February 22, 2010

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

RE: 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. FDIC RIN # 3064–AD55

Ladies and Gentlemen:

The Risk Management Association (RMA) appreciates this opportunity to respond to the Advanced Notice of Proposed Rulemaking (ANPR), dated January 7, 2010, regarding 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. RMA is a member-driven professional association dedicated to helping financial institutions identify and manage the effects of all forms of risk -- including credit risk, operational risk, and market risk -- on their businesses and customers. RMA's Capital Working Group prepared this response; the Group has been providing independent analysis on matters pertaining to risk and capital regulation, including in the context of securitization, since its inception in 1999.

The Capital Working Group agrees, in general, that the issues raised by the FDIC's ANPR are of the greatest importance. However, we believe that the safe harbor rule is not the context in which to impose conditions on the types of assets that may be originated and securitized by a bank or BHC, the type of securitization structures, including tranche architecture, that are permissible, or the type of disclosures to investors aimed at giving them the necessary tools to make appropriate investment decisions.

Rather, we believe that all of the banking agencies should focus, as a group, on the important issues of bank sponsors properly underwriting loans that are securitized, and on properly servicing such loans to maximize pool value to investors. Data availability in the form of appropriate disclosure is also vitally important to investors, but may properly be the province of another government agency such as the SEC. Also, we remind regulators that, under the new accounting standards, coupled with the new capital standards the U.S. banking agencies have attached to consolidated securitization assets, bank securitization sponsors must hold capital against all of the assets being securitized, as if the securitization never took place. These new capital requirements, coupled with the market's requirement that sponsoring banks must hold the riskiest, first-dollar residual position in a securitization, provide amply assurance of bank risk-retention, and no new regulation or legislation is needed in that regard.

Finally, we agree that, in addition to a new focus on underwriting procedures, improvements in reps and warranties can serve to protect both investors and bank sponsors. Therefore, we strongly support the efforts of the American Securitization Forum's Project RESTART dealing with such reps and warranties.

We have provided a detailed discussion in the attached response document. Please feel free to contact Ed DeMarco at 215-446-4052 or via email at edemarco@rmahq.org, or Sue Wharton, at 215-446-4089 or via email at swharton@rmahq.org.

Sincerely yours,

Edward J. DeMarco
General Counsel

Suzanne I. Wharton
Associate Director, Strategic Learning and Research

**Response regarding FDIC ANPR on Safe Harbor treatment of consolidated securitization assets.**

February 19, 2010.

I. Overview and Major Concerns.

The RMA Capital Working Group appreciates this opportunity to respond to the FDIC Advanced Notice of Proposed Rulemaking, published January 7, 2010 in the Federal Register.[1] We agree that the issues raised by the FDIC's ANPR are of the greatest importance. However, we believe that the Safe Harbor rule is not the context in which to impose conditions on the types of assets that may be originated and securitized by a bank or BHC, the type of securitization structures, including tranche architecture, that are permissible, or the type of disclosures to investors aimed at giving them the necessary tools to make appropriate investment decisions.

Rather, all of the financial institution regulators should make these decisions together. To do so separately may lead to a patchwork of regulations that apply differentially to insured banks versus regulated Bank Holding Companies. Moreover, systemically important non-bank financial companies might be excluded from such rules, thereby creating further competitive inequities. The patchwork of regulations would lead inevitably to higher costs of securitization; for example, if current bank sponsors of securitizations thought that the Fed's rules on securitization sponsorship made more sense from an implementation view-point, the banks might originate assets and conduct sponsorship in BHC affiliates rather than in the banks themselves. The higher costs associated with changing sponsorship procedures would do nothing to address the important issues such as improving underwriting processes.

Moreover, the proposed rules regarding securitization sponsorship must be considered within the context of the recent accounting changes (in FAS 166 and 167) that will likely result in almost all securitization assets being consolidated on the balance sheets of sponsoring institutions. These accounting changes have been coupled with the banking agencies' recent decision to treat capital requirements for consolidated securitization trust's assets, without exceptions, as if the assets were indeed never held by the securitization trust instead of the bank. Thus, bank securitization sponsors must now hold capital against the securitization based on all of the trust's assets -- even though the securitization does indeed transfer some tail risk to others. In this context, neither the FDIC nor the other banking agencies need to focus further on the <u>risk</u> of securitizations to banks, except insofar as existing capital rules (under either Basel I or, in the near future, Basel II) are inappropriate with regard to particular consolidated assets.

The FDIC, we would argue, should therefore focus only on making sure that securitization assets are underwritten properly, just like other bank assets, and serviced properly, just like other bank assets. Issues such as protecting tranche investors (as opposed to protecting the bank as servicer of the assets) are, we would argue, either beyond the purview of the FDIC or could lead to conflicts of interest with regard to the FDIC's role of protecting the deposit insurance fund. For example, any proposal to require banks to own a certain percentage of tranches beyond the first-dollar piece the sponsor typically owns, would result in a disadvantage to the FDIC in the event of receivership. That is, without such a rule, the bank sponsor will be holding capital equivalent to the level needed if securitization had not taken place, yet the securitization does reduce the tail risk to the insurance fund (because other parties besides the

[1] The Capital Working Group consists of senior staff in the area of risk measurement and management at major banking companies. An appendix lists the names of institutions and staff that have participated in the preparation and/or review of this response. Individual bank members may disagree with specific points made in this response and/or may be providing a separate response to the ANPR.

bank hold the mezzanine and senior tranches). By requiring the bank to hold some portion of these other pieces, the FDIC could be causing losses to the deposit insurance fund, in the event of insolvency, over and above those in effect now (without changing the incentives for good risk management for the bank, which are now driven by the consolidated assets' capital requirements and the bank's first-dollar loss position). This additional risk to the insurance fund would be especially unfair to the vast majority of smaller banks that do not engage in securitization sponsorship.

Whatever the FDIC decides, it should make sure that already-issued securitization tranches are not subject to these proposed conditions in order to continue to be subject to the current safe harbor treatment. To do so would reduce market prices for such tranches below those currently in effect, while the risk of losses associated with the underlying assets has not changed. Banks and other parties holding these instruments would incur harm that serves no purpose and which may slow the economic recovery. Therefore, we strongly support the FDIC's proposal that existing securitization structures be grandfathered.

Further, when its final rule is implemented, the FDIC should be careful to give ample time for the securitization markets to adjust to the new rules, with regard to required deal structures, asset types, etc. The securitization markets, as noted in the ANPR, are of critical importance in financing economic activity and should be given time to embody the new rules in the context of a slow recovery. The ANPR proposes roughly a 90-day transition period (through its use of the March 31, 2010 date). Ideally, however, the rules should not become finalized (i.e., should not require other than a legal separation between the bank sponsor and the securitization trust in order to continue to have the safe harbor applied) until after the securitization markets, especially the private-label RMBS market, have become stabilized. We suggest that the FDIC and the other agencies consider working with the securitization industry to try various experimental versions of securitization structures, to see whether such structures a) can be marketed, and b) can still provide economic incentive for banking institutions to undertake such structures. Given the slow pace of recovery, we would not expect that such new structures could receive a proper test of acceptance prior to the end of 2010. Thus, the transition period, rather than based on a date-certain, should be based on the pace of general economic recovery and on the pace of market-accepted changes in securitization structures.

II. Other Major Concerns.

It is in this spirit of carefully forging ahead with consensus among the regulatory agencies that we provide comment on these issues and on some of the questions raised within the ANPR. The major issues are summarized below. We do not answer the 35 question specifically but rather respond to them in the context of these overarching issues.

A. <u>Setting securitization structural requirements intended to limit the complexity and leverage of securitizations, and to require sponsors to retain risk in the securitization</u>.

The ANPR suggests several ways in which complexity of securitization structure and leverage might be reduced. The use of the term "leverage," however, requires some discussion. This term appears in Questions 3 and 4 directly, and by inference in Questions 28 through 32 (which deal with the issue of risk retention with reference to the sponsoring banking institution). Leverage in this context could refer either to the amount of the first-dollar position typically held by the sponsoring institution (relative to the size of the asset pool being securitized) or could refer to the manner in which purchasers of the trust's securities finance those purchases. We believe that the second of these definitions may relate to issues beyond the purview of the FDIC. That is, purchasers of specific tranches could be themselves

funds or trusts, which finance the purchase with other than equity. Moreover, the liabilities issued by the purchasing fund may themselves be purchased by other funds using some degree of leverage, and so on. This issue of systemic leverage cannot be adequately addressed within the context of rules that pertain only to the structure of the first-round securitization deal, and even in that context securitization rules would need to be applied to non-bank and non-domestic competitors of U.S. bank sponsors of securitizations.

1. Bank retention of risk. With regard to bank sponsors having incentive to underwrite loans and service them properly, we believe that any set, minimum percentage applying to the first-dollar loss position of the bank can be counter-productive. Rather, with the new capital treatment of assets whose consolidation onto the bank's balance sheet is now required by FAS 166-167, the bank sponsor must now hold as much capital for the securitization as if the assets never left the bank's balance sheet. This is indeed retention of risk that provides incentive for the bank to properly originate the loans and to properly service them (if the bank retains servicing). Moreover, past securitizations, and certainly those going forward, predominately require the sponsoring bank to hold a significant first-dollar position. The level of this first-dollar position -- which is the riskiest, true, risk-retention position of all the tranches -- depends on the inherent risk of the asset pool. The riskier the pool, the greater the first-dollar loss position must be to entice the buyer of any mezzanine tranche. And the riskier the pool, the greater must be the combination of the first-dollar loss position and the mezzanine tranches taken together to entice an investor to buy the senior tranche.

It is our view that the new capital rules associated with FAS 166-167, coupled with the ongoing market requirement that the sponsor hold the first-dollar position, are more than sufficient to satisfy concerns of enough "skin in the game." Setting some regulatory minimum on the size of the first-dollar loss position held by the sponsoring bank can be counter-productive, however, since the market already determines the size of this position in relation to the risk of the asset pool. If the regulatory minimum is above the market-determined first-dollar position, the securitization might no longer be attractive to the bank. That is, the market might not be willing to pay a high enough premium for credit-enhanced tranches to compensate the bank for holding the higher-than-needed first-dollar position. Since funding through securitization presumably is cheaper than funding through the bank's money desk (or otherwise why do it), the higher the first-dollar position, the lower the net return to the bank sponsor, and therefore the less likely that securitization can provide the bank with an inexpensive funding source and greater liquidity.

A rule setting a minimum first-dollar level might discourage banks from originating and securitizing low risk assets (the class of assets for which it would be most likely that the regulatory minimum first-dollar percentage exceeds the market-required first-dollar position) -- exactly the opposite of what is needed in the context of recovery of the credit markets and improvement in bank soundness.

Note also that any regulatory rule that, instead of a minimum first-dollar loss position, requires the bank to retain on its balance sheet some percentage of the underlying asset pool, suffers from the same problem. Again, if the bank has to borrow and finance some additional assets, over and above the size of the first-dollar position that is required by the tranche purchasers, the economics of the securitization change, and the value of the securitization as a source of funding and a source of liquidity may be lost to the bank. Again, the most likely class of assets to be affected by such a rule are pools of low-risk assets.

Finally, any requirement that the bank own some minimum percentage of all tranches suffers from this same problem of increasing the cost of securitization, and also suffers from the problem that, in the event of insolvency of the bank, the deposit-insurance-fund may be exposed to greater losses than

necessary (through the bank's losses on mezzanine or senior tranches that the bank typically doesn't now hold). We are well aware that just such a proposed rule is to be found within pending legislation, but we emphasize that such a rule does not alter either the banks' capital requirements under the new accounting standards (under the new capital standards) or the bank's measurement of the true risk it is retaining. The proposed rule has only the major effect of increasing the risk of loss to the FDIC insurance fund in the event of a bank insolvency in the context of some future downturn. Additionally, the cost of bank borrowing is driven up because it will be paying more to fund its ownership of tranches beyond its traditional first-dollar piece.

2. Limiting the number of tranches. The proposal to limit the number of tranches to, say, 6 we also find to be not necessary, whether for RMBS or for other asset classes. Doing so might be part of a reasonable effort to make securitization structures more understandable to investors and perhaps easier to rate. However, the number of tranches is far down on the list of structural concerns that, in the past, have led to investor confusion. Much more important is understanding the true risk of the underlying pool of assets and understanding the true nature of the legal securitization waterfall. For example, true risk of a tranche might be obscured if the securitization, for some tranches, segments the underlying pool into 2 or more segments -- with the performances of differing segments influencing heavily the performance of differing tranches. Similarly, pools of assets that have complex make-ups may make it difficult to understand the true underlying loss distribution associated with the pool, even before considering the securitization's waterfall.

Also, particularly thin mezzanine tranches are problematic for investors in that the loss-given-default (LGD) of such tranches is quite high, often approaching 100%. Investors may have, in the past, purchased such tranches because a rating based mainly on probability of default (not including LGD), may have influenced such an investment decision, without the investor realizing that the LGD component of risk was high.

The essential problem with setting regulatory minimum standards for a securitization *structure* is that any such standards may be inconsistent with what the market desires in the context of the macro-economic recovery and the context of the recovery of securitization markets. Rather, there is a clear need to find out what is acceptable to investors while still meeting the needs of the sponsor in terms of spreads and the provision of liquidity for funding the origination of new loans. In one of the examples given above, a regulatory rule that precludes structuring a pool with, say, two classes of asset, might stop sponsors from structuring safer pools -- pools in which the systemic risk of the pool is low (i.e., low asset-value-correlations between the two asset classes). Such a diversified pool would reduce the risk to the bank's first-dollar position and to each of the other tranches.

Similarly, a regulatory rule that precluded differing pool segments from supporting differing tranches could reduce the value of a securitization to a specific set of investors. For example, purchasers of Tranche 4 might desire to have their tranche supported by underlying asset class X, not underlying asset class Y, because Tranche 4 is being purchased by investors who already have significant exposure to underlying asset class Y. Finally, prohibiting thin mezzanine tranches could harm an investor that wants to supplement his portfolio with a small amount of high-yield product for which the overwhelming probability is that no loss whatsoever will be experienced (but if a loss occurs it likely will be a complete loss).

Rather than setting regulatory standards for securitization structure, we believe that a greater emphasis should be placed on securitization disclosure -- including *continuing* disclosure of pool performance -- as is stated in the ANPR. However, it is not clear to us that such disclosure -- aimed at educating investors

and providing them with all the tools necessary to make informed decisions -- should be the province of the banking regulatory agencies, rather than some other agency whose main charter is the protection of investors' interests. See our discussion below with regard to investor disclosure.

3. Requiring pool loans to be aged. Another structural requirement proposed in the ANPR is that assets associated with RMBS must be originated more than 12 months prior to any transfer to the securitization trust. This proposal presumably is rooted in the well-documented finding that default probability associated with home mortgages rises with age of loan, until leveling off, then declining somewhat, all other things equal. Also, recent loan origination vintages, when underwriting standards were at their lowest ebb, have displayed higher delinquency rates recently as the loans have aged and as the downturn continues with respect to unemployment rates.[2]

Requiring that new loans actually sit on the balance sheet of the bank sponsor, however, for a period of twelve months would drive up the cost of lending to credit-worthy home loan borrowers, because securitization funding has been a cheaper source of funding than bank direct borrowings. Moreover, the aging of the loans would have little impact on investors' willingness to buy the tranches of an RMBS, for the following reasons:

- If loan underwriting standards going forward are appropriate (as required in another portion of the ANPR), the poor-underwriting-driven delinquency and default deficiencies of recent years would not be repeated.
- Meanwhile, the current economic crisis, including unemployment rates, will be the main determinant of pool performance (again, assuming proper underwriting standards).
- Properly underwritten mortgages in normal economic times experience low delinquencies during approximately the first year or two of age, then rise somewhat, then fall somewhat before settling down into a rather stable delinquency and default rates. The rise in delinquencies as the loans age can be attributed, in normal economic times, to a) some percentage of well-underwritten loans nevertheless being inappropriate for some borrowers (it takes time for this realization to set in as new homeowners adjust their budgets to the often higher monthly payment associated with owning rather than renting) and to b) some percentage of borrowers experiencing non-systemic events such as individuals' loss of employment, divorce, or sickness in normal times.
- Thus, with proper underwriting, a delay in securitization would not fundamentally alter the number of loans that must be re-purchased by the sponsor, because such repurchases are based on violations of the reps and warranties, not on ordinary amounts of delinquency and default. Further, investors are well aware, or should be well aware, of the natural relationship between age of loan and delinquency, and this should be factored into the spreads inherent in the securitization structure. That is, the securitization is structured so that the natural growth of excess spread is more than enough to accommodate the expected growth in delinquencies and defaults during the first couple of years of the pool's age, without threatening even the highest-risk mezzanine tranches, let alone the senior tranches that comprise the bulk of the securitization.

[2] For example, see DBRS, "Prime Performance Weakening at an Alarming Rate," January 19, 2010.

Thus, once the current economic crisis abates, the warehousing of loans by the bank for a period of one year would likely not serve to increase investor demand. It is possible, however, that the strengthening of reps and warrantees might help to assure investors that loan underwriting standards are appropriate, as suggested by the ANPR. In this regard, we strongly support the proposed changes to reps and warranties proposed within the American Securitization Forum's Project RESTART. These proposed changes were released on December 15, 2009 in the form of a model set of representations and warranties for RMBS transactions. Again, we think that banking regulators should work with bank sponsors to try new structures -- structures that might be accompanied with these improved reps and warranties -- rather than to impose structural constraints that may or may not pass the test of market acceptance.

4. Synthetic securitizations. The ANPR proposes that synthetic securitizations not be eligible for the Safe Harbor treatment. We note that such synthetic securitizations, so far as we are aware, do not involve the legal sale of assets to a securitization trust. That is, the assets that are the subject of the transaction remain on the balance sheet of the bank. The question, therefore, is whether in the event of the bank being in receivership, the legal documents underlying the synthetic securitization give investors an appropriate claim on the underlying assets, much as would the legal documents associated with a covered bond or the legal documents associated with a collateralized credit default swap. We therefore do not believe that there is a policy issue associated with such synthetic securitizations, except with regard to possible specific legal language associated with such transactions.

5. External credit support. The ANPR asks whether "*external credit support*" should be prohibited *"in order to better realign incentives between underwriting and securitization structure."* If, by referring to 3rd party credit enhancement, the ANPR means a loss position that is junior to any position retained by the bank, including the typical excess spread or I/O strip, then we agree that such a structure might misalign incentives for proper underwriting and servicing. However, we are not aware of any significant number of securitizations that feature such a structure. Moreover, if the new accounting rules require consolidation of such a trust's assets within the balance sheet of the sponsoring bank, then, again, the new treatment of capital for such consolidated assets would require that the bank hold capital against the assets of the trust as if the securitization did not exist (and did not in fact transfer some amount of tail risk). This capital requirement alone should be sufficient to provide proper incentive to underwrite and service the pool properly.

Of course, 3rd party credit enhancement also refers to each of the tranches of a securitization more senior than the bank's first-dollar position. That is, each tranche owned by an investor or investors provides credit enhancement to more senior tranches. However, clearly the ANPR is not referring to all tranches not owned by the bank. The ANPR may be referring to credit-enhancing *liquidity facilities* provided by, say, another bank, but, again, so long as the riskiest first-dollar position is owned by the sponsor, and so long as the sponsor must hold capital against this position appropriately, by conservatively holding capital against all of the pool assets, we believe no misalignment of incentives exists on the part of the sponsoring bank.[3] Only if the 3rd party liquidity facility were somehow junior to

[3] It is also the case that, in the past, some banks may have been structuring a securitization in which some or all tranches were sold/transferred to a BHC affiliate of the bank. Not only might such transfers remove the assets from the bank for accounting and capital purposes, but they would also raise the issue of proper capital treatment for the affiliate that received the tranches. We are on record as agreeing with the new Pillar 2 requirements of Basel II, that bank-affiliated investors in any securitization tranche should conduct a proper risk analysis that looks through to the assets underlying the held tranche, coupled with an understanding of the securitization's legal waterfall.

the bank's typical first-dollar position would the bank's incentive to properly originate and service the loans be compromised.

6. Permitting only mortgages underwritten using documented income. The ANPR suggests that securitizers should underwrite according to the standards contained within the supervisory guidance pertaining to such underwriting. We agree that bank securitization sponsors, since they must hold capital against the underlying assets and assume the first-dollar risk position, should underwrite those assets in the same manner as when they intend to hold the assets on their balance sheet and not securitize them.

However, the ANPR goes on to suggest that "*securitizers be required to confirm that the mortgages...are underwritten at the fully indexed rate relying on documented income*.." Supervisory guidance on such underwriting indicates that there are mitigating factors that may argue for allowing stated income and reduced documentation. Such factors might include the presence of verifiable liquid reserves or other assets that demonstrate repayment capability. Also, from an economic perspective, the risk of a low-doc loan may be greatly reduced via the use of lower maximum loan-to-value ratios in order to approve such loans for origination. Indeed, some bank research has indicated that debt-to-income ratios below a certain level are not statistically significant in determining default probability -- that is, loan-to-value is more important in determining default and thus mitigates the need for fully documented income in some circumstances. In the current crisis in particular, it is not statistically clear that low-doc loans with low LTVs experience higher delinquency or default rates than fully documented loans with low LTVs.

Thus, we have no problem with requiring bank sponsors to certify that they underwrite "in accordance with regulatory agency guidance governing the underwriting of residential mortgages", but we believe that precluding low-doc loans from securitization would unfairly disadvantage low-LTV borrowers who also have other liquid reserves. At the same time, providing greater detail to investors on the nature of the underwriting process the bank uses may be appropriate and helpful in terms of re-establishing the private-label RMBS market.

B. Disclosure.

We agree with a central tenant of the ANPR, that disclosure of pool performance and of the securitization waterfall is of prime importance for investors to make informed decisions. Further, it is the case that both pool risk (as embodied, for example, in the percentage of pool assets that are past-due) and securitization waterfall structure *change* each month, so that adequate disclosure should be on a continuous basis (if not monthly, then at least quarterly). For example, most term securitizations such as private-label RMBS are structured so that scheduled principle payments on the underlying loans, coupled with scheduled accumulation of interest in the I/O strip, serve to reduce the size of outstanding tranches beyond the first-dollar I/O strip, while increasing the credit-enhancing size of the first-dollar I/O strip. This means that the lower-bound and upper-bound for each tranche change each month and, unless credit losses exceed expected amounts, each tranche should enjoy greater prior credit enhancement each month. However, realized delinquencies and loss rates in the underlying pool that are above expectations can cause any tranche to become more risky over time, not less risky, as evidenced in the run-up to the current crisis.

To be adequately informed about the true nature of risk in any particular tranche, therefore, the investor or the investment advisor must receive information on pool performance and waterfall structure on a continuing basis. Moreover, as suggested within the ANPR, pool information is necessary not only with regard to the loans underlying each tranche in a regular securitization, but also with regard

to the loans underlying each asset in a pool of assets that themselves consist of securitization tranches underlying a re-securitization. This process of looking-through to the content of the real credit assets that underlie any securitization or re-securitization is embodied within the new Basel II Pillar 2 rules that require a bank owner of securitization tranches to conduct some sort of look-through analysis on the true underlying credits in order to hold any securitization position while avoiding a 100% capital charge on the position. We strongly support the provision of such pool information, and accompanying waterfall structure information, on a continuous basis, to investors in either ordinary securitizations or re-securitizations.

However, there are important questions regarding a) how much information is minimally acceptable (which, in turn, raises the question of what kind of analysis is done with the information), and b) who pays for the provision of such information. We are strong supporters of the notion that more information, for a given cost, is always better. But there are important trade-offs between and among the quantity and quality of information, and the manner in which the information is used to measure risk of a particular tranche.

In fact, there is no broad consensus on the appropriate type of risk measurements that investors should use in evaluating the risk of a particular securitization tranche. Prior to the crisis many sophisticated investment advisors relied solely on the rating of the tranche to make buy and/or hold decisions. Other advisors relied not only on ratings but also on more sophisticated value measurement models such as so-called "risk-neutral" or "arbitrage-free" models. These modeling processes, like the rating process itself, did not utilize <u>all</u> of the monthly information on pool assets that is currently available from data sources such as Intex. This is because credit risk research has demonstrated that some data variables are not statistically significant in determining realized default frequencies. Other variables are well known to be significant -- such as delinquency status, FICO score, loan-to-value, and age of account. Thus, it is not at all clear what specific *additional* disclosures of either pool characteristics or waterfall monthly structural changes would serve to make investors comfortable on a going-forward basis. Indeed, both the rating process itself, as well as the market-price-based risk-neutral models have been criticized as being either too simplistic or too dependent on market shadow-prices such as the levels of and changes in ABS indices that reflect market consensus views of risk and therefore value.

In this climate, we do not believe that the FDIC or the other banking agencies can easily and appropriately dictate what sorts of information should be added to the data already available on a continuous basis. There is also the danger that individual investors will be inundated with new data variables and, in the process, will overlook truly significant (i.e., statistically significant) variables. We respectfully suggest, therefore, that the banking agencies and market participants continue to conduct further research on the determinants of risk in the underlying asset pools of various types, and couple this with further research on the effect of such pool risk on the riskiness of individual tranches.

It will take quite some time for such additional research to bear fruit and for experimental new securitization structures to test the waters and see what is acceptable to the market and what is not. In the meantime, we do not believe it advisable for the FDIC or the other banking agencies to posit a list of data that must be provided by someone to investors in securitizations, over and above what is now available through commonly used pool and waterfall databases, on a monthly basis, such as Intex.

There is also the question of who pays for such information. Currently, the rating agencies subscribe to the Intex data, as do managers/advisors of large funds. The sponsoring banks also have subscriptions to Intex, so that they can continue with their own research on securitization structures and risk measurement. The transmission of data from the securitization trust to Intex each month is paid for

within the securitization process itself. However, each user of the Intex database, including the bank sponsor of a securitization, must pay a subscription fee to Intex. This is a major reason why smaller investors rely solely on ratings.

In considering what to do about information dissemination, the FDIC, in our view, should work with the other agencies to determine what additional information should be supplied besides that now available in Intex. In the process, the agencies should consider that such additional information has a cost and that, therefore, the additional information will drive up the cost of funds to bank borrowers.

C. Loss mitigation and servicer matters.

One area in which we strongly support new effort is with regard to the ability of the servicer to mitigate losses in RMBS and thereby maximize the value of the underlying pool of mortgages. Such value maximization benefits all tranches of the securitization.

Unfortunately, at present, little consensus exists with respect to what kind of loan modifications, if any, act to maximize pool value. Nor is there consensus with regard to whether servicers should act to maximize value for the pool versus maximizing value for a specific set of tranches. Perhaps it would be best if it could be made clear that the servicer's job is to maximize pool value, since so doing serves to help all tranche holders. This appears to be the central position of the ANPR. However, there is still going to be disagreement among investors with regard to:

- Which loan modifications truly help pool value;
- Whether the timing of certain loan modifications or other servicer actions affect tranches differentially; and
- Whether pool value maximization also serves political objectives such as keeping families in their homes.

We believe that pool value maximization, if it is determined to be the key objective, can best be carried out by a bank servicer that also sponsors securitizations and has originated underlying mortgages and therefore understands issues of data quality. Because of this belief, we think that any language that protects such servicers from unwarranted legal suit by tranche holders, would be in the overall interests of the securitization markets and therefore the financing of mortgages or other forms of consumer credit.

D. Compensation.

The ANPR asks whether compensation -- of the loan originator, the securitization sponsor, the rating agencies, or the underwriter of the trust's paper, should be lengthened in duration and possibly capped, to avoid or reduce conflicts of interest. We are supporters of the notion of risk-based compensation when paying bank employees, in order to produce proper incentive for these employees not to take undue risk on behalf of the bank. However, in a securitization, the main credit risk associated with the deal is borne by the bank sponsor in the form of its first-dollar excess-spread (I/O) position. The holders of the mezzanine tranches, meanwhile, once given the proper information regarding the nature of the asset pool and the nature of legal waterfall, must decide whether the high spread offered to them is worth the risk associated with their mezzanine position. Again, so long as information flows freely between the bank sponsor and the mezzanine holder, we do not see a conflict of interest.

With respect to the senior tranches, in traditional securitizations, including private-label RMBS, the senior most tranche is very safe, is almost always AAA-rated, and has not suffered significant losses even in the context of the current crisis. This safety flows from the nature of the underlying traditional loan assets and the very large credit enhancement consisting of the first-dollar bank position plus the one or more second-dollar mezzanine positions. Nevertheless, senior tranche holders, should not solely rely on the rating but also should look through to the detail regarding the pool assets and the prior credit enhancements. Again, so long as information is available to appropriately assess risk, we don't see a conflict.

The underwriters of the tranches -- the firms that market the AAA-down-to-BBB or lower paper -- are now generally part of an integrated financial firm that includes the bank sponsor. As a result, and for the reasons discussed earlier, the underwriter-bank combination does indeed retain most of the risk of the underlying pool of assets and therefore operatives under proper incentives. In some minority of cases, a 3rd party underwriter may conduct a best-efforts underwriting. Requiring that such an underwriter take on credit risk would probably drive up the underwriting fees. And, in any event, underwriters cannot knowingly misrepresent the riskiness of a tranche or, in the long run, they will lose the confidence of the investors that look to them for fair-dealing and who constitute the buy-side of the underwriting process.

Only the rating agency, in our view, is subject to a potential conflict of interest -- in that failure to assign appropriately high ratings could cause the rating agency to lose future rating revenue (paid by the sponsor). Still, we believe this potential conflict is minimal, because rating agencies must continue to warrant the trust of investors or the rating agency's worth to sponsors is reduced. Spreading the compensation of the rating agency over a long period of time would not serve to reduce the potential conflict of interest unless, somehow, the rating agency were required to assume some of the credit risk associated with the securitization. But a future, realized loss on a tranche that turned out to be considerably higher than the expected loss reflected in the initial rating does NOT imply that the rating agency made a mistake in the rating. That is, financial results have a probability distribution associated with them, and a bad-tail outcome does not mean that the one-dimensional rating was wrong and that therefore the rating agency should be penalized -- the tail event can simply be the result of a "bad draw" of the macro-economic factor(s) driving realized default frequencies on the underlying pool assets.

In conclusion, we do not believe that resuscitation of the securitization markets and the meeting of public policy objectives rest importantly on altering the compensation schemes for securitization participants. Rather, we think that additional data disclosure coupled with additional measures of risk, more quickly updated measures of risk, and more prudent management decisions based on such risk measurements, can help investors from making the kinds of mistakes that led to the securitization bubble to begin with. As just one example, note that some bank trading desks invested in risky mezzanine tranches after either relying solely on the rating or on simple VaR models rather than stressed VaR models or other risk measurement processes. This shortcoming has been addressed in the new Basel II rules regarding securitization (although yet to be formalized within U.S. regulation). Meanwhile, non-bank investors have much greater concerns than whether the expected-loss focus of a rating is exactly correct. That is, macro-economic conditions are so tenuous for the foreseeable future that re-birth of the securitization markets may have to wait until there is proof of recovery. In this context, while we agree with the importance of the issues the FDIC's ANPR is trying to address, we respectfully suggest that the alteration of the Safe Harbor rule should await a) the findings of additional research on what kinds of additional measurements of securitization risk can truly help investors, and b) what kinds of securitization structural changes can pass the market test. Then, implementation of any changes in the FDIC rule should occur only after there is sufficient economic recovery.

## Appendix

**RMA Capital Working Group institutions participating in the preparation and/or review of this response[1]**

**Capital One**: Corey D. Sesin, Director, Corporate Treasury.
**Citigroup:** Fenton Aylmer, Director, Basel II Risk and Regulatory Oversight.
**HSBC North American Holdings:** Mary Ann Hageman, First Vice President, Credit Risk Management.
**KeyCorp:** Robert Kula, Executive Vice President; Tom Boltja, Senior Vice President - Director Economic Capital Management;Robert Levy, Vice President.
**M&T**: Rajas M. Gokhale, Senior Risk Analyst.
**PNC Financial Services Group:** Janis L. Tucker, Vice President.
**SunTrust:** Michael Fadil, Senior Vice Prsident.
**Union Bank of California:** Hans Helbekkmo, Senior Vice President, Enterprise Wide Risk; Desta Gebre-Medhin-Huff, Vice President, Basel II Commercial Credit and Basel II Program Support.
**US Bancorp:** Jacob J. Seljan Senior Vice President
**Risk Management Association:** Edward DeMarco, General Counsel; Suzanne I. Wharton, Associate Director, Strategic Learning and Research.
**Mingo & Co:** John Mingo, Managing Director.

[1] Individual institutions in the Capital Working Group may have opinions that differ from those expressed in this Response and, as well, individual institutions may be responding to the ANPR separately from this Response.