominator in the risk-based capital ratio) resulting from implementation of FAS 167, but also increases

in the ALLL and deferred tax assets, which are likely to eat into qualifying capital and thus reduce the numerator of the risk-based capital ratio;

- provide a six month moratorium on capital changes (both numerator and denominator) resulting from consolidation of VIEs (excluding Customer Conduits if our proposals above are implemented), followed by a three year phase-in period (with the target capital levels for core banks during the phase-in taking account of the capital that will be required under the advanced approaches);

- during the six month moratorium (and afterwards if necessary), continue working with regulated institutions to arrive at:

    - new risk transfer standards which, if met, would permit sponsors to lower their risk-based capital requirements on account of securitizations, regardless of the GAAP treatment of the transaction; and

    - a sliding scale capital charge for risk of implicit recourse, based on transaction features and other factors determined to be relevant;

- exempt legacy RMBS and other legacy transactions and structures (including specific credit card master trusts) that have not received implicit support during the recent crisis from any capital changes (both numerator and denominator); and

- adjust the qualifying capital rules to:

    - include ALLL in Tier 1 capital when it relates to losses on securitized assets, to the extent those losses are contractually allocated to unaffiliated investors;

    - raise the cap on counting other ALLL towards Tier 2 capital; and

    - provide one-time relief as to deferred tax assets arising from implementation of FAS 167.

ABCP Conduits

Our comments in this section focus on customer-centered multi-seller ABCP conduits, which we will refer to below as "Customer Conduits." Key defining characteristics of Customer Conduits are:

- Customer Conduits are designed primarily to provide the sponsor's customers with access to funding through the commercial paper market. This differentiates Customer Conduits from so-called "arbitrage conduits" and structured investment vehicles (SIVs), each of which was designed solely to enable the sponsor to profit from the difference between the coupon payable on investments in the vehicle's portfolio and the expected lower coupon on the ABCP and other securities issued to fund those investments.

- Each of a Customer Conduit's investments is individually structured and negotiated by the conduit's sponsor in bespoke transactions, involving direct, one-on-one negotiations with the customer. This also differentiates Customer Conduits from arbitrage conduits and SIVs, each of which typically purchased asset-backed securities (ABS) or debt securities from underwriters or other broker/dealers as part of wider distributions, where the vehicle purchased solely on the basis of a prospectus or other disclosure document, often purchased only a small portion of any particular class of securities and had little or no opportunity for direct negotiation with the issuer. Through their negotiation of each investment with their customers, sponsors of Customer Conduits often obtain more favorable credit terms than appear in ABS distributed in public offerings or quasi-public 144A transactions. These often include: dynamic credit enhancement, which requires more support from customers if receivables performance deteriorates; tighter triggers for early amortization or turbo features; and short term (364 day) commitments.

- A Customer Conduit has explicit, contractual liquidity facilities that in the aggregate cover at least 100% of its outstanding ABCP and are already factored into risk-based capital calculations. This further differentiates Customer Conduits from SIVs, most of which relied on the perceived liquidity of their portfolio securities as a source of payment for ABCP and did not have 100% committed liquidity coverage.

- Customer Conduits are not subject to triggers that require the conduit to dispose of its exposures as a result of a decline in the market value of the exposures. This absence of market value triggers also differentiates Customer Conduits from SIVs and some arbitrage conduits.

- Customer Conduits are actively managed by the conduit sponsor through periodic renewals and monitoring of customer transactions, which give sponsors and Customer Conduits frequent opportunities to renegotiate, re-price or exit deteriorating credits.

Largely because of the features described above, Customer Conduits have continued their historically excellent credit performance through the severe tests of recent years. In the process, they have provided an important source of funding and stability to US businesses and profits to their sponsoring banks. This also distinguishes them from arbitrage conduits and SIVs.

Banks sponsoring Customer Conduits are affected primarily by the proposal in the NPR to remove the option for bank sponsors to disregard GAAP consolidation of conduits in calculating their risk-based capital requirements (which we refer to below as the "FIN 46 Option"). For the reasons discussed below, we request that the agencies take both of the following actions:

(1) Continue the FIN 46 Option for Customer Conduits under the general risk-based capital rules, at least during each core bank's transition to the advanced approaches.

(2) Confirm availability of the internal assessment approach (IAA)[3] for assets of Customer Conduits consolidated by bank sponsors that apply the advanced approaches.

The agencies could also permit core banks to early adopt the IAA (in which case they would also have to take assets of IAA Customer Conduits out of the general risk-based capital floor[4] during the transition to the advanced approaches). However, relief under the general risk-based capital rules will be necessary at least during the qualification process for core banks and on a continuing basis for banks that are not transitioning to the advanced approaches, if those banks are going to compete in this market on a reasonable economic basis.

To be clear, we are not requesting that these actions apply to arbitrage conduits, SIVs or other non-traditional conduit structures. Our requests relate solely to Customer Conduits, which we propose be defined as set out in Attachment A. Because the characteristics of a Customer Conduit have not had regulatory significance in the past, the fact that a particular conduit may in the past have engaged in some transactions outside of the scope of our proposed definition should not preclude qualification as a Customer Conduit, so long as the conduit complies at the time of examination and prospectively.

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?*

To our knowledge, all ABCP conduits sponsored by US-regulated banks will be consolidated with their sponsors. Some bank sponsors were already consolidating some or all of their conduits, but a substantial portion are not consolidated under the current standards (prior to application of FAS 167). Importantly, sponsors had the benefit of the FIN 46 Option with respect to any previously consolidated conduits.

It is too early to be certain whether any conduits will be restructured to avoid consolidation, but it is clear that any restructuring would involve substantial changes in decision-making and the business model and will not be undertaken lightly.

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 noncontractual (implicit) support under stressed or other circumstances due to reputational risk, business model, or other reasons?*[5]

For securitization vehicles that access the ABCP market, we believe the following features are likely to elicit implicit support:

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[3] See, for example, 12 CFR Part 3, Appendix C, Section 44.
[4] We are referring to the floors required by Section 21(e) of the advanced approaches rules, as set out, for instance, at 12 CFR Part 3, Appendix C, Section 21(e).
[5] We address credit card securitizations in the section below on the term market.

- absence of committed liquidity back-up facilities covering 100% of ABCP outstandings;

- reliance on the perceived liquidity of assets to repay ABCP when unable to roll paper;

- requirements to sell assets when their market values decline; and

- purchase of portfolio securities in public or quasi-public 144A distributions, with no room for individual negotiation with the issuers.

For instance, when the deteriorating performance of residential mortgages began to impair the market value and liquidity of SIV assets (whether or not the assets were directly related to mortgages), the features above contributed to a vicious cycle that undermined the solvency of the SIVs themselves and posed serious issues for the ABS market as a whole. We believe the pressures arising from these factors contributed significantly to decisions by bank sponsors to provide implicit support to SIVS.

In contrast, none of the features listed above is present in Customer Conduits, all of which benefit from committed liquidity facilities that cover 100% of outstanding ABCP and none of which are required to liquidate assets based on market value declines. Also, any support that a sponsor may provide to a Customer Conduit is covered by the capital required with respect to those liquidity facilities and any related program credit enhancement facilities. The adequacy of this capital is amply illustrated by the historical loss experience described under question 3 below.

Responding to a question raised by agency staff at our October 14, 2009 meeting, we do not believe that purchases of a conduit's ABCP by the sponsor should be viewed as implicit support. First, dealer affiliates of sponsors often purchase ABCP as a part of their normal market-making activities, and we do not view that type of purchase as raising any issue of implicit support. We also understand that some sponsors purchased ABCP in other circumstances, where the sponsor was party to a liquidity facility that would have been drawn[6] if the purchase had not been made. Such a purchase did not place the sponsor in a materially different credit position from what would have resulted if liquidity had been drawn. The sponsor was holding capital against the liquidity commitment and also was required to hold capital against the purchased ABCP. If the agencies are concerned about the risk-weighting of the purchased ABCP, we note that the recent enhancements to the Basel II framework have already addressed that issue.

Agency staff also asked about situations in which one or more sponsors increased their program credit enhancement for a conduit in order to replace enhancement provided by a downgraded monoline insurance company. We also do not believe that these actions should be viewed as implicit support. First, in the situations with which we are familiar, the replacement of the monoline enhancement had nothing to do with the performance of the

[6] We exclude from this statement some purchases that we understand were made for liquidity planning purposes, to test the necessary procedures in case a conduit was ever unable to roll ABCP in the market.

conduit's assets. The monolines were third party service providers whose services were no longer adequate, since linkage to their ratings threatened to cause a downgrade of the ABCP. Second, a downgrade of the ABCP would almost certainly have led to a draw on liquidity facilities provided by the sponsor, since there would be little market appetite for the downgraded ABCP. Substituting for the monoline essentially took the place of a draw on the liquidity.

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?*

Consolidation of Customer Conduits will add a substantial amount of assets to the balance sheets of sponsor banks and their respective holding companies. This will increase the reported leverage of these banking organizations and reduce their return on assets. The extent to which these changes will impact funding of businesses and consumer finance by Customer Conduits depends to a great extent on whether the agencies take the actions we request on page 6 above. To provide context for the following discussion, we begin with some market information about current funding levels, types of assets funded by Customer Conduits and historical loss experience.

Market Information. We are not aware of any aggregate market statistics for Customer Conduits as a separate category. However, we have worked with ABCP market data published by Moody's to back into figures that we believe closely approximate the Customer Conduit business line.[7] Based on those figures, as of May 2009, Customer Conduits had $371.8 billion in outstanding ABCP and made up about 64% of total ABCP outstanding. All or most of the US banks that remain in this business are core banks in the process of transitioning to the advanced approaches.

The ABCP market declined by more than half between 2007 (when outstandings peaked at approximately $1.2 trillion) and 2009 ($579.7 billion at the end of May), with much of the decline attributable to the exit of SIVs, many arbitrage conduits and single seller structures relying on extendible short-term notes. However, Customer Conduits also accounted for part of the decline. In a healthy economy, and assuming reasonable capital requirements, it seems likely that Customer Conduit outstandings would rise from their current levels, helping to finance the economic recovery. As noted in the NPR (question 4), increased capital requirements could potentially affect the economy. This would be particularly unfortunate if the increases were excessive.

The table below illustrates the breadth of industries which receive material financing through Customer Conduits. Among others, many banks that have traditionally raised significant funds in the term ABS markets have also relied upon Customer Conduits sponsored by other banks

[7] We started with Moody's aggregate Multiseller Conduits data, backed out any reported securities and then added Moody's Hybrid Conduit data, backing out all securities and CDOs from those amounts.

as another funding source. To the extent that the proposals in the NPR reduce availability (or increase pricing) for Customer Conduit customers, while also rendering term ABS funding less attractive, the banks that have relied on both sectors are disadvantaged on two fronts at once.

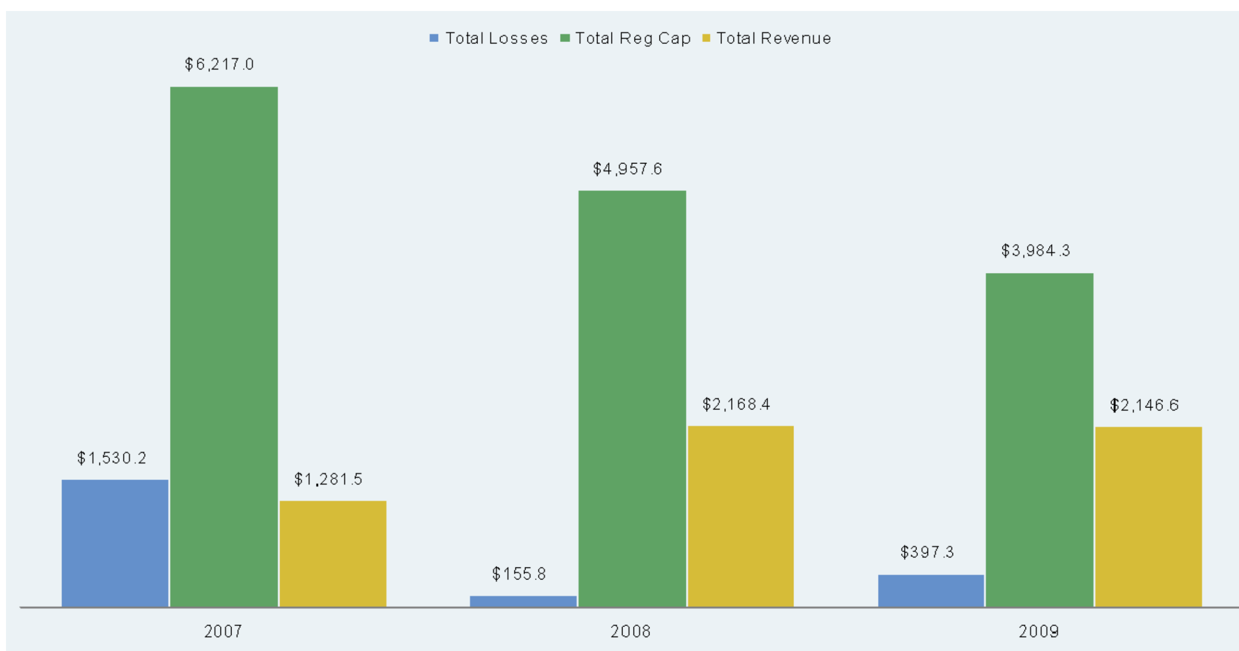
($ Billions) Industry	May 2009 Customer Conduit O/S
Consumer Finance	91.0
Automotive Finance	84.1
Commercial Finance	64.5
Other	29.0
Mortgage Finance	26.4
Equipment Financing	16.9
Oil, Gas, and Energy	7.1
Aerospace and Defense	7.0
Electronics	5.1
Banking	4.8
Finance	4.6
Mining and Metals	4.6
Manufacturing	4.5
Telecommunications	4.4
Automobile	4.4
Utilities	3.9
Chemicals, Plastics, and Rubber	3.3
Leisure and Entertainment	3.1
Farming and Agriculture	3.1
Total	371.8

Historical Loss Experience. A key question in considering the appropriate risk-based capital requirements for Customer Conduits is banks' historical loss experience over the quarter century that they have been in this business. We surveyed banks (both US and foreign) participating in the multi-seller conduit market in the US[8] and confirmed that loss experience has been very low, including during the severe stresses of the last few years. We found that cumulative losses over the history of the multi-seller ABCP conduit market have only been 25 basis points of originations, while cumulative losses with respect to the type of assets associated with Customer Conduits has been only 8 basis points.

[8] We sent surveys to the twelve banking organizations that are members of the ASF's ABCP Conduit Sponsor Subforum. Ten of the twelve responded, with US respondents cumulatively representing a large majority of US bank-sponsored multi-seller conduit outstandings.

As shown below, current regulatory capital held against multi-seller ABCP conduit exposures has been well in excess of what has been needed even in the strained environment of the last three years. In the past three years, regulatory capital has averaged more than seven times the amount of losses for the multi-seller conduit business on a global scale. In addition, current year's revenue in most years more than completely offset losses, and even in the most stressed period nearly equaled the loss amounts.

Multi-Seller Conduit Losses Compared to Regulatory Capital and Revenue (in millions)



We are aware of the mark-to-market losses that have been realized by some banks upon consolidation of sponsored conduits. The consolidated conduits in those situations were predominantly in the securities arbitrage business, and we believe their losses are directly traceable to differences in the business model between arbitrage conduits (like the ones that suffered the reported losses) and Customer Conduits.

We submit that the excellent credit history of Customer Conduits argues against any increase in risk-based capital requirements for Customer Conduit assets, let alone the extreme increases that would result from the changes proposed in the NPR.

Impact of Proposed Capital Treatment. Once a core bank is operating solely under the advanced approaches, consolidation of Customer Conduits should not significantly increase a sponsor's risk-weighted assets, so long as the IAA is available for consolidated Customer Conduit assets. Because the advanced approaches assign an "amount" to unfunded ABCP exposures generally equal to the maximum amount that a bank could be required to fund, core banks have already been planning to hold capital against the same "amount" of assets as they would if all their ABCP exposures were fully funded. The key issues for core banks are how those exposures are risk-weighted under the advanced approaches and what happens to capital requirements under the general risk-based capital rules during the qualification, parallel run

and transition periods. For any non-core banks participating in this market, the terms of the general risk-based capital rules have continuing importance.

Under the general risk-based capital rules, the 10% credit conversion factor (CCF) applicable to eligible liquidity facilities has always been important in achieving an appropriate level of capital for conduit exposures. Under the changes proposed in the NPR, no CCF would apply to consolidated Customer Conduit assets. To demonstrate the dramatic impact this would have on the risk-based capital requirements for the Customer Conduit business, consider the example of an unrated $100 million investment by a conduit, which the sponsor/liquidity bank determines has a AAA credit risk, ranks as a senior exposure, is not a resecuritization exposure and is supported by an eligible 364-day liquidity facility with a notional amount of $100 million. Assume also that the program-wide credit enhancement (PWCE) for this Customer Conduit was 10% of the program (which is the high end of the range), was provided fully by the sponsor (which is not always the case), had a CCF of 100% (as a direct credit substitute) and qualified for the minimum 100% risk weight (RW) for exposures of this type.

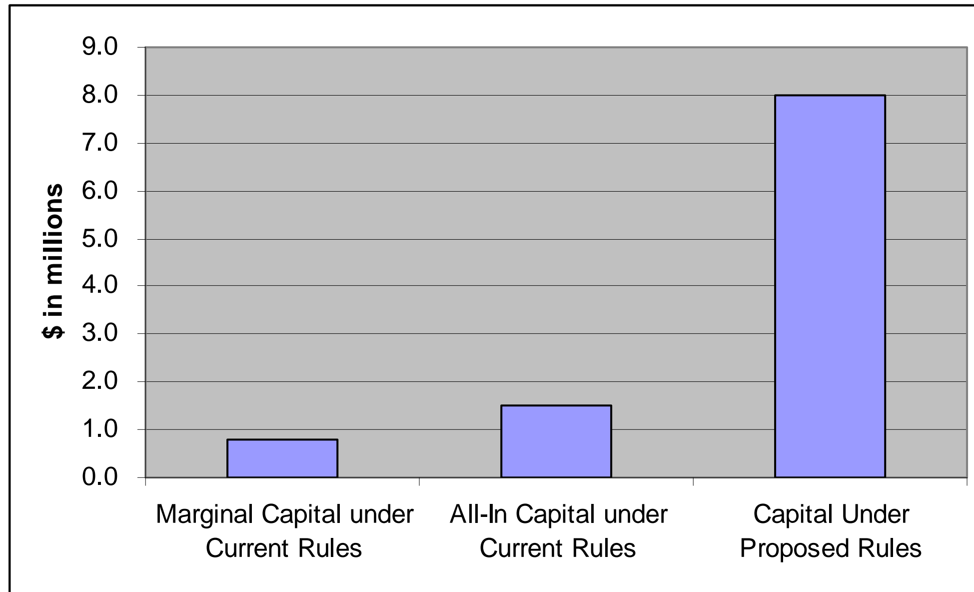
The risk-based capital requirement for the transaction under these facts would be calculated as follows:

- Under the general risk-based capital rules, as currently in effect:
  - the capital for the liquidity facility would be $<u>800,000</u> (before adjusting for overlapping exposures), which is determined by multiplying the notional amount of the liquidity commitment times a credit conversion factor of 10%, a RW of 100% (since the unrated liquidity exposure is not eligible for a ratings-based RW under the general risk-based capital rules) and the minimum capital requirement of 8%;
  - the capital for the PWCE allocated to the transaction would be $<u>800,000</u>, which is determined by multiplying the $100 million investment times the 10% PWCE facility size factor, a 100% CCF, a 100% RW and the 8% minimum capital percentage; and
  - the total capital for the transaction would be approximately $1.52 million (the sum of the two components above, minus the capital for the 10% of the liquidity facility that overlaps with the PWCE).
- Under the general risk-based capital rules, giving effect to the amendments proposed by the NPR (and assuming the sponsor would consolidate the conduit), the capital would be $<u>8 million</u>, determined by multiplying the amount of the investment times a RW of 100% times the minimum capital requirement of 8%.

Bank management could hardly fail to take this regulatory capital increase into account in deciding whether and to what extent a bank should continue to participate in the Customer Conduit market. Generally, in considering whether to enter into any new Customer Conduit transaction, the sponsor would look at the marginal capital requirements, which would mean comparing the $800,000 capital for the liquidity under the current rules to the $8 million in

capital after the proposed change, a ten-fold increase. The allocated PWCE is relevant from an overall business perspective, but generally would not be considered in the credit decision for a particular transaction because the size of the PWCE generally is not adjusted for each new transaction in mature Customer Conduits. Even considering the allocated PWCE, the increase is more than five-fold, and this was determined using assumptions that put the size of PWCE and role of the sponsor in providing PWCE at the high end of the current range. For many sponsors, the all-in comparison would be even more stark.

To illustrate the example discussed above:



If the agencies decline to make the IAA available for application to consolidated Customer Conduit assets, the required capital for those assets will increase even more – to a level (deduction from capital) that would make continued participation in this market prohibitive for core banks. While the advanced approaches effectively provide a 100% CCF for eligible liquidity, the IAA compensates for that change by permitting banks to apply ratings-based RWs to conduit exposures based on the bank's own application of publicly available rating criteria. The IAA was specifically designed for the ABCP conduit business because none of the other approaches available for securitization exposures produces an appropriate capital result.

To demonstrate this point, we will walk through each of the other possible approaches and briefly summarize why it does not yield an appropriate capital requirement for Customer Conduit exposures or assets:

- *Retail and Wholesale Frameworks.* A fundamental, threshold point is that virtually all Customer Conduit assets are securitization exposures. This is different from the situation where a sponsor has securitized its own retail or wholesale exposures and is then required to consolidate the issuing SPE. In that circumstance, the consolidated balance sheet would show the original retail or wholesale exposures as assets. Customer Conduits, in contrast, rarely hold whole loan retail or wholesale exposures.

Instead, they hold tranched credit exposures (usually senior) to pools of assets originated by their customers. When a bank sponsor consolidates a Customer Conduit, the consolidated balance sheet shows those tranched credit exposures. A bank is no more permitted to apply the retail or wholesale frameworks to a consolidated Customer Conduit's tranched exposures than it could if it held a tranched exposure directly.

- *Ratings-Based Approach (RBA).* The preferred approach for determining risk-weighted asset amounts for securitization exposures under the advanced approaches is the RBA. However, conduit investments often are not rated, especially for the largest players in the market.

- *Supervisory Formula.* The agencies provided a supervisory formula for calculating capital on unrated securitization exposures, but that formula relies on the ability to determine the amount of capital that a bank would be required to hold against the wholesale or retail exposures underlying a securitization exposure if held directly by the bank (K_{IRB}). Customer Conduit sponsors generally do not have the detailed information on the underlying exposures necessary to do that. We also believe that the IAA is a better risk-weighting system than the supervisory formula because rating agency criteria cover a number of risk dimensions that are not explicitly considered in the supervisory formula.

- *Purchased Wholesale Receivables.* The agencies also permit application of the special rules relating to eligible purchased wholesale receivables to securitization exposures involving eligible purchased wholesale receivables. However, the eligibility requirements restrict this approach to a small subset of Customer Conduit exposures, and even where applicable these rules incorporate conservative assumptions that generate excessive capital requirements.

The standard fallback when a bank is unable to calculate capital under any of these approaches is deduction from capital, but that is clearly inappropriate for the high credit quality positions held by Customer Conduits. The IAA was designed to address exactly this problem, by permitting qualified banks to set RWs using the RBA grid and applying publicly available rating agency criteria. This is just as necessary and appropriate when exposures are on the consolidated balance sheet as when banks are exposed to these same assets through liquidity or other commitments. Nor does application of the IAA to consolidated Customer Conduit assets require different analytical resources or competencies than applying it to liquidity and PWCE exposures. The key risks for liquidity and PWCE facilities were always the risks of the related securitization exposures held by the Customer Conduit.

We recognize that the current Administration seeks to limit reliance on ratings in the regulatory context, but no one has so far found a better alternative for risk-weighting securitization exposures, given regulatory unwillingness to let banks make their own estimates of correlation risk. In this connection, we note further that:

- the recent enhancements to Basel II relating to resecuritizations have addressed the main short-coming in structured finance ratings;

- in applying the IAA and managing Customer Conduits, rating agency criteria are a floor, not a ceiling – sponsors often negotiate terms more favorable than the rating agencies would require, including dynamic enhancement, tighter triggers and annual commitment expirations, as discussed above; and

- the superb credit history for Customer Conduit demonstrates that the use of rating agency criteria has not had a detrimental effect in this business line.

Conclusion. Increases in capital requirements of the magnitudes discussed above threaten to drive US banks out of the Customer Conduit business. Under the advanced approaches, bank management cannot be expected to keep their institutions in the Customer Conduit business if the banks have to hold a dollar of regulatory capital for every dollar of ABCP issued by a sponsored Customer Conduit. The ten-fold marginal increase under the general risk-based capital rules would also give management cause for a serious reconsideration of the benefits of being in this business.[9]

In each case, management would have to consider, among other things, the comparative return on risk-based capital available from riskier credits, such as unsecured loans to customers that originate assets currently funded in Customer Conduits. This comparison is easier under the general risk-based capital rules, where a 100% RW applies to C&I loans, regardless of the creditworthiness of the borrower. This means that the capital for an unsecured loan to an originator and for a well-secured and bankruptcy remote funding through a Customer Conduit would be the same. Given the higher yields on unsecured loans, banks would have strong regulatory capital incentives to pursue the riskier business. Under the advanced approaches, this incentive would be even more pronounced, as the dollar-for-dollar capital required against Customer Conduit assets would compare to customary capital levels for unsecured loans to originators. While the agencies are clearly concerned about creating capital arbitrage opportunities for securitization exposures, the proposed changes create a tremendous capital arbitrage in favor of riskier, unsecured credits.

4. *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?*

[9] At our October 14 meeting, agency staff asked for a comparison of economic vs. risk-based capital for conduit exposures. We did not have time to query all our members about this point, but the three sponsors represented at that meeting all confirmed that the risk-based capital for these exposures exceeds economic capital, even under the current rules. Thus, risk-based capital drives the effective capital requirements for this business line, at least at the three largest US bank sponsors.

Additionally, if a phase-in of the impact of the GAAP modifications is appropriate, what type of phase-in should be considered? For example, would a phase-in over the course of a four-quarter period, for transactions entered into on or prior to December 31, 2009, reduce costs or burdens without reducing benefits?

While the first sentence of this question focuses on the impacts on banking organizations that were not included in the SCAP, we believe that the proposals in the NPR relating specifically to ABCP conduits came as a surprise to management of many banks that were included in the SCAP. Nevertheless, if our proposals discussed above are accepted, no phase-in would be necessary for the Customer Conduit business. If our proposals are not accepted, then we request the same moratorium and phase-in discussed in the term market section below.

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.*

In addition to our comments made in response to the other questions, we believe that the agencies should have more confidence in the terms of the advanced approaches, as worked out in the multi-year domestic and international consultative processes leading up to the adoption of Basel II. The crises of the last few years struck before Basel II had been implemented in the US and before full compliance in the rest of the world. Also, the Basel Committee has already adopted enhancements to Basel II that address weaknesses perceived in the recent crises.

We are aware of Chairman Bair's recent statements about implementation of Basel II. In that connection, we note that the total amount of capital required for banks is a separate question from how the capital requirements are spread over various businesses and exposures. For Customer Conduits, in particular, we believe that the advanced approaches and the IAA provide a superior capital framework which has not been given a chance to operate in the US.

We also note that money market funds, an important investor constituency within the ASF, are concerned that excessive capital requirements for Customer Conduits will diminish the supply of a safe and important investment (the ABCP issued by Customer Conduits).

6. *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?*

Yes, the proposal raises serious competitive equity concerns with respect to banks in other jurisdictions, as well as unregulated competitors in the US. We believe that all or most qualifying European Union banks are currently permitted to apply the IAA to conduit exposures even if they consolidate the conduits. This enables those banks to continue in this business with appropriate capital levels that are a small fraction of what would be required of US banks under the changes proposed in the NPR.

For instance, suppose that an ABCP program were to fund a $100 million unrated, senior credit card transaction, supported by a 364-day eligible liquidity facility which is internally assigned the equivalent of "AAA" credit risk by the sponsoring bank. If the sponsor is a US bank, the current rules would require $800,000 of marginal regulatory capital against the exposure ($100 million times 10% times 8% minimum capital requirement). Under the proposed change to the general risk-based capital rules, the required capital would increase to $8,000,000 ($100 million times 100% times 8% minimum capital requirement). In contrast, a non-US bank that had adopted the IAA approach would only be required to hold $560,000 ($100 million times a 7% risk weight times 8% minimum capital requirement) of regulatory capital for the same risk. Competition from conduits sponsored by non-US banks would prevent US bank sponsors from increasing prices to provide a reasonable return on the higher capital requirements.

Excessive capital requirements like those described above would also put US banks at a competitive disadvantage to unregulated domestic competitors, since a well-functioning market would not require capital anywhere near the levels required of US banks under the changes proposed in the NPR.

7. *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?*

ASF's Requests. The ASF's proposals relating to the ABCP market are set out in paragraphs (1) and (2) on page 6 of this letter. We supply some technical background for those proposals below.

All or most remaining Customer Conduit sponsors are core banks in the process of transitioning to the advanced approaches, which already contemplated requiring the same amount of capital against undrawn ABCP conduit exposures as would be required if the exposures were drawn. Core banks have known that under the advanced approaches they will have to hold risk-based capital against approximately the same "amount" of exposures, regardless of whether or not a conduit was consolidated. This has not been a problem for core banks because the IAA provides a risk-sensitive method for setting capital against conduit exposures, and it was clear that the IAA would be available to qualifying banks (and for eligible exposures) whether or not a conduit was consolidated (given the existing FIN 46 Option).

As a result, the real issues raised by the NPR for Customer Conduits sponsored by core banks are timing and technical issues. The timing issue is that core banks still have to complete the qualification, parallel run and transition phases of moving to the advanced approaches. During that time their risk-based capital requirements will continue to be determined at least in part by the general risk-based capital rules. This is a continuing problem for any banks that are not transitioning to the advanced approaches.

The technical problems for core banks are as follows.

- From discussions with agency staff at both the policy and examination levels, we understand that the agencies are undecided as to whether or not the IAA will be available to sponsors that consolidate conduits under the revised standard. For the reasons discussed in detail under questions 3 and 6 above, it is of fundamental importance to core banks in this business that the IAA be available. The same business and policy reasons that justified the creation of the IAA in the first place also render it essential and justified in these new circumstances.

- From the same sources, we understand the agencies also have doubts as to whether or not the bulk of conduit assets are securitization exposures. This is an equally important issue and is also discussed under question 3 above.

Risk Retention. In the context of Customer Conduits, the sponsor bank's customers are the entities to which any risk retention requirement would apply, since they are the entities that transfer assets to the Customer Conduits. While we have some concerns about risk retention requirements (see discussion under question 7 in the term ABS section below), we note that customers generally retain credit risk on assets funded through Customer Conduits covering a multiple of expected losses.

Capital Arbitrage. The NPR specifically requests discussion of whether any different capital treatment requested by commenters may or may not give rise to capital arbitrage opportunities. We do not believe that our proposals relating to Customer Conduits give rise to capital arbitrage opportunities. Our main proposal is to subject conduit exposures of core banks to the IAA, which was designed for them in the Basel II consultative process. Incentives for capital arbitrage are greatly reduced by two features of the advanced approaches. First, the capital for retail and wholesale exposures is much more risk sensitive under the advanced approaches than the 100% RW catch-all category under the general risk-based capital rules. This should eliminate the incentive to use securitization as a means to reduce the net risk-weighted amount of high quality, low risk exposures. Second, under the IAA the capital for conduit exposures is approximately the same, whether or not the exposure is funded. There is no capital arbitrage between funded and unfunded exposures if the capital is the same for both.

As to our request to continue the current treatment of conduit exposures under the general risk-based capital rules (at least on a transitional basis for core banks), we do not believe the pejorative term "capital arbitrage" accurately describes the current treatment of traditional ABCP conduit exposures. The CCF for eligible liquidity has served as a mechanism to reduce the capital on the high quality credit exposures in conduits from the 100% RW catch-all to a net level more commensurate with the risk of these positions. The low historical losses on Customer Conduit exposures, discussed in our response to question 3 above, amply support the adequacy of historical capital levels.

In fact, we believe that the proposed deletion of the FIN 46 Option and possible inability to use the IAA on consolidated Customer Conduit assets would create a perverse capital arbitrage opportunity that would encourage banks to book riskier, higher yielding unsecured

exposures rather than the well-secured and bankruptcy remote exposures funded in Customer Conduits. Our proposals would avoid that capital arbitrage by maintaining and improving the risk sensitivity of the rules.

8. *If a structure must be consolidated solely due to loan modifications under the Treasury's Making Home Affordable Program, should these assets be included in the leverage and risk-based capital requirements?*

This question does not appear to be relevant to the ABCP market.

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?*

The new consolidation standard is so biased towards consolidation that it is hard to imagine any structures that will avoid consolidation but justify risk-based capital requirements. To avoid consolidation, an entity with a substantial economic stake has to give up or share power, and banks are generally unlikely to do that unless either the party with the sole or shared power has a large enough economic stake to justify the power and align its interests with the interests of the bank or the "power" to be exercised is routine, standardized servicing that has little real impact on any retained economic stake.

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?*

Banks already reserve for their ABCP conduit exposures. Since the risks under those exposures flow directly from the securitization exposures held by the conduits, we would not expect consolidation of conduits to cause significant net changes in reserves.

Term ABS Markets

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?*

US banks and/or their parent companies will be required to consolidate many formerly qualifying SPEs (and similar future transactions). The SPEs to be consolidated are likely to include:

- many used in non-agency residential mortgage-backed securities (RMBS)[10] issuances, though consolidation will generally not be required if the banking

[10] We understand that Fannie Mae and Freddie Mac have concluded that they will consolidate mortgage loans backing single-class participation certificates that they have guaranteed.

organization does not service a majority of the underlying mortgage loans or has not retained more than a threshold level of the RMBS issued in a particular transaction; conversely, banking organizations may be required to consolidate some RMBS issuers where the organization services a majority of the underlying mortgage loans and owns more than a threshold level of the RMBS, even where the organization was not the sponsor of the transaction;

- all US credit card master trusts (including so-called "issuance trusts" and other note-issuing structures), due to the importance of retained servicing for account management and customer relations and market, tax and other forces that lead sponsors to retain significant economic stakes in these trusts;

- a significant number used in commercial mortgage-backed securities (CMBS) issuances, where a banking organization acts as special servicer and holds a significant economic stake;

- collateralized debt obligation (CDO) transactions where a banking organization acts as manager and holds a significant economic stake; and

- most used in securitizations of auto loans and other asset classes, for reasons similar to those discussed for credit card trusts above – though a relatively small percentage of these transactions may avoid consolidation on similar bases to those discussed with respect to RMBS above.

We have been unable to locate data on aggregate outstanding ABS that differentiate based on bank vs. non-bank sponsors or on-balance sheet vs. off-balance sheet. As a result, we can only provide information on overall outstandings to provide a general sense of scale. According to SIFMA, at the end of June 2009, total outstanding ABS in some of the categories referenced above were:

Asset Class	*Outstandings ($ billions)*
RMBS (non-agency)	2,325.3
Home Equity Loans	354.7
Credit Card Receivables	307.5
Automobile Loans	137.7

We note that mortgage loans backing legacy RMBS are likely to constitute a very large percentage of assets newly consolidated by banking organizations as a result of the accounting changes.

For asset classes other than RMBS, the same considerations that are leading to consolidation of legacy transactions also make it likely that consolidation will be appropriate for any future transactions and make it unlikely that legacy transactions will be restructured so that consolidation is no longer required. For RMBS, consolidation is affected by independent business decisions relating to the retention or acquisition of servicing rights and retention or

purchase of securities. Banking organizations will have to weigh those considerations along with GAAP and capital consequences in structuring any future transactions.

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 noncontractual (implicit) support under stressed or other circumstances due to reputational risk, business model, or other reasons?*

We recognize that there have been significant instances of implicit recourse during the recent market crisis. It is also important to recognize, however, that many stressed transactions have not been supported by sponsor banks beyond any contractual obligations. The two most noteworthy examples are:

- RMBS, which in spite of being at the epicenter of the crisis, with investors incurring substantial credit and market value losses, have not (to our knowledge) received implicit support; and

- Several credit card trusts (including one of the largest), the sponsors of which resisted investor demand and declined to provide additional support, notwithstanding the highly publicized support provided by several large competitors.

Given the importance that the agencies attach to implicit recourse as a rationale for the capital increases contemplated by the NPR, we believe it is essential that the agencies take sufficient time to consider the issues addressed by this question. Since not all stressed securitizations have received implicit support, we do not believe implicit support provides an adequate reason for a blanket increase of capital requirements for securitization exposures. In fact, increasing capital for banks that resisted pressures to provide implicit support creates a strong, perverse incentive for the future: if all banks can expect to be treated the same, whether or not they provide implicit support (or take other actions that the agencies discourage), then why should any bank resist the competitive pressure to go with the pack?

Consequently, we support a system that adds an implicit recourse charge to the capital otherwise required, where that charge varies depending on the presence or absence of features and characteristics that the agencies determine to increase the likelihood of implicit recourse. In some circumstances we would hope the charge for implicit recourse would be zero, because it is virtually certain that no implicit recourse will be provided. In others, the charge might be sufficient to eliminate any capital reduction resulting from the securitization under current rules.

This is a very complicated topic, and we do not believe that the agencies and affected banking organizations can give it the thoughtful consideration it requires within the time constraints imposed by a January 1, 2010 effectiveness target. This is one of the main reasons that we have previously requested a six-month moratorium on capital changes resulting from the implementation of the 2009 GAAP modifications and why we request additional phase-in time in our response to question 4 below.

While we hope to have the opportunity for further dialogue on this point, we have a few specific observations to share at this time:

(1) As noted above, there is a very large body of legacy transactions and structures that have withstood the extreme stress of the last few years without eliciting implied support from their sponsors. As to those particular transactions and structures, it is hard to imagine what would happen in the future that would elicit support, given what the transactions and their sponsors have already weathered. Thus, we suggest at a minimum that legacy RMBS transactions and the credit card trusts that have not received implicit recourse should be exempt from any capital changes resulting from implementation of the 2009 GAAP modifications. For similar reasons, we believe that all other legacy ABS transactions that have not received implicit support should be exempt.

(a) For legacy RMBS and other amortizing static pool transactions that have not received implicit support ("Legacy Unsupported Amortizing Transactions"), this exemption would be straightforward since there is no new issuance activity from the SPEs involved in those transactions.

(b) For the credit card trusts that have not received implicit support, we propose the exemption not only for currently outstanding assets and liabilities, but also for future assets obtained and liabilities issued under the terms of the existing documents, without material modifications.

(2) More generically, we believe that some structural features can be identified as increasing the likelihood of implicit support. Revolving structures (like credit card master trusts) appear to elicit more support than structures involving fixed pools of amortizing assets, and the "de-linked" enhancement structures[11] used in many of the largest trusts appear to increase the likelihood of implicit support even further. For de-linked structures, we believe a key factor is the inability of sponsors to issue new securities with higher credit enhancement without also giving pre-existing series the benefit of more enhancement. We believe it might be appropriate for the agencies to apply a sliding scale implicit recourse capital charge to transactions, with discrete amortizing pools receiving the smallest incremental charge (which we believe should be zero for at least some transactions, including Legacy Unsupported Amortizing Transactions), a higher charge for revolving structures and an even higher charge if the revolving structure uses de-linked enhancement. The agencies might consider other factors to further differentiate transactions along this scale.

[11] In linked structures, each series of securities issued by a credit card trust contains its own, separate tranching structure (usually including at least three classes – A, B and C). So issuance of senior, junior and mezzanine securities is "linked." In de-linked structures, senior, mezzanine and junior class securities can be issued separately from one another, subject to conditions that limit the amount of issuance at any seniority level, based on the amount of outstanding classes that are junior to the subject class (among other conditions). Linked structures preceded de-linked structures, but de-linked structures are now dominant among the largest issuers and were the first to receive extra support in the recent wave.

(3) Besides the structural features identified above, the agencies should also bear in mind the unique accounting and regulatory context in which the recent decisions by several issuers to provide implicit support to credit card structures were made. With the adoption of FAS 167, it was clear to most issuers that their credit card structures would be consolidated beginning in 2010, and some issuers received early indications from the agencies that no regulatory capital relief was likely to be provided for this asset class once that happened. Consequently, issuers knew that they would probably have to hold full capital against the securitized card balances soon at any rate. This significantly altered the cost/benefit analysis when deciding whether to accept ratings downgrades or provide implicit support to avoid them. Providing implicit support accelerated some of the increase in capital requirements by several months but did not change the amount of capital that was likely ultimately to be required with respect to securitized card balances.

(4) The agencies have always discouraged implicit recourse and attached significant consequences to it. They could consider taking further steps in this direction. One idea that has recently been discussed is an option for sponsors to pledge not to support particular transactions and then to differentiate the risk-based capital requirements depending on whether or not such a pledge had been given. While negative about implicit recourse, the agencies appear to have always wanted to let banks retain the option, recognizing that in some cases providing implicit recourse might promote safety and soundness. Consequently, the agencies might wish to provide that, once a bank has pledged not to provide implicit recourse to a particular transaction, violating that pledge would violate safety and soundness, unless the primary regulator approved the implicit recourse. We do not think a pledge should be the sole way to achieve any capital reduction through a securitization.

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?*

Consolidation of VIEs used in the issuance of term ABS will add billions (perhaps even trillions) of dollars in assets to the balance sheets of sponsor banks and their respective holding companies. This will increase the reported leverage of these banking organizations and reduce their return on assets. From a regulatory capital perspective, the addition of newly consolidated assets will increase the denominator (total risk-weighted assets) of the risk-based capital ratio. In addition, the consolidation of VIEs is likely to increase ALLLs, consequently reducing earnings and increasing deferred tax assets, all of which are likely to decrease the numerator (Tier 1 and Tier 2 capital). We discuss these numerator effects under question 10 below.

It is difficult to quantify the likely impacts of these changes on lending, whether typically financed by securitization or more generally. Qualitatively, it seems virtually certain that:

- the decrease in GAAP and regulatory capital ratios will lead banks to some combination of raising capital and reducing assets by curtailing lending; and

- these actions by banks will further reduce the availability and/or raise the cost of credit to consumers and businesses.

A likely impact of the regulatory capital response proposed in the NPR, as distinct from the GAAP changes themselves, is a reduction in the incentives for banks to use securitization to reduce their risks. While bank management will still be sensitive to risk and the risk reduction benefits of securitization, a system where banks hold the same capital against a pool of assets regardless how much risk they have transferred removes one of the incentives to reduce risk. For instance, if the regulatory capital treatment is the same for (a) full recourse bank debt, (b) a securitization where the sponsor transfers substantially all economic risk on the assets (subject to any future retention requirement) and (c) a securitization where the sponsor retains all but the most highly rated tranches, then a bank will, at the margin, be more likely to decide among these alternatives based on pricing or other considerations, with less consideration of the risk transfer benefits of option (b).

A system where risk transfer through securitization does not reduce capital requirements is also likely to reduce (or hinder the return of) issuance volume in the term ABS market. This threatens to shrink and marginalize the term ABS market to a point where it will not be available as a source of bank liquidity and a means for banks to diversify their funding sources.[12]

4. *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?*

   Additionally, if a phase-in of the impact of the GAAP modifications is appropriate, what type of phase-in should be considered? For example, would a phase-in over the course of a four-quarter period, for transactions entered into on or prior to December 31, 2009, reduce costs or burdens without reducing benefits?

We have a number of serious concerns relating to the potential impacts of immediate application of the 2009 GAAP modifications on the regulatory capital requirements of banking organizations, whether or not included in the SCAP:

[12] The importance of diversified funding sources and market access were reiterated in the agencies' recently proposed guidance on liquidity risk management. Federal Register, Vol. 74, p. 32035, 32041 (paragraphs 26-27) (July 6, 2009).

- We are concerned that the short timeline for implementation, combined with the other serious issues that have been competing for the agencies' and affected banks' attention, is pushing the agencies towards a reaction that is not sufficiently risk-sensitive.

- We are concerned that core banks in the process of converting to the advanced approaches may be required to increase capital levels during the parallel run and transition periods to levels above what will be required once the transition to the advanced approaches has been completed.

- We are concerned that any contraction in lending resulting from immediate application may come at an inopportune time in the economic cycle.

Consequently, we reiterate our request for a six-month moratorium on any capital effects (both numerator and denominator) resulting from application of the 2009 GAAP modifications. Following that moratorium, we request a phase-in period of three years for both numerator and denominator effects. During the six-month moratorium, we propose that the agencies continue to deliberate and consult with affected banking organizations on two key points: implicit recourse (as discussed under question 2 above) and risk transference (as discussed under question 6 below). To preserve and enhance the risk sensitivity of both the general risk-based capital rules and the advanced approaches, filters addressing these two concepts should be applied to determine when sponsors will be permitted to reduce their risk-based capital as a result of a traditional securitization, whether on-balance sheet or off.

The phase-in should dovetail with the moratorium as follows. Ideally, by the end of the moratorium, the agencies would have finalized new, risk-sensitive rules relating to implicit recourse and risk transfer. The phase-in would be designed to permit banking organizations three years to come into compliance with any increased capital requirements, determined after giving effect to the new implicit recourse and risk transfer rules. In addition, core banks in the parallel run or transition periods would not include in their target capital ratio any increase under the general risk-based capital rules that causes the required capital to exceed the required level under the advanced approaches.

We are aware of Chairman Bair's and Secretary Geithner's recent statements about implementation of Basel II. Without agreeing or disagreeing with either the Chairman's or the Secretary's views about appropriate over-all capital levels for banks, we note two points. First, our proposed phase-in approach is not meant to permit banks to decrease capital but rather to avoid a temporary spike in capital requirements, if the general risk-based capital rules require an increase above what will be required under the advanced approaches. Second, we note that the total amount of capital required for banks is a separate question from how the capital requirements are spread over various businesses and exposures. Regardless of where the overall floor is set, it is important that the rules are sensitive to risk transfers by banks, so as not to reduce incentives for banks to reduce risk.

If the new implicit recourse and risk transfer rules are not complete by the end of the moratorium, then until they are finalized the target capital levels during phase-in should be set

based on the proposal set out in the NPR (the GAAP balance sheet under the new standards), with the following modifications:

- Legacy Unsupported Amortizing Transactions and credit card securitizations that did not receive implicit support would be exempted from capital increases to the extent proposed in paragraph (1) in our response to question 2 above;[13] and

- assets of consolidated Customer Conduits would be treated as requested under question 7 in the ABCP Conduit section above.

We support a three-year phase-in because it would permit a substantial portion of legacy transactions to amortize before banking organizations have to reach the full new capital levels and because it allows core banks to progress well into the transition to the advanced approaches during the phase-in process.

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.*

In addition to our comments made in response to the other questions, we have the following comments:

- We are concerned that in responding to the crises of the last few years, the agencies are in some cases not giving sufficient weight to improvements in the system that were worked out in the Basel II consultative process and embodied in the advanced approaches. For example, the new capital charge for transactions with early amortization features partially addresses the liquidity and implicit recourse concerns relating to credit card trusts. Also, the greater risk sensitivity in the capital requirements for retail and wholesale exposures under the advanced approaches moves securitization closer to capital neutrality, leaving banks to focus on its benefits in risk transfer, duration management, liquidity, funding diversification and the like.

- Many banks that have traditionally raised significant funds in the term ABS markets have also relied upon Customer Conduits sponsored by other banks as another funding source. To the extent that the proposals in the NPR reduce availability (or increase pricing) for Customer Conduit customers, while also rendering term ABS funding less attractive, the banks that have relied on both sectors are disadvantaged on two fronts at once.

- We reiterate our concern that the agencies should be cautious not to decrease incentives for banks to transfer risk.

[13] A special schedule to the call report might be required to track these positions, since the contractual positions held by banks in these transactions will otherwise be eliminated in consolidation.

6. *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?*

Yes, the proposal raises significant competitive equity concerns with respect to banks in other jurisdictions, as well as unregulated competitors in the US.

Foreign Banks. As to banks in other jurisdictions, the Basel II Capital Accord does not link the risk-based capital treatment of traditional securitizations to accounting sale treatment. Consequently, depending on the details of national implementation, it is possible for banking organizations outside of the US to reduce their capital requirements by completing traditional securitizations even when the securitized assets remain on the sponsor's balance sheet. While we have not surveyed all jurisdictions that have adopted Basel II, we have reviewed the European Union's Capital Requirements Directive on this point, and we understand that it does not require an accounting sale for a bank to reduce capital based on a traditional securitization.

This goes against one of the fundamental purposes of the Basel capital accords, by enabling foreign banks to compete with US banks on a playing field tilted by uneven capital requirements, which would permit the foreign banks to offer better returns to their investors and/or lower prices to borrowers. Even in businesses that effectively require a domestic charter to compete, the overall differences in capital requirements would give foreign banks a long-term competitive advantage.

In place of the accounting sale treatment requirement adopted in the US, Basel II and the Capital Requirements Directive impose an alternative set of operational requirements (many of which parallel the requirements for accounting sale treatment under US GAAP). Among the most significant of these requirements is that the sponsor must have transferred significant credit risk on the underlying exposures to third parties. In adopting the advanced approaches, the agencies dealt with the risk transference requirement by referring to pre-existing US guidance on this issue and directing banks to continue to comply with that guidance.

Since the agencies are concerned that some securitization structures did not transfer as much risk as previously thought, we believe it is appropriate for the agencies to reconsider their existing guidance on risk transference. We are not endorsing the European Union's or any other particular approach on this issue, but we strongly believe that the US should have risk transfer standards that, if satisfied, enable a bank to reduce its capital based on a traditional securitization[14] (whether or not the securitization is treated as a sale under GAAP).

The agencies would also need to adopt some of the other Basel II operational requirements (or parallel provisions) to define the universe of transactions to which the risk transfer standard would be applied. We propose specific language on this point in Attachment B.

[14] We also support continued recognition of risk transfers via synthetic securitizations, which do not appear to be affected by the NPR. Any new guidance on risk transfer via traditional securitizations should likely also be applied to synthetic securitizations in order to maintain risk sensitivity and avoid capital arbitrage opportunities.

Non-Banks. To the extent that unregulated financial institutions (or specialty depository institutions outside of bank holding company structures) continue to play (or resume playing) a significant role in US consumer finance and other sectors traditionally funded through securitization, the approach taken in the NPR will also place US banking organizations at a competitive disadvantage to those competitors.

7. *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?*

Proposed Exceptions. As discussed under question 6 above, we believe that traditional securitizations that meet new agency standards relating to risk transference should enable banks to reduce their risk-based capital requirements by applying the existing rules (general or advanced, as applicable) only to the retained exposures, subject to an additional charge addressing the risk of implicit recourse in structures that justify such a charge (see our response to question 2). We hope to have an opportunity to discuss appropriate standards further with the agencies.

At a minimum, we believe that Legacy Unsupported Amortizing Transactions and existing credit card structures that have not received implicit support should qualify for these risk transference standards. Also, if the agencies do not adopt our suggestion to develop and impose enhanced risk transfer requirements and a variable implicit recourse risk charge, then we support the proposal to exempt RMBS and CMBS from the additional capital charges arising from the 2009 GAAP modifications, as set out in the Mortgage Bankers Association and Commercial Mortgage Securities Association joint comment letter dated October 7, 2009 (the "Joint Mortgage Association Letter") relating to the NPR.

Risk Retention. There is tension between the proposed risk retention requirements mentioned in question 7 and our proposal to permit reduction of risk-based capital when sufficient risk is transferred. The ASF supports efforts to align the economic interests of asset originators and sponsors with securitization investors. However, we believe that alternatives to requiring originators or sponsors to retain a specified portion of credit risk of securitized exposures should be pursued, partly because of this tension. We believe that appropriate alternatives could be devised that adequately establish and reinforce commercial incentives for originators and sponsors to create and fund assets that conform to stated underwriting standards and securitization eligibility criteria, without unduly limiting banks' ability to reduce and transfer credit risk.

There is also some inconsistency between the proposed risk retention requirements and the NPR. The proposed risk retention requirement suggests that the Administration believes that explicit, contractual risk retention is advisable in order to align the interests of originators and sponsors with investors. Yet, the NPR would eliminate any risk-based capital reduction for

trillions of dollars worth of transactions, based in large part on the agencies' concern that banks will support transactions regardless of contractual limits on their support obligations.

Capital Arbitrage. The NPR specifically requests discussion of whether any different capital treatment requested by commenters may or may not give rise to capital arbitrage opportunities. Because our proposals focus on risk transfer and implicit recourse, we do not believe they would give rise to capital arbitrage opportunities.

8. *If a structure must be consolidated solely due to loan modifications under the Treasury's Making Home Affordable Program, should these assets be included in the leverage and risk-based capital requirements?*

We agree with the Joint Mortgage Association Comment Letter that (a) consolidation solely due to MHAP loan modifications is implausible and (b) if it were to occur, the consolidated assets should be excluded from the calculation of risk-based capital. This would be an extreme example of the insensitivity to risk that would result from unfiltered reliance on the new GAAP consolidation standards as a proxy for risk.

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?*

The new consolidation standard is so biased towards consolidation that it is hard to imagine any structures that will avoid consolidation but justify risk-based capital requirements. To avoid consolidation, an entity with a substantial economic stake has to give up or share power, and banks are generally unlikely to do that unless either the party with the sole or shared power has a large enough economic stake to justify the power and align its interests with the interests of the bank or the "power" to be exercised is routine, standardized servicing that has little real impact on any retained economic stake.

Nevertheless, we are proposing that the risk-based capital treatment of traditional securitizations should be independent of sale accounting, with new risk transfer standards (and a charge for implicit recourse risk) taking the place of the current sale accounting requirement. We recognize that any such system would logically, and as a matter of sound policy, be applied to all traditional securitizations, even if they achieved sale treatment (and the sponsor was not required to consolidate the issuing VIE).

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?*

ALLL. Loans securitized in off-balance sheet transactions generally are excluded from the calculation of the sponsors' ALLL. As a result, consolidation of VIEs under FAS 167 will substantially increase the consolidating entities' ALLL provisions. This will tend to reduce earnings, thus impairing banking organizations' ability to increase Tier 1 capital in the form of retained earnings. From the perspective of overall regulatory capital, this impact may be partially offset by the fact that the ALLL is included in Tier 2 capital. However, the amount of

ALLL that may be so included is capped at 1.25% of risk-weighted assets, and any excess ALLL over that cap is deducted from risk-weighted assets. We request that this cap be raised or eliminated.

In addition, the GAAP rules governing the calculation of the ALLL do not take into account the terms of standard ABS transactions, which transfer some of the risk of loss on securitized assets to holders of the related ABS. As a result, GAAP may at times require a sponsor's ALLL to cover risks of loss that are contractually borne by ABS investors that are not affiliated with the sponsor. To the extent this occurs, we believe the subject portion of the ALLL should be included in Tier 1 capital.

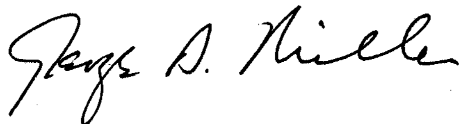
Deferred Tax Assets. Implementation of the 2009 GAAP modifications is also likely to impair banking organizations' capital position by increasing DTAs. Most financial institutions have DTAs, which are created as a consequence of the timing differences between taxable income and book income recognized under GAAP. The DTAs of many banks will grow as a result of the additional ALLL booked upon implementation of FAS 166 and 167.

The current regulatory capital rules limit the amount of DTAs that can be included in Tier 1 capital. DTAs that can be recovered through loss carry-backs are not limited, but DTAs that are dependent upon future taxable income are limited to the lesser of (a) the amount of DTAs that the bank expects to realize within one year of the calendar quarter-end date and (b) 10% of the bank's Tier 1 capital. Due to the distressed economic environment since 2007, many financial institutions are likely to have DTAs in excess of the Tier 1 cap. We request that DTA balances created as a consequence of the additional ALLL provisions resulting from the 2009 GAAP modifications be excluded from the Tier 1 capital cap described above.

* * *

Thank you for this opportunity to comment on the NPR. We look forward to continuing a productive dialogue with the agencies on these important issues. Please contact me (212.313.1116), or Jason Kravitt (212.506.2662) or Rob Hugi (312.701.7121) of Mayer Brown LLP, ASF's special outside counsel in this matter, should you have questions or wish to discuss any of the matters addressed in this letter.

Very truly yours,



George Miller
Executive Director

Attachment A

Proposed Definition of Customer Conduit

Customer Conduit should be defined as an ABCP program (as defined in the advanced rules)[15] that:

- is designed primarily to provide the ABCP program sponsor's customers with access to funding through the commercial paper market;
- makes investments that are individually structured and negotiated by the ABCP program sponsor in transactions involving direct negotiations with the customer;
- has liquidity facilities that in the aggregate cover at least 100% of its outstanding ABCP; such liquidity facilities may, but need not, be eligible ABCP liquidity facilities under the standards set out in the general risk-based capital rules;
- is not subject to triggers that require the program to dispose of its exposures as a result of a decline in the market value of the exposures; and
- is actively managed by the ABCP program sponsor through periodic renewals and monitoring of customer transactions.

[15] See, for instance, 12 CFR Part 3, Appendix C, Section 2.

Attachment B

Proposed Operational Requirements for Traditional Securitizations

An originating banking organization should be permitted to exclude securitized exposures from the calculation of risk-weighted exposure amounts if the transaction meets the agencies' guidance on risk transfer, and the transfer complies with the following conditions:

a) the securitization documentation reflects the economic substance of the transaction;

b) the securitized exposures are put beyond the reach of the originator and its creditors, including in receivership or conservatorship;

c) the securities issued do not represent payment obligations of the originator;

d) the transferee is an SPE;

e) the originator does not maintain effective or indirect control over the transferred exposures through a right to repurchase previously transferred exposures, other than an eligible clean-up call (as already defined in the advanced approaches rules) or a permitted removal of accounts provision (guidance to be modeled on prior terms of FAS 140); and

f) the securitization documentation does not contain clauses that:

    i. other than in the case of early amortization provisions, require positions in the securitization to be improved by the originator including but not limited to altering the underlying credit exposures or increasing the yield payable to investors in response to a deterioration in the credit quality of the securitized exposures; or

    ii. increase the yield payable to holders of positions in the securitization in response to a deterioration in the credit quality of the underlying pool.