October 25, 2010

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 1-5
Washington, DC 20219
Docket Number OCC-2010-0016
RIN 1557-AD35

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Docket No. R-1391
RIN 7100-AD53

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
RIN 3064-AD62

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attention: OTS-2010-0027
RIN 1550-AC43

Re: Advance Notice of Proposed Rulemaking Regarding Alternatives to the Use of Credit Ratings in the Risk-Based Capital Guidelines of the Federal Banking Agencies

Ladies and Gentlemen:

The American Securitization Forum ("ASF")[1] appreciates the opportunity to provide these comments on the advance notice of proposed rulemaking ("ANPR") of the federal banking agencies ("Agencies") to modify their risk-based capital regulations to remove references to credit ratings and substitute other standards of creditworthiness, as mandated by Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[2]

[1] The American Securitization Forum is a broad-based professional forum through which participants in the U.S. 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. 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.

[2] 75 Fed. Reg. 52283 (Aug. 25, 2010). This letter focuses on the portion of the ANPR dealing with securitization exposures and is not intended to comment on other aspects of the ANPR.

Role of External Ratings Under the Current Risk-Based Capital Rules

The current risk-based capital rules for U.S. banking organizations consist of multiple approaches depending upon the type of banking organization, the type of exposure and whether the exposure is in the banking or trading book. In contrast to the risk-weighting methodology for non-securitization exposures, *all* of the current approaches for determining capital charges for securitization exposures in the banking book either require (in the case of banking organizations that are subject to the Agencies' Basel II rules) or permit (in the case of other banking organizations) external credit ratings to be used, when available, to assign an appropriate risk weight to the exposure.[3] Since most securitization exposures that banking organizations invest in are externally rated, external ratings are currently the main determinant of the risk-based capital charge for such exposures.[4] Accordingly, elimination of credit ratings from the Agencies' existing risk-based capital rules for securitization exposures will have far reaching effects on banking organization securitizations and on the securitization markets generally.

General Principles

At the outset, we wish to emphasize that we agree with the goal of reducing overreliance on credit ratings. Such reliance was a factor leading to the financial crisis, and we support sensible efforts to ensure that investors do not use credit ratings to the detriment of their own independent risk review and analyses of the asset-backed securities ("ABS") they purchase. However, we share many of the concerns expressed by members of the Agencies, both before and after enactment of the Dodd-Frank Act, as to the wisdom and feasibility of completely eliminating the use of credit ratings to assess capital charges at this time. We appreciate that the Agencies have issued the ANPR in response to a legislative mandate that they did not initiate, and we hope that in implementing Section 939A they will address the issues expressed in this letter. We acknowledge that devising alternatives to the use of credit ratings will be challenging and believe that neither the Agencies nor the industry would be well-served by replacing such ratings as a measure of creditworthiness with an inferior alternative. Accordingly, we look forward to a continuing dialogue with the Agencies on this subject.

We agree with the Agencies that the principles that should guide the selection of any measurement of creditworthiness ("Policy Objectives") are promoting risk management, adequately capturing the risks of particular exposures, providing for timely and accurate measurement of changes in creditworthiness and minimizing opportunities for regulatory

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[3] Under the Agencies' Basel II rules (and subject to certain conditions) risk weights range from 7% (for AAA-rated senior exposures with underlying granular pools) to 650% (for BB- - rated exposures). *See*, *e.g.*, 12 C.F.R. Part 3, Appendix C, Table 6. Under the Agencies' general risk-based capital rules (and subject to certain conditions), risk weights range from 20% for AAA-rated exposures to 200% for BB-rated exposures. *See*, *e.g.*, 12 C.F.R. Part 3, Appendix A, Table C.

[4] In addition, the Agencies' general risk-based capital rules and Basel II rules permit banking organizations to determine the risk-based capital charge for certain unrated exposures to asset-backed commercial paper programs by using internal models that are calibrated to external credit ratings (under the general rules) or using publicly available rating agency criteria (pursuant to the so-called internal assessment approach ("IAA") of the Basel II rules). *See*, *e.g.*, 12 C.F.R. Part 3, Appendix A, Section 4(g); 12 C.F.R. Part 3, Appendix C, Section 44.

arbitrage. We have formed the following "guiding principles" that we believe are well-aligned with the Policy Objectives and, accordingly, should be embodied in any alternative creditworthiness standards.

Any alternative should:

- promote understanding by banking organizations of the risks associated with their securitization exposures;
- focus on (i) actual performance of assets, which is the primary driver of the performance of an ABS, and (ii) the credit support available to a given risk position within an ABS structure after factoring in the assets' performance;
- function to facilitate dynamic and timely adjustment of capital in a manner that is consistent with and proportionate to changes in asset performance and the resulting risk profile of a given exposure; and
- be premised on data that is available to all market participants and should otherwise comport with standard market practices so that all participants have the option of performing the necessary calculations.

Although we agree with the Agencies that any alternative should not be overly complex and that results should be replicable across banking organizations, simplicity should not come at the expense of the factors set forth above. Recognizing that approaches that are appropriate for banking organizations with sophisticated internal systems and controls may not be appropriate for smaller, less sophisticated banking organizations, we believe that there should be room for diversity of alternatives based on the size and sophistication of the relevant banking organization. A key focus of all approaches should be to ensure that all banking organizations have sufficient information, and conduct sufficient diligence, to understand the risk of their exposures. Further, banking organizations should not be improperly motivated to make investment decisions based on capital charges that are not consistent with the actual risk of the investment.

We believe that, as an additional Policy Objective, it is critical that any creditworthiness standard not put U.S. banking organizations at a competitive disadvantage relative to their non-U.S. competitors who operate under the Basel II framework. As discussed above, under that framework, banking organizations must use external ratings to establish the capital charge for a securitization exposure if the exposure has an external rating or if one can be inferred. As further discussed below, and as demonstrated in Annex A to this letter, all of the alternative creditworthiness standards set forth in the ANPR (the "ANPR Alternatives") that the Agencies have described in enough detail to make comparisons possible (the "Quantifiable ANPR Alternatives") will result in risk weights that far exceed those under the Basel II framework, thereby subjecting U.S. banking organizations to significantly higher capital charges for securitization exposures than apply to non-U.S. banking organizations under that framework.

As further discussed below, we are concerned that by basing the calculation of capital charges for securitization exposures on risk-insensitive approaches, the Quantifiable ANPR Alternatives do not achieve, and could actually undermine, the Policy Objectives. Because they

disproportionately focus on structure and do not adjust to reflect expected asset performance, they would not adequately capture the risk of particular securitization exposures or provide for timely and accurate measurements of changes in creditworthiness. As a result, the Quantifiable ANPR Alternatives would undermine, rather than enhance, incentives for banking organizations to understand the risk of their ABS investments or exposures. We believe more risk-sensitive approaches are needed to avoid encouraging investment in higher risk assets. Punitive new capital charges resulting from risk-insensitive assessments will also result in U.S. banking organizations foregoing securitization as a funding technique, which will impede their ability to make new loans and decrease the availability of credit in the overall economy at a time when credit remains severely constrained. Further, they will discourage banking organizations from using securitization to manage credit risk and liquidity.

Use of Credit Ratings

Because credit ratings are so integrated into the current methodology for establishing risk-based capital charges for securitization positions, an abrupt change from credit rating-based capital charges could be extremely disruptive to banking organizations and to the capital markets generally, and runs a high risk of unintended consequences. For example, elimination of credit ratings from the risk-based capital rules could have a significant impact on liquidity in the ABS markets which rely upon the ability of investors to make real-time decisions at the point of initial offering or subsequent secondary market purchase. While many non-money center banking organizations have the capacity to understand the basis for credit ratings and to perform their own supplemental diligence at that time, they may not have the capacity to perform more extensive real-time analysis. Accordingly, removing credit ratings from the risk-based capital rules may eliminate the ability of a large number of banking organizations to participate in the ABS markets, substantially reducing market liquidity. This could lead to a decline in market values, forced selling, and reduced credit in the overall economy.

Despite recent criticism of rating agencies, credit ratings continue to provide objective third-party assessments of ABS that are transparent and easily replicable and that banking organizations should be able to use, together with other analysis, in determining the capital charge that will result from an ABS position.[5] The numerous rating agency reforms contained in the Dodd-Frank Act and in SEC regulations, together with those taking place internationally, will continue to improve the ratings process.[6] Rating agencies have also voluntarily taken significant

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[5] It is therefore not surprising that the Federal Reserve continues to use credit ratings as a criteria for accepting ABS and other structured finance products at its discount window and used credit ratings as a criteria for ABS to be eligible for loans under its Term Asset-Backed Securities Loan Facility ("TALF"). See Discount Window and Payment System Risk Collateral Margins Table, *available at* http://www.frbdiscountwindow.org/discountmargins.xls (discount window) and Term Asset-Backed Securities Loan Facility: Terms and Conditions, *available at* http://www.ny.frb.org/markets/talf_terms.html.

[6] The Dodd-Frank Act provides the SEC with greater enforcement and examination authority over rating agencies by, among other things, creating an Office of Credit Ratings ("OCR") within the SEC to promote rating agency accuracy and independence. The OCR will have the power to administer SEC rules with respect to rating agency practices, conduct annual examinations of the rating agencies, and impose fines and other penalties for violations of SEC rules. The Dodd-Frank Act also requires the rating agencies to make extensive disclosures regarding their ratings methodologies and the data relied upon to determine their ratings, as well as information that can be used by investors to better understand credit ratings of each class. Further, by repealing the SEC's Rule 436(g), the Dodd-

steps to improve such process, particularly for ABS.[7] We believe that all of these factors argue against eliminating credit ratings as a creditworthiness standard without an alternative that is both practical and achieves the Policy Objectives.

Despite past issues with credit ratings, there is a broad consensus among policymakers, both in the United States and abroad, that the best way to address those issues is to regulate, rather than prohibit, the use of credit ratings for capital and other regulatory purposes and to improve the regulation and supervision of the credit rating agencies themselves.[8]

As Acting Comptroller of the Currency John Walsh recently testified:

> the prohibition against references to ratings in regulations under section 939A goes further than is reasonably necessary to respond to these issues. Rather than disregard credit ratings, it may be more appropriate to assess their strengths and weaknesses and to supplement ratings with additional analysis in appropriate cases. We suggest that section 939A be amended to direct regulators to require that ratings-based determinations be confirmed by additional risk analysis in circumstances where ratings are likely to present an incomplete picture of the risks presented to an institution, or where those risks are heightened due to concentrations in particular asset classes.[9]

Internationally, regulators continue to permit the use of credit ratings for capital and other regulatory purposes, but have imposed additional requirements on their use and increased credit rating agency regulation. For example, the new Article 122A(a)(4) of the EU Capital Requirements Directive (which implements Basel II in the EU) requires banking organizations to perform their own stress tests appropriate for securitization positions, but provides that they may rely upon models developed by the credit rating agencies if they can demonstrate, when

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Frank Act introduces the possibility of exposing the rating agencies to liability as experts with respect to ratings disclosed in prospectuses. Separate and apart from the Dodd-Frank Act, the SEC has issued Rule 17g-5, which requires issuers of structured finance products to provide other interested rating agencies with access to the information they give to the rating agencies hired to rate their product. Steps undertaken in the European Union include mandatory registration of all credit rating agencies and the adoption of a comprehensive set of regulations aimed at ensuring the quality and transparency of ratings and prohibiting rating agency conflicts of interest. The European Commission has also proposed the introduction of centralized oversight of the rating agencies under the new European Securities and Markets Authority (which would have the power to request information, conduct investigations and perform on-site examinations) and a rule similar to the SEC's Rule 17g-5 that would require disclosure to other interested rating agencies of the information given to a rating agency hired to rate a structured finance product.

[7] *See* International Monetary Fund, The Uses and Abuses of Sovereign Credit Ratings, Global Financial Stability Report, chapter 3 (Oct. 2010), *available at* http://www.imf.org/External/Pubs/FT/GFSR/2010/02/pdf/chap3.pdf ("IMF Report").

[8] IMF Report, pg 9.

[9] *See* Testimony of John Walsh, Acting Comptroller of the Currency, before the Committee on Banking, Housing and Urban Affairs, United States Senate (Sept 20, 2010), Attachment A, pp 2-3 *available at* http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Testimony&Hearing_ID=45d8ba0b-04b1-41d6-b5b5-2008c0ce72d9&Witness_ID=b6b6249a-799f-44e7-aecd-2fe30fa9b172.

requested, that they took due care prior to investing to validate the relevant models and to understand their methodology, assumptions and results.[10] The rest of the EU Capital Requirements Directive likewise continues to implement Basel II with extensive use of credit ratings from the rating agencies. The Basel Committee's June 2010 revisions to its market risk framework[11] continue to permit banking organizations to use credit ratings, as does its July 2009 paper on increased risk weights for resecuritization exposures[12] (which also adds additional requirements to ensure appropriate diligence in connection with their use). The Basel Committee's Basel III proposals also reference credit ratings, although they indicate that the Basel Committee is undertaking a review of the Basel II framework for securitization exposures which may result in revised capital charges and a reconsideration of the requirement to use credit ratings where a credit rating exists.[13] Also under consideration is a requirement for credit rating agencies to comply with the requirements of the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies[14] in order for their ratings to be used for Basel II purposes.[15]

ASF Recommendations

Given the above considerations, ASF believes that the Agencies should consider a regulatory framework that permits the use of two different approaches for establishing capital charges for securitizations exposures: a "general approach" that would set capital charges based on third-party inputs and, for banks that have more sophisticated credit risk evaluation capabilities, an "advanced approach" that would allow such organizations to use their own internal systems to establish capital requirements for such exposures. Under both approaches, banking organizations would classify securitization exposures into risk categories which would be mapped to appropriate risk weight percentages. Actual risk weights for each risk category may vary between the general and advanced approaches described below.

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[10] Committee of European Banking Supervisors, Consolation Paper on Guidelines to Article 122a of the Capital Requirements Directive (CP 40), para. 4 at pg 28 (July 1, 2010), *available at* http://www.c-ebs.org/documents/Publications/Consultation-papers/2010/CP40/CP40.aspx. A similar approach has been suggested by others. *See*, *e.g*., Richardson and White, "Fixing the Rating Agencies," *available at* http://whitepapers.stern.nyu.edu/summaries/ch03.html (urging that, following the removal of credit ratings from statutes and regulations, "regulated financial institutions [should] be free to take advice from sources they considered most reliable" but should have to be able to justify the choice to their regulators).

[11] Basel Committee on Banking Supervision, Changes to the Revisions to the Basel II Market Risk Framework (June 18, 2010), *available at* http://www.bis.org/press/p100618/annex.pdf and Revisions to the Basel II Market Risk Framework (July 13, 2009), *available at* http://www.bis.org/publ/bcbs158.pdf.

[12] Basel Committee on Banking Supervision, Enhancements to the Basel II Framework (July 13, 2009), *available at* http://www.bis.org/publ/bcbs159.htm.

[13] Basel Committee on Banking Supervision, Strengthening the Resilience of the Banking Sector, Consultative Document, para 198 at pg 59 (Dec. 2009), *available at* http://www.bis.org/publ/bcbs164.pdf?noframes=1; Basel Committee on Banking Supervision, International Framework for Liquidity Risk Measurement, Standards and Monitoring (Dec. 17, 2009), *available at* http://www.bis.org/publ/bcbs165.pdf. *See also*, Basel Committee on Banking Supervision, The Basel Committee's response to the financial crisis: report to the G20, pg 13 (Oct. 2010) *available at* http://www.bis.org/publ/bcbs179.pdf.

[14] International Organization of Securities Commissions (IOSCO), Code of Conduct Fundamentals for Credit Rating Agencies (May 2008), *available at* http://iosco.org/.

[15] IMF Report, pg 9.

General Approach

Under the general approach, a banking organization would, subject to appropriate due diligence requirements and Agency supervision, be permitted to use inputs derived from or provided by a third party (which could include credit rating agencies) to calculate capital charges for securitization exposures (whether rated or unrated). Such inputs could include expected loss, the level of credit enhancement (whether provided by structural features or the price at which the assets were purchased) and other structural elements which affect the overall risk profile of the exposure. Banking organizations would then map such inputs to a risk category which would be used to determine the risk-based capital charge.

It is important to note that this is not a replication of a ratings-based approach; rather, inputs provided or derived from third parties would form the basis of the assignment to a risk category, and these inputs could be sourced from a variety of third parties. While Section 939A of the Dodd-Frank Act requires the Agencies to remove references to rating agencies in their regulations, we do not read it as prohibiting the Agencies from allowing banking organizations to use properly supplemented third-party inputs to establish capital charges.

The Agencies already have in place safety and soundness standards that banking organizations are required to follow before they invest in ABS and other complex instruments or otherwise assume exposure to securitizations.[16] Such standards require banking organizations to conduct appropriate diligence and to be able to demonstrate an adequate understanding of the securitization exposures they invest in or otherwise assume. To the extent appropriate, such standards could be enhanced to ensure that banking organizations conduct proper diligence to understand the applicable third-party inputs. Banking organizations that are not able to demonstrate that they have complied with such standards could be subjected to higher capital charges.

Advanced Approach

ASF believes that the soundest alternative for many banking organizations, and the one most consistent with the objectives of Section 939A and with the Policy Objectives, would be to allow such organizations to use their own internal systems, subject to Agency approval, oversight and supervision, to assign securitization exposures (whether rated or unrated) to defined risk categories. These categories would be mapped to risk weight percentages that are consistent with international standards for assets with similar risk characteristics. We believe that this consistency is critical to maintaining a competitive landscape between U.S. and foreign banking organizations. Enhancements to risk management systems and controls resulting from Basel II and the Agencies' Supervisory Capital Assessment Program ("SCAP"),[17] along with the new requirement in Title I of the Dodd-Frank Act that the Federal Reserve Board, in coordination with the Agencies, perform annual stress tests on systemic banking organizations,[18]

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[16] *See*, *e.g.,* Supervisory Policy Statement on Investment Securities and End-User Derivatives Activities, 63 Fed. Reg. 20191 (May 26, 1998); OCC Bulletin 2009-15.

[17] *See* Federal Reserve Board, Supervisory Capital Assessment Program Design and Implementation (Apr. 24, 2009), *available at* http://www.federalreserve.gov/bankinforeg/bcreg20090424a1.pdf.

[18] Dodd-Frank Act, Section 165(i).

all suggest that this should be a viable approach for many institutions and that consistency of results among institutions (a possible issue when internal systems are used) should be addressable. Such an approach would enable banking organizations to model exposures more extensively and would lead to capital charges that better differentiate risk based on differing structures and underlying exposures. It would also provide the Agencies with a better understanding of how similar risk exposures are being assessed across multiple banking organizations, thereby leading to greater transparency with respect to the adequacy of each organization's systems and controls. Such approach could also lessen systemic risk that can result when all banking organizations use identical, simple models for assessing capital (*i.e.,* risk that all such organizations act in the same manner at the same time with respect to such exposures).

A banking organization's internal assessment of its securitization exposures should consider expected losses on the underlying assets according to its own cash flow analyses, amount and type of credit enhancement, seller/servicer risk analysis, priority of exposure in the cash flow waterfall, and other financial and structural parameters.

Banking organizations using the Advanced Approach could be required to meet certain predefined criteria including that (i) the use be based on a foundation of generally accepted credit risk evaluation metrics, (ii) internal assessments used for purposes of determining capital requirements not differ from assessments used in the organization's risk management process, and (iii) assessments be subject to periodic reevaluation. The Agencies would be able to review the underlying models with a view to assuring the transparency and consistency of the resulting capital charges across banking organizations. In addition, banking organizations that are unable to demonstrate that they have adequately complied with these criteria on a consistent basis could be required to use the general approach.

The ANPR Alternatives

Since November 29, 2001 (the date of the adoption by the Agencies of their so-called "Recourse Rule" for securitization exposures[19]), all U.S. banking organizations have been eligible to use the external ratings-based approach for securitization exposures. That approach was adopted to address the failure of the Agencies' then-existing Basel I Rules, which did not foster prudent risk management, to adequately take account of the different risks presented by various positions in a securitization.

Subsequent changes to the U.S. risk-based capital rules, including the adoption of the Advanced Internal Ratings Based Approach of the Basel II framework for certain banking organizations[20] and the proposal to adopt the Basel II's standardized approach as an option for others, have all been aimed at increasing the risk-sensitivity of the capital rules to better align capital charges with potential economic loss and encourage improvements in risk management.

[19] 66 Fed. Reg. 59617 (Nov. 29, 2001).

[20] 72 Fed. Reg. 69287 (Dec. 7, 2007).

In the ANPR, the Agencies propose a number of alternatives to the use of ratings to establish the risk-based capital charges for securitization exposures. These include (i) a pre-Recourse Rule approach under which all securitization exposures in a transaction would receive the same risk-weight (the "one-size-fits-all approach"); (ii) simple and more complex "gross-up approaches" under which banking organizations would maintain capital based on the securitization position and more senior securitization positions based on the risk-weight of the underlying assets (and, in the case of the more complex gross-up approach, the transaction's overcollateralization ratio, interest coverage and waterfall priority); (iii) a special rule for the most senior exposure, which would base capital charges on the underlying exposure type and the aggregate amount of subordination that provides credit enhancement for the exposure; (iv) the use of a "concentration ratio" to set the capital charge;[21] and (v) a simplified Supervisory Formula Approach ("SSFA") that uses specific inputs, including the capital requirements for the underlying exposures, to set the capital charge but fewer inputs than under the Supervisory Formula Approach in the Agencies' Basel II capital rules.

Because all of the Quantifiable ANPR Proposals are largely capital structure-based, they represent, to differing degrees, a return to the risk-insensitive Basel I/pre-Recourse Rule approach (*i.e.,* the same or similar capital charge for higher and lower risk exposures) that does not encourage banks to fully understand the risks involved in their securitization exposures. Similarly, they do not meet the Policy Objectives of appropriately distinguishing credit risk exposures within asset classes, providing for timely and accurate measurements in credit quality and fostering prudent risk management. As demonstrated in Annex A to this letter, all of the Quantifiable ANPR Alternatives would result in capital charges well in excess of what would be required under the Recourse Rules and the Basel II Advanced Internal Ratings Based Approach, and, if adopted, would place U.S. banking organizations at a significant competitive disadvantage relative to their non-U.S. competitors.

The impact of this increase and disadvantage will be significantly magnified due to:

- changes in GAAP accounting rules (FAS 166 and 167) that bring onto the balance sheet most securitizations and therefore result in more securitization positions being subject to risk-weighting;

- the Banking Agencies' December 2009 amendments to their risk-based capital rules relating to FAS 166 and 167, which require banking organizations to retain risk-based capital against all on-balance-sheet securitization exposures regardless of the amount of risk they have transferred through the securitization;[22]

- increased capital requirements that could result from systemic regulation under Title I of the Dodd-Frank Act, and from implementation of Basel III, which will require

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[21] The "concentration ratio" would be equal to the sum of the notional amounts of all tranches divided by the sum of the notional amounts of the tranches junior to or *pari passu* with the tranche in which the position is held, including the tranche itself.

[22] 75 Fed. Reg. 4635 (Jan. 28, 2010).

substantially more (and higher quality) capital per dollar of risk-weighted exposure;[23] and

- the risk-retention requirements in the final Safe Harbor Rule for Securitizations recently adopted by the Federal Deposit Insurance Corporation and in the Dodd-Frank Act, which will result in banking organizations having to retain some exposure, which will be subject to a capital charge, in connection with most securitizations.[24]

As an additional proposal, the Agencies propose the SSFA, which is a simplified version of the current Supervisory Formula Approach ("SFA") for unrated securitization exposures in the Agencies' current Basel II rules. The Agencies have not detailed what exposure-specific inputs they intend to require or how the SSFA would be adjusted to compensate for reduced inputs, making such proposal difficult to evaluate. However, given that many of the current informational inputs in the SFA may not be generally available and given the SFA's requirement to segment assets into homogenous risk pools, there are substantial questions as to whether an SSFA would be a viable approach for many securitization exposures, especially for banking organizations that are investing in, rather than originating, such exposures and therefore have more limited ability to access and model information. The current SFA also puts severe limitations on the ability to invest in wholesale assets with a maturity greater than a year. Further, given the SFA's complexity, it lacks transparency and therefore could significantly reduce primary and secondary market liquidity for ABS compared to the current ratings-based approach and other alternatives. However, despite the SFA's limitations, an SSFA could nonetheless provide a useful alternative for some banking organizations for certain securitization exposures, provided its inputs are appropriately adjusted to permit the use of market-based data of the type generally available to investors with flexibility on the number of years of historical information and the applicable formula is further calibrated to result in a smoother relationship between capital requirements and risk. In order to counter its rigidity, banking organizations would also likely have to be given the flexibility to make their own adjustments to the SSFA formula, subject to supervisory review. As noted above, with material modifications, SFA may be a viable alternative for sophisticated banks and some segments of the securitization market.

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[23] Dodd-Frank Act, Section 165(b); Basel Committee on Banking Supervision, Strengthening the Resilience of the Banking Sector, Consultative Document (Dec. 2009), *available at* http://www.bis.org/publ/bcbs164.pdf?noframes=1; Basel Committee on Banking Supervision, International Framework for Liquidity Risk Measurement, Standards and Monitoring (Dec. 17, 2009), *available at* http://www.bis.org/publ/bcbs165.pdf; Basel Committee on Banking Supervision, The Group of Governors and Heads of Supervision reach broad agreement on Basel Committee capital and liquidity reform package (July 26, 2010), *available at* http://www.bis.org/press/p100726.htm; Basel Committee on Banking Supervision, Group of Governors and Heads of Supervision announces higher global minimum capital standards (Sept. 12, 2010) , *available at* http://www.bis.org/press/p100912.htm.

[24] 75 Fed. Reg. 60287 (Sept. 30, 2010).

Conclusion

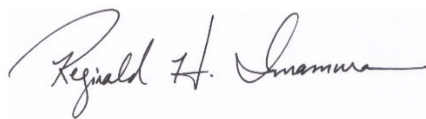
ASF understands the complexity of finding an alternative to the use of credit ratings in the Agencies' current capital regulations, both in terms of the need to engineer a methodology with appropriate sensitivities and in terms of the consequences for the banking industry nationally and internationally. We believe that neither the Agencies nor the industry would be well served by any solution that has not been carefully considered.

As indicated above, ASF believes that banking organizations should have the choice of using one of two different approaches for establishing capital charges for securitization exposures: a "general approach," which would set capital charges based on third-party inputs and, for banking organizations with more sophisticated risk evaluation capabilities, an "advanced approach," which would allow such organizations to use their own internal systems to establish capital requirements for securitization exposures.

Given the extent to which credit ratings are integrated into the current framework, in adopting the above approaches (or any other approach), we believe that it is critical that there be adequate phase-in periods and grandfathering to avoid abrupt and potentially destabilizing changes in capital requirements and to provide banking organizations the necessary time to make system changes (and avoid the need for such changes to be made more than once). In addition, we believe that the Agencies should consider a delayed effective date to permit systems and other changes that may be required by the revised risk-based capital rules.

We thank you very much for this opportunity to comment on the ANPR. If you have any questions about this comment letter, please contact Tom Deutsch, ASF Executive Director, at 212.412.7107 or at tdeutsch@americansecuritization.com, or Daniel M. Rossner, of Sidley Austin LLP, who served as ASF's counsel in the preparation of this letter, at 212.839.5533 or at drossner@sidley.com.

Sincerely,



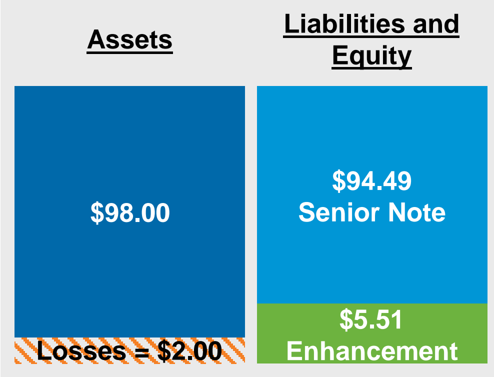
Reginald H. Imamura
ASF Ratings Alternatives Task Force Chair &
Executive Vice President, PNC

Tom Deutsch
Executive Director
American Securitization Forum

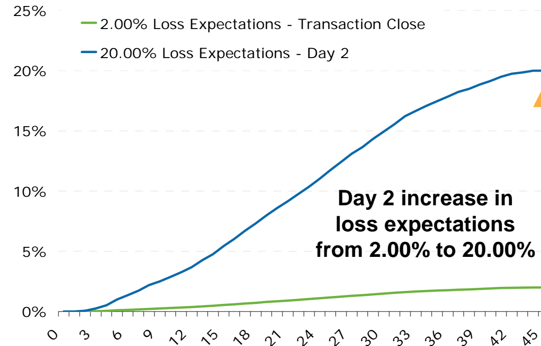
Annex A

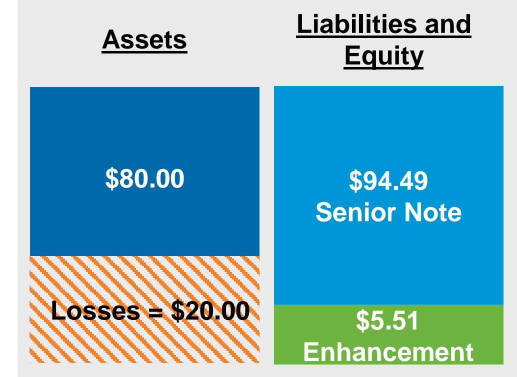
Risk Sensitivity - Term Securitization Exposure - Regulatory Capital Example[1]

- The Quantifiable ANPR Alternatives are capital structure-based approaches and do not contemplate asset-level performance
- Quantifiable ANPR Alternatives are not risk-sensitive, resulting in regulatory capital that does not adequately reflect the risk position of securitization exposures
  - In instances of low expected losses, Quantifiable ANPR Alternatives require <u>excessive</u> capital, putting U.S. banks at a competitive disadvantage
  - In instances of high expected losses, Quantifiable ANPR Alternatives may require <u>insufficient</u> capital, potentially resulting in Senior Note losses that exceed regulatory capital



Expected loss on Senior Note = $0.00





Expected loss on Senior Note = $9.70[2]

2.00% Expected Loss Scenario[3]:

Methodology	Reg Cap %	Reg Cap $
ANPR		
One-Size-Fits-All	8.00%	$7.56
Gross Up	8.00%	$7.56
Concentration Ratio	8.00%	$7.56
RBA		
Basel I	1.60%	$1.51
Basel II	0.56%	$0.53

Regulatory capital under the Quantifiable ANPR Alternatives does not change with loss expectations and may be insufficient to cover the expected loss on the Senior Note

Regulatory capital under the RBA is risk-sensitive and changes directionally with asset-level loss expectations

20.00% Expected Loss Scenario[4]:

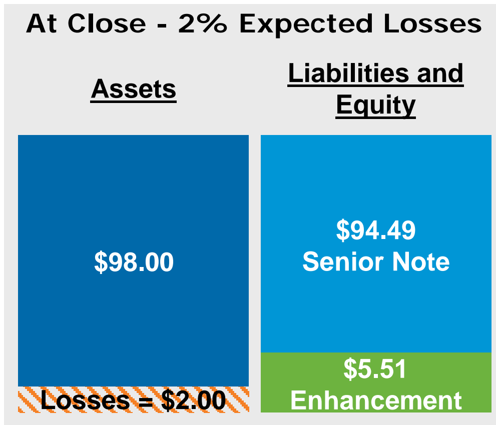
Methodology	Reg Cap %	Reg Cap $
ANPR		
One-Size-Fits-All	8.00%	$7.56
Gross Up	8.00%	$7.56
Concentration Ratio	8.00%	$7.56
RBA		
Basel I	100.00%	$94.49
Basel II	100.00%	$94.49

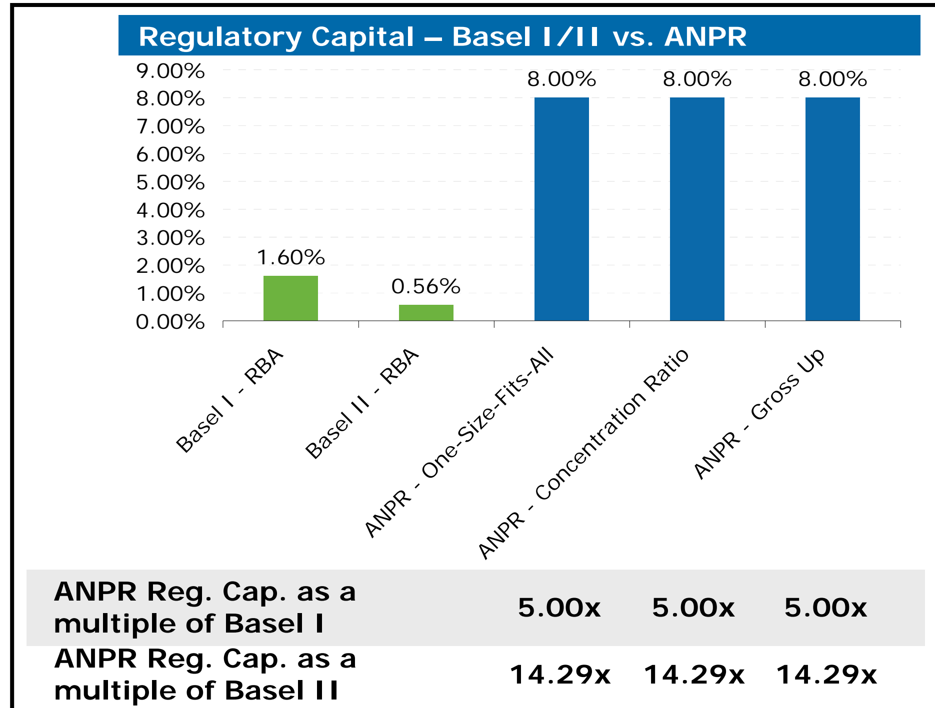
[1] Capital structure based upon public term securitization exposure originated in 2006. Expected losses on assets/Senior Note derived from cash flow model run using publically available information
[2] Expected loss on Senior Note is less than the difference between asset losses and Senior Note credit enhancement due to the benefit of excess spread
[3] Scenario assumes loss expectations of 2.00% at close, that the Senior Note is rated AAA and has a granular pool. 20% and 7% risk weights assumed for Basel I and Basel II, respectively. Assumes exposure not held in an ABCP conduit
[4] Scenario assumes loss expectations of 20.00% at day 2, that the Senior Note is unrated and has a granular pool. 1250% and 1250% risk weights assumed for Basel I and Basel II, respectively. Assumes exposure not held in an ABCP conduit

Annex A

Competitive Issues - Term Securitization Exposure - Regulatory Capital Example[1]

- The Quantifiable ANPR Alternatives will put U.S. banks at a competitive disadvantage to foreign competitors as risk weights under the Quantifiable ANPR Alternatives are generally higher than those required under Basel I/II
- For senior, AAA-rated tranches of securitization exposures, regulatory capital under the Quantifiable ANPR Alternatives would be 5.00x and 14.29x the regulatory capital required under Basel I and Basel II methodologies, respectively
  - The Quantifiable ANPR Alternatives have a regulatory capital floor of 8.00%
  - Basel II methodologies allow for regulatory capital of as low as 0.56%
  - Basel I methodologies allow for regulatory capital of as low as 1.60%
- Difference in regulatory capital is more pronounced in non-senior tranches (see detailed example on the following slide)





ANPR Reg. Cap. as a multiple of Basel I	5.00x	5.00x	5.00x
ANPR Reg. Cap. as a multiple of Basel II	14.29x	14.29x	14.29x

[1] Capital structure based upon public term securitization exposure originated in 2006. Expected losses on assets/Senior Note derived from cash flow model run using publically available information

Annex A

Detailed Securitization Exposure Regulatory Capital Example

Regulatory Capital (%)

Class	Rating	Amount ($MM)	ANPR			RBA	
			One-Size-Fits-All	Concentration	Gross-Up	Basel I	Basel II
A	AAA	$2,765.560	8.00%	8.00%	8.00%	1.60%	0.56%
B	A+	$87.333	8.00%	100.00%	100.00%	4.00%	1.44%
C	BBB+	$58.222	8.00%	100.00%	100.00%	8.00%	4.00%
D	BB	$58.000	8.00%	100.00%	100.00%	16.00%	34.00%

Regulatory Capital ($MM)

Class	Rating	Amount	ANPR			RBA	
			One-Size-Fits-All	Concentration	Gross-Up	Basel I	Basel II
A	AAA	$2,765.560	$221.24	$221.24	$221.24	$44.25	$15.49
B	A+	$87.333	$6.99	$87.33	$87.33	$3.49	$1.26
C	BBB+	$58.222	$4.66	$58.22	$58.22	$4.66	$2.33
D	BB	$58.000	$4.64	$58.00	$58.00	$9.28	$19.72