Name	Firm
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Mr. George Ellison *Managing Director*	Banc of America Securities LLC
Ms. Amy Amsler *Senior Director*	Capital One
Mr. Steve Linehan *Executive Vice President*	Capital One
Mr. James B. Murray *Managing Director*	Citi
Mr. Ted Yarbrough *Managing Director & Head of Global Securitized Products*	Citi
Ms. Deborah A. Toennies *Managing Director*	JPMorgan Securities Inc.
Mr. Robert Hugi *Partner*	Mayer Brown LLP
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Mr. Lawrence D. Rubenstein *General Counsel*	Wells Fargo
Diane Citron EVP, Government Affairs	Carrington

Response to:
Notice of Proposed Rulemaking

Risk-Based Capital Guidelines;
Capital Maintenance;
Regulatory Capital

Term Securitization Issues and Recommendations

December 2009

Executive Summary - Term

- The current risk based capital rules will cause issuers to hold increased amounts of regulatory risk-based capital and loan loss allowances, which in turn will cause an increase in cost and reduction in supply of consumer credit. When applied against the existing $11.3 trillion of ABS & MBS, the effect on the recovery of the US economy will be material.

- Capital should equal risk – while the current linkage between regulatory and accounting off-balance sheet treatment worked for accounting standards that were risk-focused, this no longer remains the case and a revised approach is required that takes the time to evaluate the true risk within each ABS and MBS transaction.

  - Securitization structures vary and some are more prone to cause implicit recourse more than others. These structural differences should be recognized and a nuanced approach to the risk based capital rules applied.

  - While there have been some recent cases where issuers have provided non-contractual support, there are many instances where this has not happened and investors have suffered losses. Regulatory risk-based capital rules should recognize that there have been many cases where risk has been transferred in an ABS or MBS structure.

- The change in accounting treatment will also cause issuers to hold loan loss allowance for losses which they are not contractually required to absorb. A reserve relating to a risk that an issuer does not bear should be treated as capital.

- Issuance of a final rule should be delayed so that the structural nuances and accounting concerns can be addressed more comprehensively.

- The transition period should extend beyond 2010 to a point in the economy where unemployment is lower and issuers are less capital constrained from growing their balance sheet and providing credit.

While some banks recently provided non-contractual support to ABS, there are many examples, both current and historical, demonstrating that securitization does transfer risk

- **MBS and Auto ABS: there are virtually no examples of issuer support being extended to these amortizing trusts**
- **Credit Card ABS: trust support has recently been extended by some banks, but history shows that issuers have typically allowed troubled trusts to unwind, with investors taking losses**

Bank	Commentary
Historical	
Republic Bank	Entered into insolvency (late 1980s)
Southeast Bank	Entered into insolvency (1991)
Heilig-Meyers	Trust early amortized and investors in all classes (AAA-BBB) experienced losses (2000)
NextCard	Trust early amortized and almost half of BBB investors experienced losses (2002)
Spiegel	Trust early amortized (2003)
People's	Trust early amortized
First Equity	Trust early amortized, with investors taking losses
Current	
Advanta	Trust early amortized upon performance problems, with investors taking losses
First National Bank of Omaha	Issuers have withstood significant performance degradation and ratings pressure without extending support to their card trusts
First Financial	
Capital One	
Several European & Canadian banks, including some branches/subs of U.S. banks	

Risk-based capital rules should account for the structural nuances of a transaction and the history of actions across issuers and asset-classes

- **The "Great Recession" has proved to be a robust testing ground for whether risk has truly been transferred**
  - Issuers across asset classes have demonstrated a track-record during the highest loss period the industry has ever witnessed and that history should not be overlooked
- **Structural features can reduce the incentive to support**
  - <u>MBS and Auto ABS</u>: amortizing trusts allow for matched funding
    - These trusts have no refinance risk since there is no obligation to refinance assets that are maturing
  - <u>Card ABS</u>: revolving assets are not match funded
    - Assets continuously revolve while the debt matures with a fixed term
    - The need to refinance maturing debt increases the liquidity risk associated with a revolving trust
    - Additionally, as many revolving trusts "share" credit enhancement across all trust issuance, the act of increasing enhancement for new deals will also cause enhancement to increase for existing deals i.e. non-contractual support
    - However, structural alternatives exist that can eliminate the recourse risks caused by shared enhancement.
- **Recommendations**
  - Take a more nuanced approach regarding capital requirements, taking into account structural features that impact the probability of issuer support
  - Develop risk-based capital rules that deal appropriately with issuing banks who have not provided recourse, as well as with those that have

GAAP accounting will also require banks to hold loss allowance for assets that have no contractual risk of loss

- **Statement of Financial Accounting Standard No. 5 *Accounting for Contingencies* (FAS 5) requires banks to hold loan loss allowance to protect their balance sheets from potential expected future losses**
  - The application of FAS 5 following FAS 166/167 implementation will result in allowance having to be built for all securitized assets on exactly the same basis as if the assets were never securitized
  - No distinction will be made for the contractual terms of a securitization and issuing banks will be obliged to hold reserves against all losses associated with an asset, irrespective of who owns the risk of loss
  - If an asset suffers a loss, in most ABS structures an offsetting reduction in the security would ensure that there is no actual balance sheet exposure to the issuer other than that stemming from any retained interests it might hold
- **Given that banks will have to build allowance for assets whose losses they are not contractually obligated to absorb, the allowance should be viewed as capital**
  - ***We recommend the agencies increase the Tier 2 capital credit given for loan loss allowance created as a consequence of consolidating assets post-FAS 166 / 167 implementation and allow for an add back of some portion of the allowance to Tier 1 capital***
- **Building allowance against newly consolidated assets during this recession will also result in the creation of more Deferred Tax Assets (DTAs), exacerbating regulatory capital problems**
  - These DTAs are not only being built at the worst point in the economic cycle, they are also being built in part for losses that banks are not contractually required to absorb
  - ***We suggest a blanket inclusion in the calculation of regulatory capital of DTA balances that are specifically created as a consequence of the additional loan loss reserves resulting from FAS 166 and 167***

The combination of loan loss allowance and regulatory capital required post FAS 166 / 167 will result in banks holding reserves much in excess of actual risk

- **If RAP continues to be tied to GAAP following FAS 166/167 implementation, issuing banks will have to hold reserves (capital and allowance) that are much higher than the risk they actually face**
  - The below example demonstrates how much the total reserve requirement for banks increases under the proposed FAS 166 and 167 framework relative to today's FAS 140 methodology, which is based on actual risk-transfer and the financial components approach

Loss Rate	Contractual Risk	New Regulatory Capital	New FAS 5 Loan Loss Allowance	New Total Reserves under FAS 166/167	Excess Reserves	Multiple of Total Reserves to Contractual Risk
10%	$50	$100	$100	$200	$150	**4.0x**
15%	$50	$100	$150	$250	$200	**5.0x**
20%	$50	$100	$200	$300	$250	**6.0x**

Assumptions:
$1,000 portfolio
$50 issuer retained interest
100% risk-weighting
10% "well-capitalized" level

Worked Example:	**$**	
Loan Loss Allowance under FAS 140	**-**	
Regulatory Capital under FAS 140	**50**	**restricted to amount of total contractual risk (retained interest)**

Total impact to Capital and Reserves under FAS 140	**50**	

Loan Loss Allowance under FAS 166/167	**100**	**$1,000 portfolio at 10% losses x 12 months**
Regulatory Capital under FAS 166/167	**100**	**$1,000 portfolio at 100% risk weighting at 10% well capitalized**

Total impact to Capital and Reserves under FAS 166/167	**200**	

The requirement for higher reserves will result in the lower availability and higher cost of consumer credit

- **The regulatory capital impact of FAS 166/167 will be a reduction in available credit and an increase in cost to consumers**

While the below example demonstrates the impact relating to the credit card industry, the impact of FAS 166/167 will be felt across classes of consumer credit, most notably in the mortgage arena where private MBS accounts for 9 times the amount of credit card securitizations

Example 1: Potential Reduction in Credit Availability

(numbers in billions)	RAP	GAAP	Total
Total Card ABS Outstanding	$307.50	$307.50	
Total Off-B/S Card ABS	$50.00	$307.50	
Additional Regulatory Capital (at 10% "well-capitalized" level)	$5.00		$5.00
Additional Loan Loss Allowance (assuming 12-month losses of 10%)		$30.75	$30.75
Total Additional Capital Requirement			$35.75
Reduction in Credit Availability			**$357.50**

The source of this data is SIFMA as of Q209.
Issuing banks that structured their securitization trusts as off-balance sheet vehicles but provided optional support currently consolidate their trusts for RAP purposes, but not under GAAP. Following recent support actions we have assumed the majority of credit card ABS is already back on-balance sheet for RAP purposes but has remained off-balance sheet under GAAP.
Represents the shrinkage of credit card portfolios necessary to account for the additional capital requirement, assuming the 10% "well-capitalized" level.

Example 2: Increased Costs From New Capital Requirements

(numbers in billions)	
Approximate Cost of Raising Tier 1 Capital	12.00%
ABS Cost of Funds	- 2.55%
Incremental Cost of Raising Capital	9.45%
Total Additional Capital Requirement	$35.75
Annual Cost of Raising Additional Capital	$3.38
Total Credit Card Receivables Outstanding	$972.73
Potential Increase in APR (all cardholders)	**0.35%**
Potential Increase in APR (new cardholders only)	**3.47%**

Assumed Tier 1 common capital raised at a required annual return of 12%.
Assumes swap rate of 1.8% and spread of 75bp.
Represents the difference between cost of issuing common equity and interest paid on ABS issuance.
Source: "Credit Card Outstandings – Market Share", The Nilson Report, April 2009.
Assumes annual new origination volume equal to 10% of outstanding issuance.

- **Any transition period that ends in 2010 will effectively force the above as unemployment is expected to stay at its current high level through the next 12 months**

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FDIC Repudiation Risk

- **First Principles:** Legal isolation of financial assets in a special-purpose entity that is separate from the depository institution.
- **Under the FDIC's 2000 Securitization Rule:** "The FDIC shall not, by exercise of its authority to disaffirm or repudiate contracts under 12 U.S.C. 1821(e), reclaim, recover, or recharacterize as property of the institution or the receivership any financial assets transferred by an insured depository institution in connection with a securitization or participation, **provided that such transfer meets all conditions for sale accounting treatment under generally accepted accounting principles,** other than the 'legal isolation' condition as it applies to institutions for which the FDIC may be appointed as conservator or receiver, which is addressed by this section."

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FDIC Legal Isolation Safe Harbor

- Summer 2009-FAS 166/167 Announced by FASB
  - Implementation date of November 15, 2009 for reporting periods thereafter
  - Majority of outstanding and future securitizations will come back on-balance sheet or will not receive off-balance sheet treatment
- ASF Summer and Fall Proposals
  - Sale vs. Security Interests; "Respect for Transaction" v. "Remedies" Approach
- FDIC November 12th Action
  - Interim Final Rule Grandfathering Outstandings
  - At least until March 31, 2009 for new transactions (TALF expiration date)
  - ASF Comment Letter in Formulation; Extend Grandfathering until at least 3-6 months after finalization of the new FDIC safe harbor

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FDIC Legal Isolation Safe Harbor

- December 15th, 2009 FDIC Board Meeting
  - "The FDIC is intending to publish in December 2009, a Notice of Proposed Rulemaking to amend its regulations further regarding the treatment of participations and securitizations issued after March 31, 2010."
  - New Possible 'Preconditions' to Achieve Safe Harbor
    - Appropriate FDIC Regulations/Market Intervention?
    - Legislative Process Underway
    - Risk Retention
    - Additional disclosure and transparency
    - Limit on number of tranches
    - Tie underwriting and rating agency compensation to long-term performance of securities
    - Servicing Reforms-Act in best interest of all securityholders; servicer advances
    - No REREMICS or CDOs without additional disclosure

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