



October 22, 2012

VIA ELECTRONIC FILING – www.regulations.gov

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Re: Basel III Proposal; Standardized Approach Proposal; and Advanced Approaches and Market Risk Proposal¹

Ladies and Gentlemen:

The Commercial Real Estate Finance Council (the “**CRE Finance Council**”) appreciates the opportunity to submit this response to the above-referenced joint notices of proposed rulemaking issued by the Board of Governors of the Federal Reserve System (the “**Board**”), the Federal Deposit Insurance Corporation (the “**FDIC**”) and the Office of the Comptroller of the Currency (the “**OCC**”, and together with the Board and the FDIC, the “**Agencies**”), which together propose to revise the risk-based capital and leverage standards in the United States to

¹ As used herein, “**Basel III Proposal**” means the joint notice of the Agencies titled “Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action”, 77 Fed. Reg. 52,792 (Aug. 30, 2012); “**Standardized Approach Proposal**” means the joint notice of the Agencies titled “Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements”, 77 Fed. Reg. 52,888 (Aug. 30, 2012); and “**Advanced Approaches and Market Risk Proposal**” means the joint notice of the Agencies titled “Regulatory Capital Rules: Advanced Approaches Risk-based Capital Rule; Market Risk Capital Rule”, 77 Fed. Reg. 52,978 (Aug. 30, 2012). The Basel III Proposal, Standardized Approach Proposal and Advanced Approaches and Market Risk Proposal together are referred to as the “**Proposed Rules**.” The respective rule identifiers for (i) the Basel III Proposal are OCC Docket ID OCC-2012-0008 (OCC); Docket No. R-1430; RIN No. 7100-AD87 (Board); and FDIC RIN 3064-AD95 (FDIC); (ii) the Standardized Approach Proposal are OCC Docket ID OCC-2012-0009 (OCC); Docket No. R-1442; RIN No. 7100 AD87 (Board); and FDIC RIN 3064-AD 96; and (iii) the Advanced Approaches and Market Risk Proposal are OCC Docket Number OCC-2012-0010; Docket No. R-1442; RIN 7100 AD-87 (Board); and FDIC RIN 3064-D97.

reflect the global accord reached by the Basel Committee on Banking Supervision (“BCBS”) under the Basel Framework² and certain aspects of the Wall Street Reform and Consumer Protection Act of 2010 (the “**Dodd-Frank Act**”). Concurrently with the release of the Proposed Rules, the Agencies issued a final rule (the “**Market Risk Capital Rules**”), which requires banking organizations³ that satisfy one of the applicable thresholds to adjust their risk-based capital ratios to reflect market and other risks arising in connection with their trading activities. Our comments primarily pertain to various provisions of the Proposed Rules that affect the capital treatment or risk-weighting of commercial real estate (“**CRE**”) loans, commercial mortgage-backed securities (“**CMBS**”) and commercial mortgage servicing assets.⁴

The CRE Finance Council is the collective voice of the entire \$3.1 trillion commercial real estate finance market, including portfolio, multifamily, and CMBS lenders; issuers of CMBS; loan and bond investors such as insurance companies and pension funds; servicers; rating agencies; accounting firms; law firms; and other service providers. Our principal missions include setting market standards, facilitating market information, and providing education at all levels, including securitization, which has been a crucial and necessary tool for growth and success in CRE finance. Because our membership consists of all constituencies across the entire CRE finance market, the CRE Finance Council has been able to develop comprehensive responses to policy questions that promote increased market efficiency and investor confidence.

Our principal functions include setting market standards, facilitating the free and open flow of market information, and education at all levels, particularly related to securitization. Securitization is one of the essential processes for the delivery of capital necessary for the growth and success of commercial real estate markets. One of our core missions is to foster the efficient and sustainable operation of CMBS. To this end, we have worked closely with policymakers to educate and inform legislative and regulatory actions to produce efficient and practical regulatory structures. We look forward to continuing to work with policymakers on this effort. We also continue our ongoing work with all market constituencies to develop industry standards which provide marked improvements in the CRE finance arena.

² As used herein, “**Basel Framework**” generally refers to the risk-based capital and leverage requirements, including those that would apply to advanced approaches banking organizations, articulated under *Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems* (“**Basel III**”), as well as certain aspects of the agreement of the BCBS entitled *International Convergence of Capital Measurement and Capital Standards: A Revised Framework* and subsequent amendments and consultative papers (“**Basel II**”).

³ As used herein, the term “**banking organizations**” generally means all banking entities subject to minimum capital requirements under the Proposed Rules, as referred to in the preamble to the Basel III Proposal. The term “**advanced approaches banking organizations**” is intended to refer to those banking organizations that meet one of the relevant required thresholds under the advanced approaches rules or have opted-in and been approved to apply the advanced approaches framework.

⁴ We are not commenting on the proposed treatment of other commercial real estate assets, such as one-to-four family residential pre-sold construction loans, “statutory” multifamily residential loans, mortgage pass-through securities sponsored by the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation (the “**government-sponsored enterprises**” or the “**GSEs**”) or exposures to the U.S. federal government, including Government National Mortgage Association-sponsored pass-through securities.

I. Overview

The CRE Finance Council commends the Agencies for their considered efforts in undertaking the enormous task of proposing regulations that reflect the Basel Framework and applicable U.S. law. A properly and responsibly implemented Basel Framework in the United States and worldwide will serve to improve financial market stability, and ensure that banks are less susceptible to excessive risk-taking, and better able to absorb economic shock. We appreciate the Agencies' care and attention in constructing a more integrated capital adequacy framework that fits within the international compact while addressing U.S.-specific concerns, both under the Dodd-Frank Act and as a policy matter. We, like others, want to ensure that the regulations benefit the banking system without unnecessarily and unduly harming segments of the financial markets, particularly those supported by community banking organizations and their business partners. Ill-conceived or overly rigorous capital, leverage and operational requirements will limit the participation of banking organizations, particularly smaller regional and community banking organizations, in the credit markets, including the commercial real estate finance markets. Any unnecessary disruption in the availability of valuable sources of affordable credit for consumers and businesses may have unintentional consequences that harm the CRE markets. An overwhelming negative impact on regional and community banking organizations may harm overall industry health, which will affect all banking organizations, large and small, and the broader U.S. economy.

While we generally support the aims of the Agencies, certain aspects of the Proposed Rules would disproportionately harm the commercial real estate finance markets generally and relative to other credit markets, and potentially overwhelm certain segments of CRE lending, including community bank lending. As the Agencies have recognized, stable and functioning commercial real estate bank funding is vital to the financing, development and construction of office, retail, multifamily and other commercial property nationwide.⁵ Disruption in the CRE credit markets could have harmful short-term effects and may set back real estate development over an extended period.

We generally support the achievement of maximum harmonization across countries, however care must be taken by the Agencies in strictly implementing those aspects of the Basel Framework that may disproportionately disadvantage certain financial markets as the result of individual sovereign differences and other factors. While we acknowledge the overall benefits of a unified global banking framework that more closely reflects the interconnectedness of banking systems, limited flexibility is undoubtedly permissible, and in some cases desirable. As the Agencies have previously recognized,⁶ customizing aspects of the Basel Framework in crafting U.S. banking regulations to account for local concerns is appropriate. Similarly, banking

⁵ See, e.g., *Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices*, 71 Fed. Reg. 74,580 (Dec. 12, 2006), as augmented by statements and supervisory guidance issued thereafter (collectively, the “**Agency Guidance**”).

⁶ See, e.g., *Risk-Based Capital Guidelines; Capital Adequacy Guidelines: Standardized Framework*, 73 Fed. Reg. 43,982, at 43,985 (July 29, 2008) (the “**2008 Standardized Framework Proposal**”) (“This NPR, however, diverges from the [Basel II] Accord where the U.S. markets have unique characteristics and risk profiles, notably the proposal for risk weighting residential mortgage exposures.”). The 2008 Standardized Framework Proposal was never implemented.

supervisors must take additional care in considering and implementing those provisions of the Basel Framework that are expressly reserved for individual sovereign discretion.

II. Summary of Recommendations

The CRE Finance Council endorses the application of stronger capital and leverage requirements, which we agree will increase long-term stability within the banking system and stabilize the broader economy. We support rules that enhance the quantity and quality of capital, while improving risk sensitivity in assigning risk weights to a banking organization's assets. If implemented in their present form, however, the Proposed Rules would disrupt the way banking organizations lend to CRE borrowers and sell to, sponsor or invest in CMBS securitizations. In addition, elements of the Proposed Rules will limit the ability of banking organizations from acting as mortgage loan servicers under existing and future CMBS securitization transactions. While non-bank commercial mortgage servicers do exist, the proposed changes could harm CMBS investors and other participants in the commercial real estate markets by limiting the ability of banking organizations to facilitate commercial real estate financing transactions.⁷

We believe that, with the modifications proposed in this letter, the risk-based and leverage requirements implemented in the United States will better serve to reinforce the safety and soundness of banking organizations and strengthen the global banking system, without unduly disrupting critical segments of U.S. credit markets, in particular the CRE finance markets.

More specifically, we recommend that the Agencies revise the Proposed Rules with respect to the following matters:

- We urge the Agencies to modify the definition of mortgage servicing assets (“**MSAs**”) to distinguish residential MSAs from commercial MSAs, and for commercial MSAs to continue to be subject in substance to the risk-weighting and deduction methodology under the current general risk-based capital rules⁸ (with some modification to give effect to certain Basel III-related changes).
- The Agencies should eliminate application of higher risk-weights for high-volatility commercial real estate (“**HVCRE**”) exposures from the standardized approach rules and apply a standard 100% risk-weight across commercial real estate assets in a manner consistent with the general risk-based capital rules currently in effect. In the alternative, if the Agencies determine to retain the definition of HVCRE under the standardized approach, the risk weighting rules governing commercial mortgage exposures should be re-balanced by proposing a lower risk weight for certain high quality commercial mortgage loans.

⁷ In addition to the recommendations set forth in this letter, CRE Finance Council endorses the recommendations made in the letters anticipated to be submitted by the following organizations: Real Estate Roundtable, National Association of Real Estate Investment Trusts, National Multi Housing Council and Mortgage Bankers Association.

⁸ The term “**general risk-based capital rules**” is intended to refer to 12 C.F.R. part 3, appendix A, 12 C.F.R. part 167 (OCC); 12 C.F.R. parts 208 and 225, appendix A (Board); and 12 C.F.R. part 325, appendix A, and 12 C.F.R. part 390, subpart Z (FDIC).

- We request that the Agencies clarify that a banking organization acting as servicer not be obligated to hold capital against the undrawn amount of an advance facility provided under a commercial mortgage pass-through or other financing transaction that does not meet the definition of “traditional securitization”, so long as the other applicable criteria under the definition of eligible servicer cash advance facility are satisfied.

We discuss each of these recommendations in detail below. In addition to the modifications outlined above, we encourage the Agencies to further consider the intersection between the proposed credit risk retention requirements (the “**Proposed Risk Retention Rules**”) under new Section 15G of the Securities Exchange Act of 1934, as amended (the “**Exchange Act**”),⁹ as well as other risk retention laws and regulations currently in effect or proposed to be implemented,¹⁰ and the condition under the operational requirements for securitization that the underlying exposures not be subject to reporting on the banking organization’s consolidated balance sheet under generally accepted accounting principles (“**GAAP**”). The consequence to banking organizations under the Proposed Rules in the event of a failure to satisfy such condition – maintaining capital against the underlying exposures as if they had not been securitized – would be severe, and, if other risk retention options are not feasible, would diminish the role of securitization as an otherwise valuable financing tool.

III. Recommendations

A. The definition of MSAs should be modified to distinguish residential MSAs from commercial MSAs, and the existing deduction and risk-weighting methodology for commercial MSAs should in substance be retained.

The dramatic shift in capital treatment of mortgage servicing assets under Basel III and the Proposed Rules would present extraordinary challenges for banking organizations currently holding, and looking to continue to hold, MSAs. If the Agencies implement the Proposed Rules in their current form, banking organizations (both large and smaller regional banks) may be required to substantially reduce servicing activities and possibly exit the servicing business altogether, which could harm CRE borrowers and CMBS investors. Regulatory oversight of the commercial mortgage servicing industry would diminish.

Overview and Background of Mortgage Servicing Assets

General. MSAs generally refer to the contractual right of a mortgage loan servicer to service residential mortgage loans or commercial mortgage loans for third parties, including in connection with mortgage-backed securities transactions. When a lender makes a loan to a borrower, it generates two assets – the loan and the related servicing rights – which the lender may transfer separately or together. Upon transfer in connection with a securitization transaction, an originating banking organization or nonbank lender will sell or otherwise transfer the loan to the related securitization vehicle, either directly or through other transaction parties.

⁹ 76 Fed. Reg. 24,090 (Apr. 29, 2011).

¹⁰ See *infra* fn 39.

The lender may retain the servicing rights and continue to service the loan on behalf of the securitization vehicle in accordance with negotiated transaction documentation or, as is more commonly the case in CMBS transactions, may sell the related servicing rights for servicing by a third party.

In securitization and mortgage pass-through transactions, servicers generally are responsible for making collections on underlying assets, ensuring maintenance of adequate insurance, tracking remittances and administering escrow arrangements and engaging in loss mitigation strategies if and when appropriate, including through foreclosure and the exercise of other available lender remedies. A master servicer is generally responsible for overseeing and supervising the servicing of the securitized mortgage loans by one or more primary servicers and special servicers, and coordinating reporting on performance of the portfolio to investors. A primary servicer deals directly with the borrower, and is therefore responsible for many of the administrative or ministerial tasks associated with servicing a mortgage loan, including payment collection, cash management, escrow administration and insurance and tax administration. A master servicer or primary servicer may service all or a portion of the pool of performing (*e.g.*, where the obligor is making timely scheduled payments in full) or re-performing (*e.g.*, where the obligor has resumed making timely scheduled payments in full after not doing so for some period) mortgage loans. If a loan defaults, securityholders are insulated from any possible short-term cash flow shortfall by the master servicer, which is obligated to make advances of principal and interest on the securities to the trustee, and to pay property taxes and insurance payments to the extent that such advances are determined to be recoverable from the underlying mortgage obligation. In CMBS transactions, and in a limited number of residential mortgage-backed securities (“**RMBS**”) transactions, servicing duties are divided between a master servicer that services, or oversees the servicing by one or more primary servicers of, performing mortgage loans, and a special servicer, which is typically responsible for the servicing of at-risk mortgage loans that have become seriously delinquent, are in default, or for which credit or other negative events have occurred. Special servicing typically involves substantially more costly performance of operationally complex duties, and for commercial mortgages requires more substantial individual borrower attention.¹¹

Servicers usually are entitled to periodic compensation from amounts collected on the securitized mortgage loans as partial consideration for performance of their servicing duties. Typically master servicers and primary servicers will be entitled to periodic payment of a fixed rate of interest on the notional amount of the mortgage loans serviced, along with the interest income on amounts held in one or more of the transaction accounts, and all or a portion of various ancillary and incentive fees. The right to payment of servicing compensation generally ranks super senior in priority to other liabilities of the securitization vehicle, and may be withdrawn from one or more transaction accounts in between payment dates for the CMBS, thus insulating servicing compensation from credit risk on the assets.

¹¹ Special servicing rights are often held by non-bank servicers. To the extent banking organizations maintain special servicing rights, those rights typically are not easily transferable and difficult to value. Accordingly, banking organizations generally do not treat such rights as assets under their capital ratios. We focus in this letter on MSAs representing master servicing and primary servicing rights.

Commercial MSAs vs. Residential MSAs. Residential MSAs and commercial MSAs are distinct from one another in many ways, due in part to the nature and performance of their respective asset classes. See Appendix A for a chart showing certain of the differences between residential and commercial mortgage servicing generally and in connection with RMBS and CMBS transactions, many of which will affect the stability and certainty of the values of MSAs.

Despite the fundamental differences between residential MSAs and commercial MSAs, historically MSAs have been lumped together under the risk-based capital rules. This is so even though residential mortgages and commercial mortgages themselves (and, under the Proposed Rules, RMBS and CMBS) traditionally have been subject to different capital and risk-weighting treatment in circumstances where the nature of the asset class demanded separate treatment. For example, non-agency residential mortgage exposures are subject to separate risk-weighting requirements than non-agency commercial real estate exposures. Other than in the case of high-volatility commercial real estate exposures, “statutory” multifamily mortgages and certain other assets, non-agency commercial real estate exposures generally would be treated under the catch-all provision for corporate exposures, and risk-weighted at 100%. Past due residential mortgage exposures under the Proposed Rules similarly would be subject to a separate risk-weighting regime from that applicable to past due commercial mortgages.

The Proposed Rules

The existing general risk-based capital rules permit banking organizations to count mortgage servicing assets (and other intangible assets) against up to 50% or 100% of tier 1 capital before deduction is required. The amount of any intangible assets not deducted would be subject to a 100% risk weight. Mortgage servicing rights currently are defined under the general risk-based capital rules to mean the contractual rights owned by a banking organization to service for a fee mortgage loans that are owned by others.

The Proposed Rules would require banking organizations to deduct the following intangible assets from common equity tier 1 capital, to the extent any such threshold deduction item individually exceeds 10% of common equity tier 1 capital (after reduction in respect of all required deductions and adjustments under sections 22(a) through 22(c)(3) under the Basel III Proposal) (the “**common equity tier 1 capital deduction threshold**”):

- Deferred tax assets (“**DTAs**”) arising from differences that the banking organization could not realize through net operating loss carrybacks, net of any associated valuation allowance, and deferred tax liabilities (“**DTLs**”) (subject to limitations specified in the Basel III Proposal).
- MSAs, net of associated DTLs.
- Significant investments in the capital of unconsolidated financial institutions in the form of common stock.

Furthermore, after applying any deduction required with respect to the 10% common equity tier 1 capital deduction threshold, to the extent the aggregate of the threshold deduction items listed above exceeds 15% of the common equity tier 1 capital deduction threshold, banking organizations would be required to deduct the amount of such threshold deduction items from common equity tier 1 capital. The amount of any readily marketable MSAs that may be included

in risk-based capital must be valued at less than or equal to 90% of fair market value (which must be determined at least quarterly).¹² These threshold deductions would be subject to a phase-in period ending January 1, 2018. Amounts counted against common equity tier 1 capital and not deducted would continue to be assigned a 100% risk-weight until termination of the phase-in period, after which such items would be risk-weighted at 250%.

Application of Basel III to Commercial MSAs Is Unwarranted. MSAs in the United States, including commercial MSAs, are unique relative to similar instruments globally, and MSA values are significant among U.S. banking organizations. This means that the Agencies are the primary global regulators of MSAs. As such, the Agencies have a long history of mortgage servicing supervisory experience in the United States, and correspondingly a more sophisticated understanding of mortgage servicing than the BCBS or bank supervisors for other countries. While we believe global agreement on consistent treatment of MSAs may be desirable, and commend the U.S. banking regulators for their considered efforts in seeking to obtain such agreement, the (i) shift in capital treatment and (ii) grouping together of residential MSAs and commercial MSAs under the MSA deduction and risk-weighting methodology under Basel III,¹³ as reflected in the Proposed Rules, will unduly harm U.S. banking organizations. Notably, the Agencies' application of the common equity tier 1 capital threshold under the Proposed Rules would result in more onerous treatment of MSAs than that set forth under Basel III, placing U.S. banking organizations at a competitive disadvantage with respect to their global counterparts.¹⁴ We believe that departure from Basel III with respect to commercial MSAs is not only justifiable, but desirable.¹⁵

The Proposed Rules differ from the Basel Framework in certain respects, due in part to legislative directive under Dodd-Frank and differences drawn as a policy matter by the Agencies. For example, in a significant departure from the Basel Framework, which relies heavily on external credit ratings in its risk-weighting methodology, the Proposed Rules incorporate alternative standards of credit-worthiness in accordance with Section 939A of the Dodd-Frank Act. Various distinctions drawn by the Agencies, in addition to those demanded by statutory mandate, appear throughout the Proposed Rules and in the final Market Risk Capital Rules.¹⁶

In implementing Basel III in the European Union ("EU"), the European Commission ("EC") has assumed that the impact to European banks of the shift in treatment of mortgage

¹² Section 475(a) of the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA").

¹³ Basel III, paragraphs 87 through 89.

¹⁴ Operation of the 10% fair market value haircut under Section 475(a) of FDICIA currently results (and without revision to the Proposed Rules will continue to result) in higher capital requirements with respect to MSAs than that specified under the Basel Framework. *See supra* fn 12 and accompanying text.

¹⁵ *See supra* fn 6.

¹⁶ For example, the Basel Framework generally recognizes only insurance as a form of operational risk mitigation. In the Proposed Rules, the Agencies have expressly excluded certain insurance companies from the definition of "Eligible guarantor" and "Eligible doubt default guarantor." *See also* BCBS, *Report to G20 Leaders on Basel III implementation* (June 2012).

servicing rights would be minimal.¹⁷ This result has been preliminarily confirmed by the European Banking Authority (“EBA”) in its most recent Basel III monitoring exercise. Significantly, the EBA recently reported in the second of two publications on the Basel III monitoring exercise that the shift in capital treatment of mortgage servicing rights under Basel III would have no aggregate capital impact on the 156 European banks responding to the survey.¹⁸ U.S. banking organizations, on the other hand, which hold MSAs in substantially greater quantities, would be severely impacted, yet would be subject to the same Basel III-based limitations with respect to MSAs as their European counterparts. In addition, under EU implementation of Basel III – being an amendment to the EU Capital Requirements Directive (such amendment being “CRD IV”) – the EU will be departing from Basel III in its treatment of MSAs (albeit more conservatively in favor of a full deduction of MSAs), on the basis of the belief that MSAs are illiquid and have uncertain value, yet without express reference to any principle of conservatism.¹⁹

We believe that departure from the Basel III regime in the case of commercial MSAs is warranted. As noted above, other regulators internationally already have chosen to depart from Basel III. The Agencies are the primary global regulators of MSAs and have the sophistication and experience to determine the adequacy of capital requirements governing commercial MSAs. We encourage the Agencies to do so in accordance with the recommendations in this section.

Commercial MSA Values Are Stable; Liquidity of Commercial MSAs. Banking organizations typically value commercial MSAs based primarily on the present value of the expected net interest cash flow on the serviced mortgage loans representing servicing fees, as discounted based on various measures of risk, including prepayment, credit and general interest rate risk. As the Agencies have recognized,²⁰ MSAs generate reasonably predictable revenue streams (unlike other intangible assets under the Proposed Rules and the Basel Framework, such as goodwill), albeit under varying methodologies.

¹⁷ In its statement entitled *Commission Staff Working Paper, Impact Assessment, Accompanying the document Regulation of the European Parliament and the Council on prudential requirements for the credit institutions and investment firms* at 31 (July 20, 2011), the EC states as follows:

full, rather than limited, deduction from [common equity tier 1 capital] of mortgage servicing rights, as for all other intangible assets – such an approach takes account of the relative illiquidity and uncertain value of mortgage servicing rights, and the potential difficulty of realising significant amounts of them in a stressed or emergency situation. EU banks have limited amounts of mortgage servicing rights – by virtue of their US subsidiaries – and therefore impact of this adjustment is expected to be very small.

¹⁸ BCBS, *Results of the Basel III monitoring exercise based on data as of 31 December 2011* at 16-17 (September 2012).

¹⁹ See *supra* fn 17. Under CRD IV, the 10% and 15% common equity tier 1 capital threshold deductions set forth under paragraphs 87 and 88 of Basel III thus would apply solely to significant investments in common shares of unconsolidated financial institutions and certain deferred tax assets, and not to mortgage servicing rights.

²⁰ See, e.g., Statement of Sheila C. Bair, Chairman, FDIC, on Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate 538 Dirksen Senate Office Building (Sept. 30, 2010), available at <http://www.fdic.gov/news/news/speeches/chairman/spsep3010.html>.

Residential MSAs generally have less stable values than commercial MSAs due in large part to fundamental differences in the nature and performance of the underlying assets, including the absence of prepayment risk for commercial MSA valuations. See [Appendix A](#) for a more detailed description of these differences. For residential mortgages, consumer protection regulation and state law generally limit the application of prepayment penalties which otherwise may deter consumers from prepaying their mortgage loans. Unpredictable swings in prepayment activity may contribute to price instability and make residential mortgage servicing asset valuation more challenging for banking organizations. Commercial mortgage assets typically have substantially shorter durations than residential mortgages and, as a result, experience lower price volatility, which lends to more stable values. Moreover, commercial real estate loan assets have call protection features that promote stable interest cash flows, which contributes to predictable servicing fees, and protect against material prepayment risk, unlike residential mortgages. Prepayment of commercial mortgages may trigger call protection features under borrower loan documentation, any of which would mitigate cash flow and interest rate risk to the lender, and as such discourage early prepayment. Defeasance provisions may permit a commercial mortgage obligor to prepay its commercial mortgage loan in whole in or in part through a pledge to the related securitization vehicle of non-callable government securities that provide for substantially identical payment to the prepaid loan through the maturity date (or in some cases the date of expiration of a negotiated lock-out period), thus providing an even more certain cash flow, which contributes to more stable commercial MSA values.²¹

The transfer of commercial MSAs occurs in a well-established liquid market, including during periods of economic stress, and regularly in connection with securitization transactions. For example, a sponsor of a CMBS transaction often will aggregate commercial mortgages from multiple originators and concurrently acquire the related commercial mortgage servicing rights. Valuations are made at the time of such acquisition. During recent periods of economic downturn, except for shifts in value traceable to interest rate declines that diminished anticipated future net interest cash flow, commercial MSA values generally showed limited fluctuation.

Overall Negative Economic Impact. The overall negative economic impact of the shift in treatment of MSAs on banking organizations will be severe, and undoubtedly will change the scope and nature of banks' servicing platforms. The phase-in period provides little support to banking organizations that presently hold comparatively large portfolios of MSAs. The release of Basel III, followed by notice of the Proposed Rules, has already affected market values of MSAs, and sales of MSAs have accelerated. In addition, as federal regulators have acknowledged, residential and commercial mortgage originators will pass through a substantial portion of the increased regulatory costs of mortgage servicing to borrowers.²² Particularly of

²¹ Defeasance generally refers to the right of a commercial mortgage borrower to satisfy its repayment obligation in full prior to maturity by pledging non-callable government securities to the securitization vehicle or transferring cash to the securitization vehicle which in turn acquires government securities. Partial defeasance may be permitted in some circumstances, including if multiple properties secure a single commercial mortgage loan. Modeled weighted average lives of CMBS disclosed to investors in offering documents often will assume that the prepayment rate is zero prior to the conclusion of defeasance, yield maintenance or other lock-out periods.

²² See, e.g., FHFA, *Alternative Mortgage Servicing Compensation Discussion Paper* (Sept. 27, 2011) (the "**FHFA Paper**"), at 11 ("...Some of the largest originators, who are market leaders in setting mortgage rates, will need to either raise the mortgage rate offered to borrowers while reducing servicing released premiums paid in order to compensate for any incremental capital required, or accept lower returns....Alternatively, entities near or above the

concern is the impact to smaller and regional banks, some of which may not have the infrastructure and operational capability to absorb the overall increased cost of servicing that the shift in capital treatment would cause.

Harm to CMBS Investors. The exit by banking organizations from the servicing business would dilute the availability of qualified resources and could lead to increased servicing costs and, potentially, a decline in the quality of servicing. Weak servicing performance may impact cash flow to CMBS investors, or may result in ratings downgrades of tranches of CMBS. In addition, for existing CMBS transactions, contraction of servicing platforms may leave bank servicers with insufficient capacity to adequately service commercial mortgage loans. Replacement of bank servicers following a servicer termination event under the securitization transaction documentation could become more challenging. The failure to timely appoint a successor servicer may disrupt cash flow, delay or prevent any workout or exercise of remedies of defaulted commercial mortgage assets, or otherwise harm CMBS investors.

Policy Considerations Justify Separate Treatment of Commercial MSAs. As noted above, the Proposed Rules retain the identical treatment of commercial MSAs and residential MSAs for capital adequacy purposes. To the extent any bank regulatory policy considerations that discourage bank servicing may underlie the proposed increased capital requirements with respect to MSAs, we believe any such considerations should be limited to residential MSAs. Commercial mortgage servicing simply has not been subject to the same experience as residential mortgage servicing in the United States, nor the same post-credit crisis regulatory and governmental response.²³ To converge capital treatment of commercial MSAs with residential MSAs would essentially subject commercial mortgage servicing by banking organizations to identical regulations notwithstanding an overwhelmingly separate regulatory response to the two asset classes generally.

Implementation of regulations that discourage bank servicing of commercial mortgage assets may harm CRE borrowers and CMBS investors as a result of the decrease in the number of qualified servicers. This could limit the availability of commercial real estate credit and further strain an economic recovery.

10% threshold may look for other solutions to manage the 10% capital limitation, including acquisition/merger, selling the MSR, and structuring and/or holding more loans on balance sheet (eliminating the recognition of a separate servicing asset).”).

²³ Regulatory and other governmental attention to residential mortgage servicing by banks has been overwhelming relative to commercial mortgage servicing. Recent regulatory initiatives focusing on residential mortgage servicing include (i) the formation of an interagency coalition consisting of the Agencies, the Department of Housing and Urban Development, the Department of Treasury, FHFA and the Consumer Financial Protection Bureau (“CFPB”) to consider uniform mortgage servicing standards, (ii) supervisory consent orders entered into by the Agencies with the largest U.S. mortgage servicers, (iii) FHFA implementation of GSE protocols for servicing of delinquent loans, (iv) the settlement in early 2012 by the Department of Justice and attorneys general of 49 states with the largest U.S. mortgage servicers in connection with alleged foreclosure abuses and other residential mortgage servicing deficiencies, (v) formation of the CFPB under the Dodd-Frank Act and the CFPB’s recently proposed residential mortgage servicing guidelines, (vi) FHFA’s *Joint Mortgage Servicing Compensation Initiative* to consider alternative servicing compensation models for servicing of conforming balance mortgages held in GSE-sponsored trusts, and (vii) proposed and implemented state and local legislation. *See also* Financial Stability Oversight Council 2012 Annual Report, at 18-19 (July 2012).

Risk-Weights for Commercial MSAs Are Excessive. The CRE Finance Council further urges the Agencies to reconsider the shift in risk-weighting of commercial MSAs (including those not subject to deduction), which we believe is unwarranted and would apply a risk weight far in excess of that applicable to assets having a similar risk profile.

As a threshold matter, commercial MSAs subject to deduction would in effect be treated for capital purposes similarly to higher credit risk assets. Other assets that are subject to substantially high risk weighting under the Proposed Rules would include deeply subordinated securitization exposures and resecuritization exposures, and credit-enhancing interest-only strips that do not constitute after-tax gain-on-sale. Commercial MSAs would be treated only slightly more favorably than securitization exposures for which a banking organization cannot demonstrate adequate due diligence, which are assigned a punitive 1,250% risk weight.

We note that the Agencies provide no concrete reason for calibrating non-deducted commercial MSAs at a 250% risk-weight other than conformity with the Basel Framework. Simply because commercial MSAs may reflect payment for services should not warrant such substantially different treatment. The Proposed Rules would risk-weight senior interest-only securitization exposures at as low as 100%. Servicing fees, which constitute the bulk of servicing compensation, typically are payable super senior in priority to such securitization exposures yet would either be subject to full deduction or a 250% risk weight. Commercial MSAs that are not deducted would be assigned a higher risk weight than past due exposures under the Proposed Rules, which are delinquent assets subject to a 150% risk weight.

Recommendation: We urge the Agencies to modify the definition of MSAs to distinguish residential MSAs from commercial MSAs, and to retain in substance the existing risk-weighting and deduction methodology for commercial MSAs, thereby limiting the application of (i) the 10% and 15% common equity tier 1 capital deduction thresholds and (ii) the 250% risk-weight to the non-deducted portion of such MSAs, to residential MSAs.

In giving effect to the above modifications, we propose that the “Mortgage servicing assets (MSAs)” definition be replaced as set forth below and new definitions of residential MSAs and commercial MSAs be added instead. The new definitions of “Mortgage servicing assets (MSAs)”, “Residential mortgage servicing assets (MSAs)” and “Commercial mortgage servicing assets (MSAs)” would read as follows:

“‘Commercial mortgage servicing assets (MSAs)’ means the contractual rights owned by a banking organization to service for a fee mortgage loans (other than residential mortgage loans primarily secured by a first or subsequent lien on one-to-four family residential property) that are owned by others.”

“‘Mortgage servicing assets (MSAs)’ means commercial MSAs and residential MSAs, collectively.”

“‘Residential mortgage servicing assets (MSAs)’ means the contractual rights owned by a banking organization to service for a fee residential mortgage loans primarily secured by a first or subsequent lien on one-to-four family residential property that are owned by others.”

The term “MSAs” in §__.22(d)(1)(ii) and §__.300(c)(4)(i) and (iii) should correspondingly be amended to read “residential MSAs” in each place it appears.²⁴

New §__.22(d)(5) should be added to read as follows:

(5) (i) A [BANK] must deduct from common equity tier 1 capital elements the amount of commercial MSAs (net of associated DTLs) and the items listed in §§__.22(d)(1) and (2) that are not deducted as a result of the application of the 10 percent common equity tier 1 capital deduction threshold or the 15 percent common equity tier 1 capital deduction threshold, and that, in aggregate, exceeds [50][100] percent of the sum of the [BANK]’s common equity tier 1 capital elements, minus adjustments to and deductions from common equity tier 1 capital required under §§__.22(a) through (c), minus the items listed in §__.22(d)(1) and (2).

(ii) The amount of commercial MSAs (net of associated DTLs) that is not deducted from common equity tier 1 capital pursuant to this §__.22(d)(5) must be included in the risk-weighted assets of the [BANK] and assigned a 100 percent risk weight.²⁵

B. The definition of high volatility commercial real estate (“HVCRE”) should not apply under the Standardized Approach Proposal, and, accordingly, commercial mortgage loans should be subject to a uniform risk-weight of 100%. If the Agencies determine to implement the higher risk weight for HVCRE, a lower risk weight for high quality commercial mortgages should be proposed.

Under the general risk-based capital rules currently in effect, the Agencies treat commercial real estate loans as corporate exposures subject to a 100% risk weight. Under the Standardized Approach Proposal, certain acquisition, development or construction commercial real estate loans that meet the definition of HVCRE²⁶ would become subject to a 150% risk weight. We believe that, consistent with the standardized framework under the Basel Framework, commercial real estate exposures that are not past due exposures should be treated consistently, and assigned a 100% risk weight. Otherwise the risk weighting rules governing commercial mortgage exposures should be re-proposed to include a lower risk weight for certain high quality commercial mortgage loans.

²⁴ We believe that the fair value limitation under Section 475 of the FDICIA should also be lifted for commercial MSAs. The term “MSAs” in §__.22(d)(3) and §__.300(c)(4)(iv) should correspondingly be amended to read “residential MSAs” in each place it appears.

²⁵ A simpler, and perhaps more sensible, approach than the addition of new §__.22(d)(5), would be to exclude commercial MSAs from the deduction methodology, and simply risk-weight all commercial MSAs (net of associated DTLs) at 100% (with various conforming changes) for purposes of the risk capital ratios.

²⁶ Standardized Approach Proposal, 77 Fed. Reg. at 52,901. We note that definition of HVCRE is substantially identical to the definition of high-volatility commercial real estate currently in effect under the advanced approaches rules.

Separate Risk-Weighting for HVCRE Has Not Historically Applied Under the General Risk-Based Capital Rules. Under the Basel Framework, the generally applicable standardized framework for calculating risk weights does not specify a separate risk weight for HVCRE. Only those banks that meet the applicable qualifications and have been approved to determine risk weights under the internal-ratings based approach (“**IRB**”) may utilize the specialised lending risk weighting rules, part of which includes methodology for determining risk weights for HVCRE.²⁷ Consistent with Basel II, in 2008 the Agencies did not propose distinguish risk weighting for HVCRE under the 2008 Standardized Framework Proposal. Also consistent with Basel II, in 2007 the Agencies opted to incorporate the advanced internal ratings-based approach under Basel II, and to add an HVCRE definition to the advanced approaches rules applicable only to advanced approaches banking organizations.²⁸

In a departure from the Basel Framework, the Standardized Approach Proposal would apply higher risk weights for HVCRE under the general risk-based capital rules. We believe this is ill-advised. Moreover, despite previously treating HVCRE in a manner generally consistent with the global framework, the Standardized Approach Proposal cites no compelling reason for requiring all banking organizations, including community and regional banks, to apply a higher risk weight for these types of commercial real estate exposures, or for the risk weight being set at 150% in lieu of some other threshold, other than passing reference to supervisory experience with respect to certain acquisition, development and construction loans.²⁹

Generally speaking, regional and community banking organizations, not large banking organizations, hold acquisition, development and construction loans in portfolio and are expected to be the banks that originate substantial numbers of such loans when an active commercial construction industry returns. The end result of application of the HVCRE risk weights would be to single out regional and community banks for harsher capital treatment, while diverging from the Basel Framework without justification. Broad application of the capital adequacy rules, and corresponding undue regulatory burden, has come as a surprise to smaller banking organizations, some of which would be most affected the shift in treatment. We believe that the disproportionate impact of the HVCRE risk weights on regional and community banking organizations is one of the unintended consequences of the Proposed Rules of concern to regulators and legislators alike, and as such its application should be limited.³⁰

²⁷ Basel II, Part 2, Section III. In addition, application of the specialised lending risk weights under Basel II to IRB banks is not mandatory and banking supervisors have discretion in categorizing HVCRE exposures and implementing corresponding risk weights. Countries have adopted varying approaches in this regard.

²⁸ The Agencies have not proposed amending that definition under the Advanced Approaches and Market Risk Proposal.

²⁹ The preamble to the Standardized Approach Proposal (pg. 36) states as follows: “Supervisory experience has demonstrated that certain acquisition, development, and construction loans exposures present unique risks for which the agencies believe banking organizations should hold additional capital.” We note that no reference is made to the Agency Guidance, so it is not clear whether the shift in capital treatment supersedes the Agency Guidance, or if banking organizations must comply with both requirements.

³⁰ See, e.g., Senators Mark R. Warner, Patrick J. Toomey, Johnny Isakson, *et al.*, Letter to Agencies (September 27, 2012). A bipartisan group of 53 U.S. Senators recently expressed concern that application of the Proposed Rules to

Existing Supervision is Sufficient. Banking organizations, including those that originate HVCRE, presently are subject to substantial bank regulatory oversight of commercial mortgage lending activities. The CRE Finance Council believes that the existing regulatory supervision of HVCRE origination and commercial real estate lending, including the policies and procedures outlined in the Agency Guidance, sufficiently addresses any credit and operational risk concerns. Representatives of the Agencies conduct regular onsite review and examination of risk management processes and other internal bank risk limitation measures for deficiencies, and periodically provide targeted or broad-based guidance.³¹ The safety and soundness of community banks, which will be more dramatically harmed by the shift in capital rules governing HVCRE exposures, would on balance be protected more from targeted supervision and guidance than from increased risk weights, which may unduly compromise lending capability. We expect that the Agencies will continue to further enhance supervisory oversight of CRE lending activities. Any present concerns are better addressed in that manner.

Lower Risk Weights for High-Quality Commercial Mortgages. The general risk-based capital rules currently apply a 100% risk weight to commercial mortgages, regardless of credit quality or the presence of other risks, even though a more sensitive risk weight for high credit quality commercial mortgages would in many circumstances be less than 100%. The Agencies propose to implement higher risk weights for HVCRE, yet no corresponding balancing change in capital treatment is proposed for high quality commercial mortgage exposures. We believe that the definition of “qualifying CRE loan” under the Proposed Risk Retention Rules, as modified per the recommendations contained in Attachment D to our comment letter dated July 18, 2011 (the “**CREFC Risk Retention Comment Letter**”),³² which we have attached to this letter as Appendix B, should have the benefit of a risk weight lower than 100%. We propose a risk weight of 50% for such assets. Should the Agencies determine to implement risk-weighting of HVCRE under the Standardized Approach as proposed, we ask that the Agencies re-propose the Standardized Approach Proposal to provide for a sub-category of commercial mortgage exposures within corporate exposures that have the benefit of a 50% risk weight.

Economic Impact. The change in capital treatment for HVCRE exposures will diminish the availability of affordable credit to commercial mortgage borrowers, particularly those looking to refinance existing loans, at a time when access to credit is critical. The impact on borrowers (and lenders and investors entitled to ultimate repayment) of commercial mortgage loans providing for balloon payments at maturity will be particularly harsh.³³ Undercapitalized

community banks may have unintended consequences which may threaten the continued viability of such institutions.

³¹ The Agency Guidance provides for benchmark supervisory criteria which, if exceeded, may subject a banking organization to further supervisory review. The Agency Guidance sets target thresholds for total construction, land development and other land loans of not more 100% of total capital, and total commercial real estate loans of not more than 300% of total capital (and the banking organization’s CRE portfolio has increased by at least 50% in the past three years).

³² The CREFC Risk Retention Comment Letter is available at <http://www.sec.gov/comments/s7-14-11/s71411-113.pdf>.

³³ Approximately \$2 trillion of the commercial mortgage debt is scheduled to mature over the next five years.

borrowers that cannot satisfy the 15% equity contribution threshold will be forced to pay higher interest rates set by banking organizations or as may be available from non-bank financing.

The severity of the impact on smaller regional and community banks that originate and service HVCRE loans would be further augmented by the proposed increased capital requirements for commercial MSAs. Regulators and legislators alike have publicly expressed concern regarding the disproportionate impact application of the Proposed Rules will have on smaller banks that do not have the access to capital or regulatory compliance capabilities that large U.S. banks have.³⁴

In addition, if an originating banking organization cannot satisfy the operational requirements in connection with the transfer of underlying exposures to a securitization vehicle in connection with a traditional securitization, it must maintain capital against the underlying exposures as if they had not been securitized. Following implementation of the proposed risk retention rules, or if a sponsoring banking organization wishes to satisfy the risk retention rules currently in effect under Article 122a of the EU Capital Requirements Directive, or must do so under the FDIC Securitization Safe Harbor Rule,³⁵ the effects of the 150% risk weight would be further magnified.

Recommendation: The CRE Finance Council proposes the removal of the proposed separate risk-weighting of HVCRE from the Standardized Approach Proposal. Should the Agencies determine to implement HVCRE under the standardized approach, we ask that the Agencies balance the impact of the addition of HVCRE by re-proposing the standardized approach to provide for lower risk weighting of “qualifying CRE loans” (as modified per our recommendations under the CREFC Risk Retention Comment Letter).

C. The Agencies should clarify that a banking organization acting as servicer not be required to hold capital against the undrawn amount of any servicing advance facility provided by such servicer to a commercial mortgage pass-through transaction that would otherwise be an eligible servicer cash advance facility but for the fact that such transaction is not a securitization.

Under the Proposed Rules, a banking organization that provides to a securitization a “servicer cash advance facility” that meets the definition of “eligible servicer cash advance facility” would not be required to hold capital against the undrawn amount of the advance facility. Failure to satisfy such definition would require the banking organization to treat its exposure under the advance facility as a recourse-like off-balance sheet exposure subject to a 100% credit conversion factor. As a technical matter, the definitions of “servicer cash advance facility” and “eligible servicer cash advance facility” refer to servicers under securitizations.³⁶

³⁴ See *supra* fn 30.

³⁵ See *infra* fn 39.

³⁶ We note that the definition of mortgage servicer cash advances for residential mortgage servicers under the existing general risk-based capital rules does not expressly limit application to advance facilities provided to securitizations. Satisfaction of this definition operates as an exclusion from the risk-weighting rules applicable to recourse exposures and direct credit substitutes.

The treatment of servicing rights under proposed rules departs from the basic Basel III scheme. We ask that the Agencies clarify that bank servicers under other commercial mortgage pass-through or other commercial mortgage financing transactions that do not meet the definition of a “traditional securitization”, including due to the absence of tranching of credit risk or the failure to satisfy another technical requirement, yet otherwise satisfy the applicable criteria, similarly not be required to hold capital against the undrawn amount of the advance facility.³⁷

A servicer under a CMBS transaction or similarly structured commercial mortgage pass-through transaction often will agree to periodically advance from its own funds (or funds held on deposit in an account for payment to securityholders on future payment dates) scheduled regular payments of principal and interest not timely paid by a borrower, as well as advances of certain administrative payments. Debt service advances are not intended to provide credit enhancement for the obligations, but rather to ensure that no shortfall or delay in payment on the obligations on a monthly (or other periodic) payment date occurs due to a late payment by an obligor on an underlying exposure or other shortfall in collections expected to be made up for at a later date. A servicer that does not believe in its reasonable good faith judgment (or similar standard) that an advance will be reimbursed out of collections will not be obligated to make any such advance.

Although the obligation of a servicer to make debt service advances and servicing advances often is characterized as mandatory, it is subject to the reasonable good faith judgment (or other similar standard) of the servicer that the advance would be recoverable from proceeds on the related mortgage loan. Such standard is broad enough, and sufficiently discretionary in nature, to distinguish it from more definitive recourse obligations a banking organization may have. Unlike a liquidity facility or other lending arrangements, many banking organizations do not treat an advance facility as a commitment for accounting purposes. A commercial mortgage pass-through or other financing transaction that meets the criteria under the definition of eligible servicer cash advance facility but for the fact that the transaction is not a securitization would, like that for a CMBS transaction, not be recourse-like with respect to the bank servicer. Such a transaction should not subject a banking organization to more onerous capital treatment simply because a technical requirement under the definition of “traditional securitization” has not been satisfied.

Recommendation: The CRE Finance Council requests that the Agencies clarify that a banking organization acting as servicer not be obligated to hold capital against the undrawn amount of an advance facility provided under a commercial mortgage pass-through or other financing transaction that does not meet the definition of “traditional securitization” so long as the other applicable criteria are satisfied.

IV. Operational Requirements for Traditional Securitization

The Proposed Rules add operational requirements for “traditional securitizations” (as defined under the Proposed Rules) that determine whether an originating banking organization would not be required to hold risk-based capital against the securitized exposures. The

³⁷ For example, a single class or pari passu commercial mortgage pass-through transaction may not meet the definition of traditional securitization yet may include a servicer advance facility that is identical to that of a CMBS transaction issuing multiple credit tranches.

Standardized Approach Proposal and the Advanced Approaches and Market Risk Proposal require in substantial part that an originating banking organization satisfy four conditions in connection with the transfer of assets to a securitization, the failure of any of which would require the banking organization to apply capital treatment to the transferred exposures as if such exposures had not been securitized, and must deduct from common equity tier 1 capital any after-tax gain-on-sale resulting from the transaction. Among those conditions is the requirement that “[t]he exposures are not reported on the [banking organization]’s consolidated balance sheet under GAAP.”³⁸ Recently implemented³⁹ and proposed risk retention regulations, including the Proposed Risk Retention Rules, may inhibit satisfaction of the Nonconsolidation Condition for certain CMBS transactions.

Under Section 15G of the Exchange Act, a securitizer generally must retain a sufficient unhedged economic interest of the credit risk of any assets it transfers in connection with the issuance of asset-backed securities. Various exceptions and exemptions would be permitted. The Agencies, with the Securities and Exchange Commission and other federal bodies, jointly issued the Proposed Risk Retention Rules, which presently remain under consideration.⁴⁰ Application of the FAS 166 and 167 accounting rules to an underlying asset transfer by a bank sponsor that has complied with certain options under the proposed “base” risk retention requirements under Section 15G⁴¹ may require such assets to continue to be reported on the banking organization’s consolidated balance sheet under GAAP.

We recommend that the Agencies consider the interplay between the Nonconsolidation Condition and the Proposed Risk Retention Rules. As proposed, satisfaction of certain of the proposed risk retention options under the Dodd-Frank Act will have the effect of shifting the accounting treatment for certain CMBS transactions. At best, a banking organization acting as securitizer that wishes to satisfy the Nonconsolidation Condition would have a severely limited number of options under the risk retention rules proposed pursuant Section 15G. The only option that may be available is the so-called “B-piece buyer” option. If that option as ultimately adopted is not practicable for CMBS transactions, transaction activity inevitably will slow, perhaps significantly.

³⁸ We refer to this condition as the “**Nonconsolidation Condition**”.

³⁹ See, e.g., *Treatment of financial assets transferred in connection with a securitization or participation*, 12 C.F.R. § 360.6 (the “**FDIC Securitization Safe Harbor Rule**”). The FDIC’s Securitization Safe Harbor Rule conditions safe harbor treatment of the transfer of financial assets in connection with a securitization sponsored by an insured depository institution on satisfaction of risk retention requirements. An insured depository institution wishing to take advantage of the safe harbor must retain at least 5% of the credit risk of the transferred assets. See also, e.g., Directive 2006/48/EC, as amended by Directive 2009/111/EC. Article 122a of the EU Capital Requirements Directive requires that, before an EU bank (or affiliate) invests in a securitization, it must ensure that the originator or sponsor retain 5% of the securitization. This risk retention requirement will also from mid-2013 apply to EU alternative investment managers and mutual fund managers, and from 2014 to EU insurance companies (in each case under the relevant sectoral legislation; e.g. the EU Solvency II Directive in respect of insurance companies).

⁴⁰ 76 Fed. Reg. 24,090 (Apr. 29, 2011).

⁴¹ CMBS transactions for which a banking organization that transfers underlying exposures is, or is affiliated with, the “B-piece buyer”, or such other entity that may have appointment and termination rights over the special servicer may, other things being equal, be more at-risk.

V. Conclusion

The CRE Finance Council again recognizes that an extraordinary amount of thought and work went into the development of the Proposed Rules. We appreciate the opportunity to comment on the topics discussed above and for consideration of our members' views. We would be happy to provide any additional information on any of the subjects discussed in this letter and would also be happy to meet with the Agencies to discuss the same.

Should you have any questions or desire any clarification concerning the matters addressed in this letter, please do not hesitate to contact me at srenna@crefc.org or at 202-448-0860.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Stephen M. Renna", with a long horizontal flourish extending to the right.

Stephen M. Renna
Chief Executive Officer
CRE Finance Council

Appendix A
Certain Differences Between CMBS and RMBS Transactions that May Affect MSAs

Below is a chart showing primary differences in certain characteristics of CMBS and RMBS transactions, certain of which may affect the valuation and liquidity of MSAs.

<u>Characteristics</u>	<u>RMBS</u>	<u>CMBS</u>
<i>Asset Duration</i>	Residential mortgages typically have scheduled durations ranging from 15 to 40 years, and in most cases 30 years.	Commercial mortgages typically have durations of three, five or ten years.
<i>Prepayment Activity</i>	Prepayment activity for residential mortgages is highly sensitive to changes in interest rates. Interest rate fluctuation may lead to greater refinancing activity during lower interest rate environments and increased principal payment in rising interest rate environments. Prepayment premium features may be limited under consumer protection and other laws.	Prepayment activity for commercial mortgages is generally more stable primarily because of the various call protection features, including: <ul style="list-style-type: none"> • defeasance; • yield maintenance; or • prepayment premiums.
<i>Nature of Servicing Duties</i>	Prior to delinquency or default, residential mortgage servicers perform fairly standardized and highly automated administration, collection and management duties with respect to homogenous consumer obligations.	Commercial mortgage servicing depends on the relationship between the servicer and borrowers, which are sophisticated business entities. A substantial degree of borrower-specific attention is required.
<i>Special Servicer</i>	RMBS transactions usually have a servicer that services or supervises the servicing of residential mortgage loans for the life of the mortgage. An RMBS servicer often will be obligated to engage in various forms of loss mitigation and to realize on defaulted collateral, including the exercise of rights of foreclosure. The post-delinquency process followed, and the governing rules and regulations, differ substantially from those applicable in commercial mortgage servicing.	CMBS transactions usually will employ a master servicer to service, or supervise the servicing by one or more primary servicers of, performing commercial mortgages. CMBS transactions typically employ a separate special servicer to assume the servicing of at-risk and delinquent or defaulted commercial mortgages, and to exercise any lender remedies on behalf of the securitization vehicle.
<i>Servicer Compensation</i>	RMBS servicers generally are entitled to servicing compensation at a fixed rate of interest on the notional amount of the related mortgage loans. An RMBS servicer would service the loan for the life of the mortgage, and be responsible for more costly activities such as engaging in loss mitigation and exercising foreclosure remedies, but would not be entitled to higher or additional or higher compensation for such activities.	CMBS master servicers and primary servicers generally are entitled to periodic payment of a fixed rate of interest on the notional amount of the mortgage loans master serviced, along with the interest income on amounts held in one or more of the transaction accounts, and all or a portion of various ancillary and incentive fees. A master servicer would typically only service or supervise the servicing by primary servicers of performing commercial mortgages.

<u>Characteristics</u>	<u>RMBS</u>	<u>CMBS</u>
		A separate special servicer, which services at-risk and delinquent or defaulted commercial mortgages, is entitled to separate servicing compensation, usually at a higher fixed rate of interest on the notional amount of the mortgage loans relative to that payable to master servicers or primary servicers. The higher rate reflects more costly and complex obligations performed.
<i>Transferability</i>	In RMBS transactions, residential mortgage servicers historically often have also been the sponsor of the securitization. As a result there is very limited bidding for servicing rights at the time of securitization.	Commercial mortgage servicing rights for securitized commercial mortgages are subject to a competitive bidding process which generates a market value for the servicing asset at or prior to the time of securitization.
<i>Post-Delinquency or Default</i>	RMBS servicers may engage in various forms of loss mitigation, including regulated loan modification in accordance with government-sponsored programs, and may exercise rights of foreclosure if the applicable conditions are satisfied.	CMBS special servicers generally will have the right to exercise lender remedies in accordance with negotiated borrower loan documentation.

Appendix B

CATEGORY	PROPOSED RISK RETENTION RULES	CRE FINANCE COUNCIL'S RECOMMENDED MODIFICATION
Definition of a "Commercial Real Estate Loan"	Specifically excludes "loans to REITs" as eligible.	Include loans to REITs as eligible if secured by commercial or multifamily property.
Debt Service Coverage Ratio	At least 1.5-1.7x depending on loan type.	Replace with minimum debt yield of 12%.
Qualified Tenant	Minimum DSCR calculated only based on income derived from "qualified tenants", defined as a tenant that (1) is subject to a triple net lease that is current and performing with respect to the CRE property, or (2) was subject to a triple net lease that has expired, currently is leasing the property on a month-to-month basis, has occupied the property for at least three years prior to closing, and is current and performing with respect to all obligations associated with the CRE property.	Eliminate; it is common industry protocol for many office leases and leases of other CRE product categories to not be structured as triple net leases. Rental income from tenants with gross leases using an expense stop are common and sound and should not be excluded. Many considerations are taking into account when determining how much credit to give to rental income from month-to-month tenants.
Amortization and Interest-only Periods	All loan payments required to be made under the loan agreement are based on straight-line amortization of principal and interest over a term that does not exceed 20 years; borrower must be qualified for the CRE loan based on a monthly payment amount derived from a straight-line amortization of principal and interest over the term of the loan, but not exceeding 20 years. Borrower is not permitted to defer repayment of principal or payment of interest.	Each loan should have some form of amortization but the amount of which should be able to vary based on LTV (loans that are below 50% LTV should be able to be interest only for the loan term, while loans that are in excess of a 50% LTV should be able to have a portion of their loan term be interest only).
CLTV	Less than 65% at origination, or less than 60% if the capitalization rate used at appraisal is \leq (10 yr swap rate + 300 bp)	-- Beginning LTV of 65% or less and ending LTV of 55% or less; --Eliminate "Combined" as CLTV is not directly relevant to the credit backing the first mortgage.
Sponsor Credit	Require 2 yr look forward and 2 yr look back.	-- 2 yr look forward – eliminate. -- 2 yr look back – support.
Buy Back Requirement	A sponsor that has relied on the QLE will not lose it for the entire transaction if the sponsor repurchases	Eliminate; the appropriate place to address the buy-back requirement is in the representations and warranties. In addition, the proposed rule does not provide for a materiality

CATEGORY	PROPOSED RISK RETENTION RULES	CRE FINANCE COUNCIL'S RECOMMENDED MODIFICATION
	the non-compliant loan(s) from the issuing entity at a price at least equal to the remaining principal balance and accrued interest on the loan(s) within 90 days after the determination that the loans do not comply, among other requirements.	test for the breach, which could result in otherwise well underwritten loans being required to be repurchased.
Maturity	Not less than 10 years	Fixed rate loans should be no less than 5 years and floating rate loans should be no less than 3 years
Financial Disclosure	Require the borrower to provide to the originator and any subsequent holder of the commercial loan, and the servicer, the borrower's financial statements and supporting schedules on an ongoing basis, but not less frequently than quarterly, including information on existing, maturing and new leasing or rent-roll activity for the property securing the loan, as appropriate.	Require the borrower to provide the property's financial statements, rather than the borrower's, because for CRE the review is focused on analysis of property performance.
Collateral restrictions/subordinate financing	<p>Loan docs must contain covenants that prohibit:</p> <p>-- the creation or existence of any other security interest with respect to any collateral for the CRE loan;</p> <p>-- the transfer of any collateral pledged to support the CRE loan; and</p> <p>-- any change to the name, location or organizational structure of the borrower, or any other party that pledges collateral for the loan.</p>	Subordinate financing should be permitted subject to a combined maximum LTV.
Borrower insurance requirements	Maintain insurance that protects against loss on the collateral at least up to the amount of the loan	Support.
Junior lien exception	Junior lien on any property that serves as collateral for the CRE loan is permitted if such loan finances the purchase of machinery and equipment and the borrower pledges such machinery and equipment as additional collateral for the CRE loan.	Support.
Fixed/Floating Rate	Only Fixed Rate Loans or Floating Rate with Interest Rate Cap	Support.
Floating Rate Issues	Loans permitted to have an adjustable	Floating rate loans should be allowed with a min. term of 3

CATEGORY	PROPOSED RISK RETENTION RULES	CRE FINANCE COUNCIL'S RECOMMENDED MODIFICATION
	interest rate if the borrower, prior to or concurrently with origination of the CRE loan, obtained a derivative that effectively results in a fixed interest rate.	years (w/ an interest rate cap agreement that is commercially reasonably based on the debt yield, cash flow and reserves (i.e. debt service reserves, TI/LC, etc.))
Appraisal	<p>Obtained a written appraisal of the real property securing the loan that:</p> <p>-- Was performed not more than six months from the origination date of the loan by an appropriately state-certified or state-licensed appraiser;</p> <p>--Conforms to generally accepted appraisal standards as evidenced by the Uniform Standards of Professional Appraisal Practice (USPAP) and the appraisal requirements of the Federal banking agencies and</p> <p>-- Provides an “as is” opinion of the market value of the real property, which includes an income valuation approach that uses a discounted cash flow analysis.</p>	Support.
First Lien	The CRE Loan must be secured by the first lien on the commercial real estate	Support.
Environmental Assessment	Conducted an environmental risk assessment to gain environmental information about the property securing the loan and took appropriate steps to mitigate any environmental liability determined to exist based on this assessment;	Support.
Defer Principal and Interest	The borrower is not permitted to defer repayment of principal or payment of interest; and	Support.
Interest Reserve	The originator does not establish an interest reserve at origination to fund all or part of a payment on the loan.	Support.

CATEGORY	PROPOSED RISK RETENTION RULES	CRE FINANCE COUNCIL'S RECOMMENDED MODIFICATION
Payments at Closing	At the closing of the securitization transaction, all payments due on the loan are contractually current.	Support.
Internal Supervisory Controls	<p>The depositor of the asset-backed security must certify that it has evaluated the effectiveness of its internal supervisory controls with respect to the process for ensuring that all assets that</p> <p>collateralize the asset-backed security meet all of the requirements set forth in paragraphs(b)(1) through (9) (the QLE criteria) and has concluded that its internal supervisory controls are effective.</p>	Support.