Proposed Risk Based Capital Rules
&
Term Securitization

Background

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October 14, 2009

Executive Summary

- Impact of NPR

  - The proposed rules, if put in place without modification, will have significant consequences to the term securitization market, which will have an adverse impact on consumers and businesses that have relied on this market for credit and financing. Trillions of dollars of mortgage and non-mortgage assets are currently funded via term securitizations.

  - Most term ABS structures will be consolidated and hundreds of billions of dollars of assets will be added to bank balance sheets, with attendant regulatory capital and loan loss reserve charges. This will likely lead banks to some combination of raising capital and reducing assets by curtailing lending, making credit less available and more expensive.

Executive Summary

- Capital Should Equal Risk

  - Term ABS transaction features that will dictate accounting consolidation (e.g., asset servicing or special servicing relationships, ownership of more than a threshold level of securities) are measures of "control," and are not necessarily indicative of risk exposure that risk-based capital rules have historically addressed. As a result, accounting consolidation is a poor proxy for risk that should be addressed by those rules.

  - While we understand the agencies' desire to add capital to the banking system, it is imperative that this capital be appropriate for the risks inherent in the transactions to avoid creating disincentives for safe and sound banking practices.

Executive Summary

► This Should Not Be A One Size Fits All Rule

- While there are some instances of implicit recourse being extended to some term ABS securitizations during the recent financial market crisis, those limited instances do not provide an adequate reason for a blanket increase in capital requirements and loan loss reserves for all securitization exposures.

- There is a large body of legacy transactions and structures that have withstood the extreme test of the last few years without eliciting implied support from their sponsors.

- While some securitization exposures involve greater risk for banks than had been previously reflected in risk-based capital rules, this is not universally true. Risk-based capital rules should therefore be sensitive to the relative risk of different types of exposures, to provide appropriate protections and risk management incentives to banks and the banking system.

Executive Summary

- ASF requests that:
  - The agencies provide a six-month moratorium on capital charges resulting from consolidation of VIEs, followed by a three year phase-in period;
  - During the six month moratorium (and afterwards, as 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 implement a sliding scale capital charge for risk of implicit recourse, based on transaction features and other transactions determined to be relevant;
  - Exempt from any capital charges legacy RMBS and other legacy transactions and structures that have not received implicit recourse; and
  - Adjust the qualifying capital rules to include appropriate allowances for ALLL in Tier 1 and Tier 2 Capital, and provide one-time relief for deferred tax assets arising from implementation of FAS 167.

Scope of FAS 167 in Term ABS Markets

Asset Class	ABS Outstanding (billions)
Agency MBS	$6,623
Non-Agency MBS	$2,325
Home Equity	$355
Credit Card	$308
Student Loan	$242
Auto Loan	$132
Manufactured Housing	$19
Miscellaneous	$1,479
Total	**$11,482**

Source: SIFMA (as of Q2 2009). The $1,479 billion miscellaneous category includes collateralized debt obligations (CDOs) and numerous smaller asset classes. The assets underlying the CDOs include other asset-backed securities (CDOs of ABS), some or all of which might be viewed as double counting with other ABS outstandings.

Impact of FAS 167 on Bank Balance Sheets

- Most term ABS structures will be consolidated and hundreds of billions of dollars of assets will be added to bank balance sheets

- New securitizations will be likely to remain on-balance sheet, with attendant regulatory capital charges

Overview of Common Term ABS Structures

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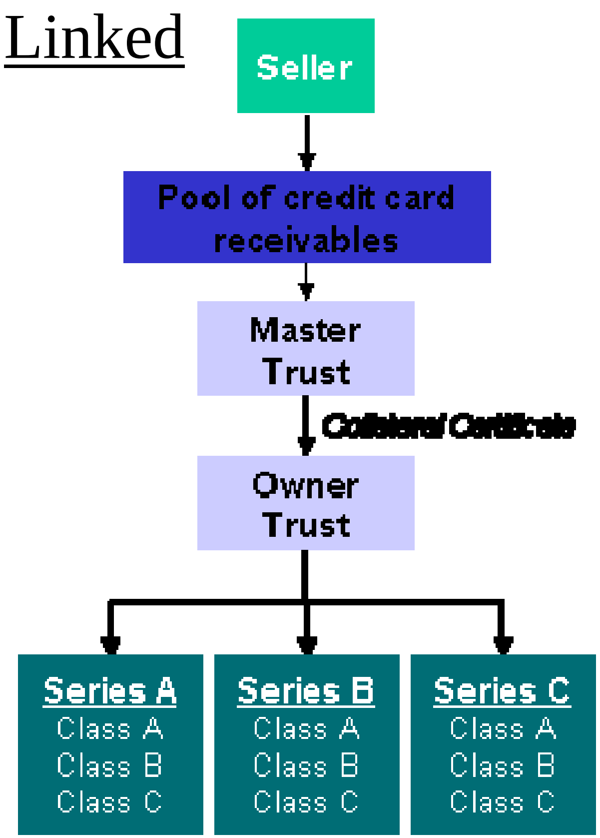
Credit Enhancement Features

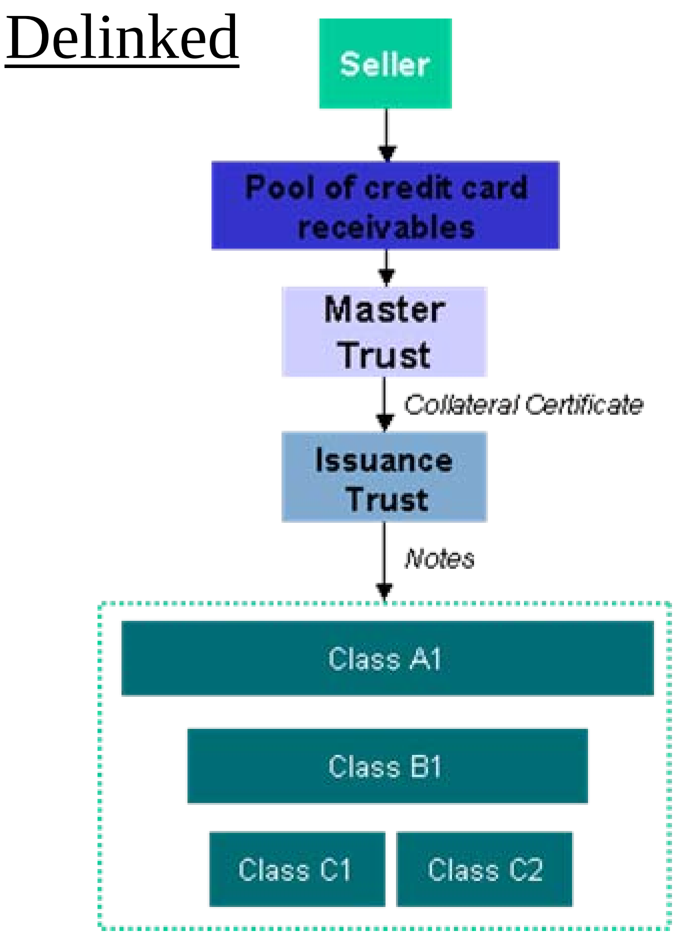
Credit Card ABS – Basic Structures

- Linked Structure
  - Subordinate classes of securities are issued to support senior classes, maturing concurrently with or after the senior classes. Each series is entitled to a pro rata share of collections on receivables.
  - No subordinate class provides enhancement to the certificates of any other series and no series provides enhancement to any other series.
  - Each series is entitled to a pro rata share of collections on receivables.
  - A new series can be issued with different enhancement requirements without changing the available enhancement for the prior series.

- Delinked Structure
  - De-linked issuance platforms typically have only one outstanding series
  - Subordinate classes of the single series provide enhancement to the more senior classes. All tranches within a subordinate class provide enhancement to all of the more senior classes.

Credit Card ABS Structures - Examples





Credit Card ABS - Enhancement Features

- Simple card trust structures do contain certain features that provide investors with a degree of credit protection, without being considered recourse:

  - **Excess spread -** the difference between income received on the underlying credit card receivables and the interest paid to investors. If a trust's excess spread turns negative, it enters an early amortization period

  - **Cash collateral account -** Funded at closing and available throughout the life of the deal to fund cash flow shortfalls

  - **Spread or reserve accounts -** When performance deteriorates (i.e. excess spread declines), cash from the spread account can be used to cover shortfalls.

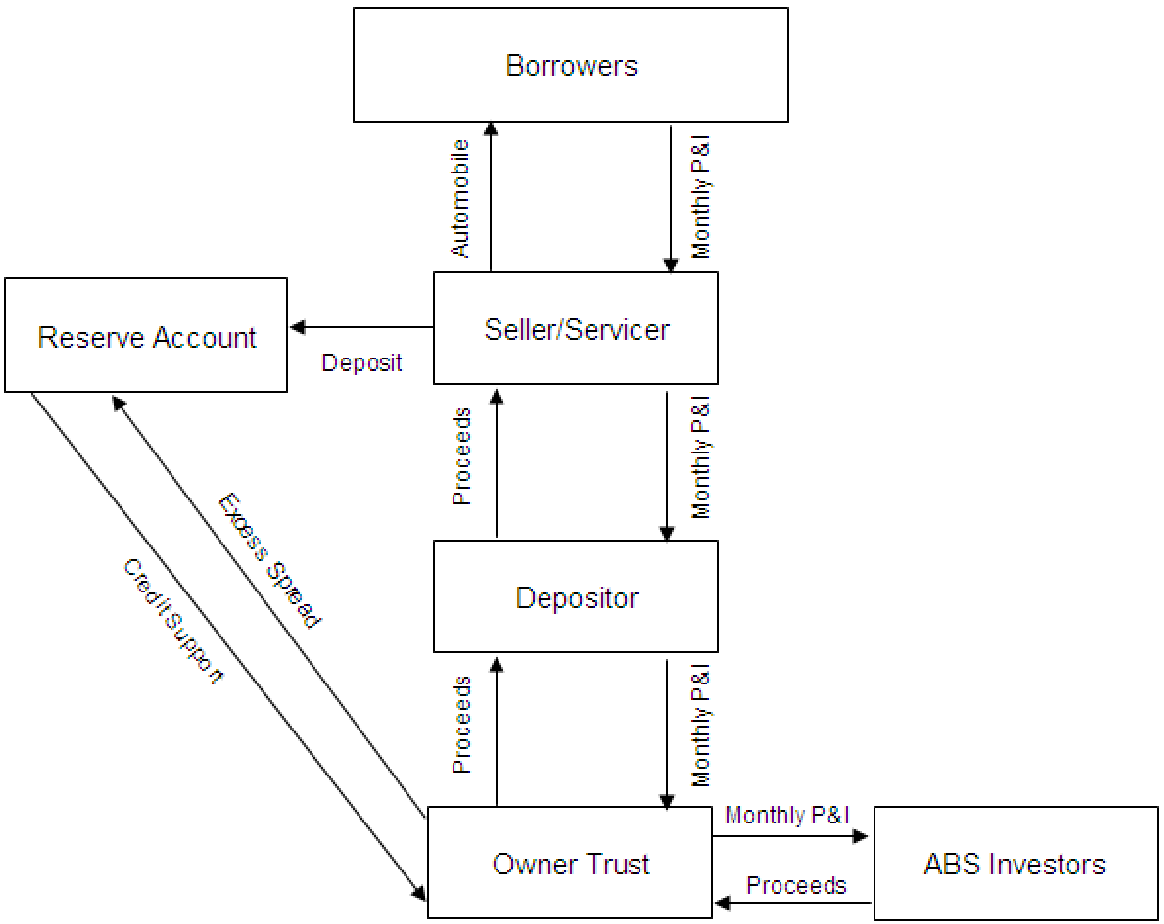
  - **Subordinate series or tranches**

  - **Discounting (by issuers who have recently added credit enhancement to their transactions)**
    - Certain portions of principal receivables are considered to be finance charges. The increase in finance charges collected increases excess spread and provides support to investors in the face of increasing losses

Auto ABS – General Features

- Auto loan asset-backed securities transactions are discrete trusts
- Usually have a sequential-pay structure in which subordinate securities provide credit enhancement for senior classes.
- The most-senior classes are typically retired very quickly, with weighted-average lives of less than one year.
  - Many of the most-senior classes of auto ABS are money market-eligible.

Auto ABS Structure - Example



Auto ABS - Enhancement Features

- **Pre-funded reserve account -** seller makes a deposit of cash into the reserve account for the benefit of the trust.
  - Each month, any "excess spread" is deposited in the reserve account. If, in any given month, interest payments by borrowers are insufficient to pay interest to investors, cash is taken from the reserve account to make up the shortfall.

- **Yield Supplement Over-collateralization (YSOC)** - For transactions issued by captive issuers (subsidiaries of auto manufacturers), it is common for the reserve account deposit to be very large, as captive issuers often lend at below-market interest rates in order to spur auto sales

- **Monoline Guarantees** - in the past it was common for certain securities issued by auto ABS trusts to be insured by monoline insurance companies

GSE MBS

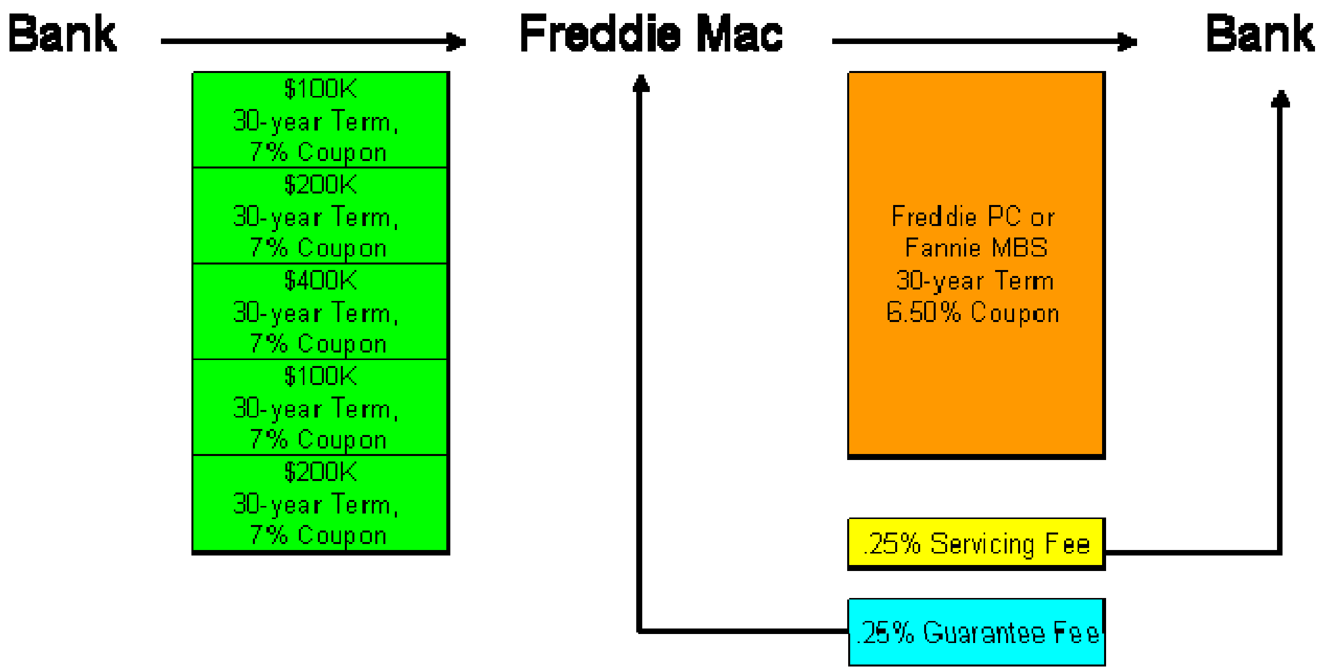
- An originating bank will sell a pool of mortgage loans to one of the Government-Sponsored Enterprises ("GSEs")…

- …which either holds the loans in portfolio, securitizes them for sale in the GSE MBS markets, or bank and the GSE engage in a "swap" of securities for loans.

- The GSE is paid a guarantee fee ("g-fee") in return for the timely payment of full principal and interest on the security.

- If the bank retains the security instead of selling it into the market, it assigns it only a 20% risk-weighting since the credit risk has been assumed by the GSE.

Agency MBS - Example



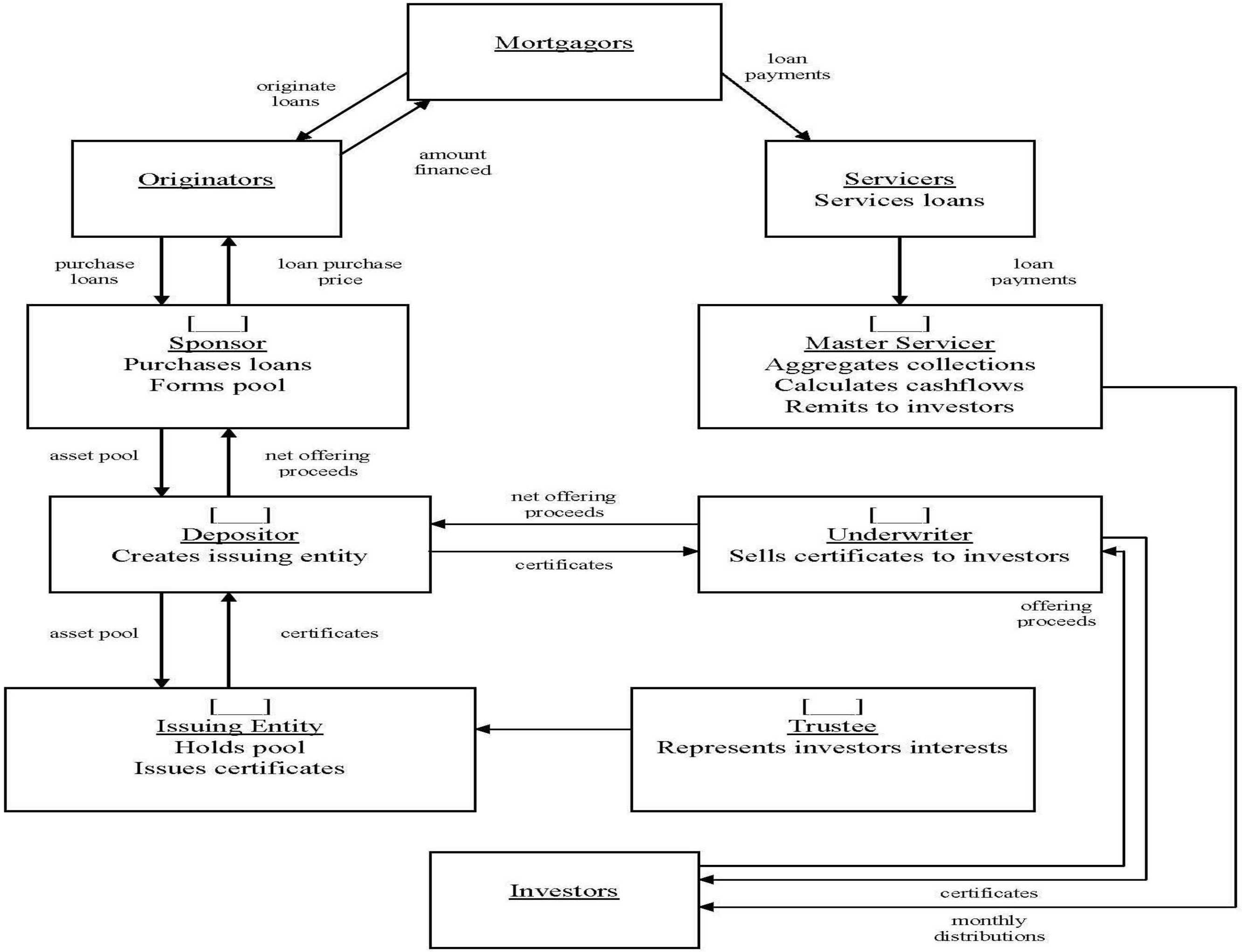
Non-Agency RMBS –Basic Features

- Mortgage loans securitized in Non-Agency RMBS securitizations can be originated by the issuer (or an affiliate), by several lenders who sell the loans to the issuer (i.e. an aggregator), or some combination of both.

- Loans with characteristics outside the Agency guidelines generally fall within one of three categories:
  - Prime jumbo loans, which generally conform to Agency guidelines except that their balances exceed maximum loan amounts;
  - Alt-A loans, whose borrowers usually have credit scores somewhere between prime and subprime borrowers, and may contain characteristics such as less than full documentation of income and assets, higher loan-to-value ratios, or other non-traditional features.
  - Subprime loans, which tend to be made to borrowers with lower credit scores and adverse credit histories

- In a typical RMBS structure, mortgage loans are sold by the sponsor to a depositor, then to a bankruptcy-remote special-purpose entity (SPE) with limited powers which acts as issuing entity (usually formed as a trust). The SPE issues securities which are sold through the depositor to investors.

Non-Agency RMBS - Example



Non-Agency RMBS –Enhancement Features

- **Third Party Enhancement**
  - Some Non-Agency RMBS provide third party credit enhancement, usually in the form of a financial guaranty insurance policy

- **Shifting Interest Subordination**
  - Typically used in prime jumbo and Alt-A transactions, up to six tranches of subordinate classes provide enhancement by absorbing losses (in order) as principal write downs
  - This structure typically directs all principal prepayments to the seniormost class for a period of time, followed by a phase in of directing prepayments pro rata, and subject to loss and delinquency triggering events which would maintain directing prepayments to the seniormost class

- **Overcollateralization**
  - Typically used in subprime and some Alt-A transactions, overcollateralization refers to the pool balance being greater than the securities balance, which is created and maintained by using excess spread (interest on the pool minus interest on the securities) to cover losses and pay down securities principal
  - This structure also includes a number of tranches of subordinate classes.
  - This structure directs all principal to the seniormost class for a period of time, after which principal may be applied in a way that pays all classes down to specified target levels, subject to loss and delinquency triggering events