February 17, 2010

Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington DC 20429

Re: 12 CFR Part 360 / RIN 3064-AD55
Advance Notice of Proposed Rulemaking: Treatment by the Federal Deposit Insurance Corporation as Conservator or Receiver of Financial Assets Transferred by an Insured Depository Institution in Connection with a Securitization or Participation After March 31, 2010.

Dear Mr. Feldman,

Thank you for the opportunity to comment on the ANPR.

By way of background, I worked at Citigroup (and its predecessor Citicorp) from 1988 – 2008, most recently as a Managing Director in the Treasury Capital Markets Group, which has responsibility for funding the company in the debt, equity, and securitization markets. I am currently writing a book on the history and development of securitization.

The implementation of FAS 166/167 has set into motion the wholesale reconstruction of securitization. In fact, securitization may well be a thing of the past, if no viable and economic structure is found that allows for GAAP sale under the new framework. The FDIC's ANPR reflects this new reality: transactions issued after March 31, 2010 that do not achieve GAAP sale come to greatly resemble secured borrowings, and are securitizations only in name. This may be an unavoidable consequence of cumulative policy shifts, but the timing is most unfortunate, given the current state of the US economy. The securitization industry is unprepared for a switch to a secured borrowings framework, and it will take time to make the change.

Time will also be needed to comply with extensive disclosure requirements as well. The costs of compliance will, of course, be assessed by issuers, and could discourage securitization altogether, or encourage a shift from bank to non-bank or special purpose company sponsorship, perhaps offshore. For the US, much is at stake, given how deeply securitization has been woven into the fabric of the economy after more than 30 years. In 2006, according to the Federal Reserve Board's Flow of Funds data, private securitization funded 27% of all mortgage (including commercial) and consumer credit in the US, Agency/GSE securitization 24%.

To date, economic recovery has been slow to emerge. The employment situation has been disappointing. The parlous condition of commercial real estate along with the failure of residential housing to stage much of a recovery keeps inventory high, and construction enfeebled. Retail sales have been reasonably encouraging, but consumer purchasing power is limited by lean wage and salary growth, high unemployment, and frail confidence. Output growth has not been robust, constrained by tempered expectations.

The pace of the recovery has been hindered by developments in credit. Despite the expansionary efforts of the Federal Reserve and other Government agencies, total household credit outstanding as of late 2009 is lower, in nominal terms, than at year end 2007. Consumer (non-mortgage) credit as reported in the Federal Reserve Board's G.19 release for year end 2009 has shrunk by 2.5% compared to 2007 (nominal GDP grew 0.875% over the same time period). Examination of the G.19 data by provider illuminates how liquidity was ravaged in the crisis of 2007-2009. Consumer credit provided by finance companies is lower by 16.1% from year end 2007 to year end 2009, and while commercial banks' consumer credit increased by 3.3% over that time frame, a drop of 5.5% in that segment was observed from year end 2008 to year end 2009. Consumer credit funded by securitization fell 10.8%. The growth segment, unsurprisingly, was the Federal Government, which increased by 89% from year end 2007 to year end 2009. 7.5% of US consumer non-mortgage credit was provided by the Federal Government at year end 2009.

The situation for mortgage debt is similar. According to the Federal Reserve's Flow of Funds data, total mortgage debt outstanding fell 0.8% from year end 2007 to Q3 2009. For home mortgages, the decline is 2.3%, or $260 billion. The Flow of Funds data on mortgage securitization describes contours similar to that of consumer credit, but even more dramatic. Private residential (single-family) mortgage-backed securities outstanding fell by 26.5% from year end 2007 to Q3 2009, or $575 billion. Agency/GSE-sponsored residential (single-family) mortgage-backed securities rose by 18.9%, or $814 billion. Clearly the shift from private to government-sponsored funding was born of crisis response; current policy decisions are not expected to reinforce that trend.

The decline in outstanding consumer credit does reflect impulses from both the demand and supply side. Household de-leveraging, voluntarily and involuntarily, continues apace. But de-leveraging is not the sole dynamic in consumer credit. Demand for credit may be weaker, but it has not vanished. The ability of the housing, automobile, and retail and leisure industries to rebound will depend on credit availability. Anecdotal evidence regarding availability and/or restrictive terms of credit is discouraging. The anecdotes are credible and even predictable, given the monumental upheaval in banking and finance that has gone on for nearly three years. Financial markets liquidity was squeezed, at times severely, during the crisis that ensued from 2007-2009, and credit terms and availability were of necessity shifted. Liquidity conditions have improved, but credit terms remain restrictive. The Federal Reserve Board's January 2010 Senior Loan Officer Opinion Survey on Bank Lending Practices states: "The January survey indicated that commercial banks generally ceased tightening standards on many loan types in the fourth quarter of last year but have yet to unwind the considerable tightening that has occurred over the past two years." Numerous cross-currents are impeding credit's restoration: *inter alia*, the recoil of Government stimulus in its many forms, the Credit CARD Act (cited in the FRB's Loan Officer Opinion Survey), and uncertainty from pending legislative changes to financial services practices.

Exceptionally powerful cross-currents are at work in securitization. For providers of credit funded through securitization, 2010 changes everything. Most existing securitizations are now on-balance sheet courtesy of FAS 166/167; as a consequence, loan loss reserves must now be held against these amounts. Gain-on-sale accounting is no longer permitted for on-balance sheet securitizations. Bank sponsors must now hold full regulatory capital. No structural solution is yet apparent that will restore GAAP sale while preserving the desired economic stake in the business. The economics of securitization have been fundamentally altered, which in turn means the economics of the credit business have been fundamentally altered, in an already unstable and highly uncertain environment.

Market conditions for securitization as well as for unsecured debt improved over the course of 2009. The securitization market staged a remarkable recovery, aided in part by the Federal Reserve's Term Asset-Backed Securities Lending Facility. Investor sponsorship for securitization has been quite impressive. Still, it cannot be said that liquidity conditions are back to solid-state for either securitization or unsecured debt. Liquidity is still poor for certain segments of the securitized market, such as non-conforming mortgages, consumer assets of lower credit quality, and subordinated securities. The question of liquidity must also be assessed with a view to the effects of the withdrawal of various stimulus programs, including the run-off of liabilities issued under the FDIC's Temporary Liquidity Guarantee Program.

The terms of the ANPR layer yet another set of challenges on an already struggling industry. Part 360 – Resolution and Receivership Rules, Section (d) Safe Harbor, Part (4) For Securitizations Not Meeting Sale Accounting Requirements – lays out a profound shift in practices. Without the ratification provided by GAAP sale, the isolation and disposition of a securitization vehicle can no longer be relied upon in insolvency. Standards and expectations of "bankruptcy-remoteness" have been in place since the market's inception. Investors now have a new set of unfamiliar investment considerations, such as the implications of a stay period, and rights under FDIC repudiation. Suddenly, the forward market value and even the forward market existence for various types of collateral must be contemplated. Moody's has announced that the ratings approach to bank-sponsored securitizations may change, such that the rating of a securitization will be much more dependent on the rating of the sponsor. Banks rated less than "AA" may not be able to structure "AAA"-rated securitizations. This in turn raises further considerations about the economics of securitization, and the allocation of credit toward the secured and unsecured debt of banks. The possible abandonment or modification of "too big to fail," and uncertainties surrounding a new Resolution Authority, are elements of these considerations and make assessment even more challenging.

Some of these issues had been raised but not fully resolved in the US Treasury's Covered Bond initiative of 2008. As the experience with covered bonds showed, the new requirements for securitization will take time to resolve, time that's a drag on economic recovery. A more severe scenario is one where institutions determine the costs of issuing secured debt (including maintenance of the infrastructure needed to support it) outweigh its benefits, resulting in sub-optimal liquidity choices, and/or further diminution of credit extension. Asymmetry between banks and non-banks with respect to the isolation condition is likely not an equilibrium state; if it did persist, the probable outcome is a set of fragmented markets, and confusion.

Finally, although I generally advocate the free flow of capital, the case can be made that policy should not be constructed in a way to disfavor flows to domestic entities, especially during critical periods. Anecdotally much is made of capital flows to the "BRIC" nations, and more generally to emerging markets. That funding activity, as well as funding activity on behalf of developed nations, is accommodated to some degree by US domestic capital markets. For example, according to the Federal Reserve Board's Commercial Paper data, over 40% of unsecured commercial paper purchased in the US is either issued by a foreign-owned entity, or a foreign-parented domestic entity. In the term debt market, according to IFR, 34% of all debt issued in the US to date in 2010 (through February 12) is from a Yankee, Sovereign, or Emerging Markets borrower. This compares to 22% for all of 2009. In fact, Yankee issuance represents the single largest category of debt issuance so far this year, higher than (domestic) Industrials, Finance, or Agencies.

Resolution of matters arising from the implementation of FAS 166/167 slowed or stopped much bank-sponsored securitization issuance in late 2009; investable funds that may have been deployed to securitizations had to go elsewhere. It is likely that securitization will be slowed or stopped as matters arising from the ANPR are resolved: the full set of new conditions required to qualify for the Safe Harbor, and the terms of the Safe Harbor itself. Transformation may be inevitable, but considering the risks of prolonging the credit crunch, I urge the FDIC to allow the provision of consumer credit in the US to stabilize before imposing the conditions of the ANPR.

Sincerely,

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