



**AMERICAN
BANKERS
ASSOCIATION**
*World-Class Solutions,
Leadership and Advocacy
1875-2000*

25

Paul Alan Smith
Senior Federal Administrative Counsel
Regulatory And Trust Affairs
(202) 663-5331; Fax: (202) 828-4548

Robert W. Strand
Senior Economist
(202) 663-5350; Fax: (202) 828-4547

1120 Connecticut Avenue, N.W.
Washington, D.C. 20036

June 15, 2000

Communications Division, Third Floor
Office of the Comptroller of the Currency
250 E Street, S.W.
Washington, DC 20219

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve
System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551.

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments/OES
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429

Manager, Dissemination Branch
Records Management and Information Policy
Office of Thrift Supervision
1700 G Street, N.W.
Washington, DC 20552

Re: Risk-based Capital Standards: Recourse and Direct Credit Substitutes; OCC Docket No. 00-06; FRB Docket No. R-1055; FDIC Part 325; OTS Docket No. 2000-15; 65 Federal Register 12320; March 8, 2000

Dear Sir/Madam:

The Office of Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation and the Office of Thrift Supervision (collectively referred to as the "Agencies") are proposing significant changes to the risk-based capital standards in the treatment of recourse obligations, direct credit substitutes, and securitized transactions that have credit risk. The proposal is complex and would have significant impact on the securitization market as well as on other asset sales and the issuance of financial letters of credit. The proposal would affect most banks and savings associations. The American Bankers Association ("ABA") brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional and money center banks and bank holding companies, as well as savings associations, trust companies and savings banks – makes ABA the largest bank trade association in the country.

General Comments

This proposal by the Agencies builds off of the November 5, 1997, proposal (62 Federal Register 59943). In that proposal, the Agencies suggested using credit ratings from nationally recognized statistical rating organizations (“NRSROs”) to determine the capital requirement for recourse obligations, direct credit substitutes (“DCS”), and senior asset-backed securities. The 1997 proposal also put forward a number of options and alternatives to supplement or replace the ratings-based approach. ABA, in its comments on the 1997 proposal, expressed several concerns. ABA urged the Agencies not to adopt the proposed treatment of DCS unilaterally but instead to make any changes as part of a comprehensive proposal applying internationally through the Basel Committee on Banking Supervision (“Basel Committee”). To proceed unilaterally would create competitive disadvantages and might well price domestic banks out of the DCS market. ABA also was concerned that the various options and alternatives proposed by the Agencies would finally result in a “one-size fits all” standard that would be inappropriate for our members and instead suggested that the Agencies rely upon banks’ internal models for capital assessment and upon more case-by-case supervision. Finally, ABA was very concerned about the impact of the proposal on existing securitizations and on on-going securitization programs or conduits, and recommended a transition period of up to five years for such conduits to move to any higher capital requirements.

The Agencies’ current proposal addresses many of ABA’s concerns from the 1997 proposal; however, ABA still has some reservations about the proposed risk-based capital treatment of recourse, DSC, and asset securitizations. Overall, ABA is very concerned that the Agencies appear to intend to proceed to amend the risk-based capital adequacy guidelines before securing agreement from the other national supervisors participating in the Basel Committee. Such an action will result in domestic banks competing against foreign institutions (providing DSC and engaging in asset securitizations) that will be subject to a different and generally lower capital requirement. Additionally, we are concerned that some of the proposed risk weightings are too high and therefore not reflective of the underlying credit risk, which will result in additional economic disadvantage for domestic banks as well as possible dislocations in the securitization market. ABA requests that the Agencies modify the proposal in accordance with the recommendations below. The Agencies then should place the proposal before the Basel Committee and proceed to amend the International Capital Adequacy Framework, rather than adopt changes that will only apply to domestic institutions.

ABA supports the proposal’s intention to update the risk-based capital standards to better reflect the risks associated with securitized transactions and to encourage better risk management in this activity. ABA member institutions generally agree with the overall approach of the proposed rule. They see several important improvements in the proposal over the status quo by:

- ◆ applying equal capital charges for equivalent exposures for recourse obligations and direct credit substitutes;
- ◆ linking capital requirements more closely to relative exposure to credit risk in asset securitization transactions;

- ◆ taking into consideration credit ratings by NRSROs to improve risk assessments; and
- ◆ making the capital treatment of recourse obligations and direct credit substitutes more consistent among the Agencies.

Consistent with these improvements, ABA supports the Agencies' proposed use of banks' internal models to assess credit risk. ABA firmly believes that institutions that have incorporated sophisticated internal credit, liquidity and interest rate risk management strategies to evaluate and protect against the risks related to recourse, DCS, and securitized assets should not be penalized with increased capital requirements. ABA believes that the Agencies currently have broad powers and authority to address risk on an individualized basis through their supervisory review processes. The Agencies should evaluate securitization risks on an "institution by institution" basis and give significant weight to the overall internal risk management practices of the organization. This approach will encourage the use of prudent internal risk management strategies by organizations that are best qualified to evaluate those risks.

Specific Comments

Definitions. Banks ABA consulted on the proposal generally agree with and support the proposed definitions of "recourse," "direct credit substitute" and "credit derivative." They agree with the proposal's premise that the underlying risks for recourse and direct credit substitutes are essentially the same and should have the same risk-based capital treatment. They also agree that credit derivatives should be included in the definitions of recourse and DCS.

Representations and warranties. The proposal appropriately focuses on whether a representation or warranty creates a credit risk exposure, rather than whether it is standard or customary in the industry. If representations and warranties function as credit enhancements to protect asset purchasers or investors from credit risk, then they should be treated as recourse or DCS. ABA member banks believe that the proposed definition for "representations and warranties" improves upon the definition from the 1997 proposal; the newer definition better limits recourse to representations and warranties that function as credit enhancements. However, bankers note that there are significant differences in the representations and warranties provided by different institutions, as these are negotiated provisions. Therefore, a case-by-case approach may be appropriate in evaluating the credit risk assumed under representations and warranties.

Take Full Advantage of Accredited Internal Risk-Rating Models. ABA supports the use of internal risk rating systems in determining rating categories whenever possible – whether the exposure is rated by an NRSRO or not, traded or not. As ABA stated in its March 31, 2000, comment to the Basel Committee on its Consultative Paper on "A New Capital Adequacy Framework" (June, 1999), the Agencies should promote the development and use of internal risk rating systems. Every bank that has an adequate internal risk rating model, as verified by its supervisory agency, should be allowed to use the model's output in risk-based capital risk classifications. The proposed use of internal risk

rating systems for unrated direct credit substitutes in asset-backed commercial paper programs is a good step in this direction. We encourage the Agencies to continue to accept internal risk ratings for supervisory purposes. ABA also supports the use of program ratings for DCS as outlined in the proposed rule.

Capital Treatment of Rated Positions. For institutions that do not have acceptable internal risk rating models, external credit ratings can be the next best way to evaluate the credit quality for capital purposes. Almost all asset-backed securities are rated by NRSROs. These ratings are widely used and relied upon by market participants. Thus, capital treatment based on NRSRO ratings for traded recourse obligations, DCS and asset-backed securitization positions would be logical and practical.

ABA believes that the proposed use of external credit ratings will more accurately reflect the risk in recourse obligations, DCS, and securities held in asset securitizations. We believe that such an approach, with some refinements, would provide banking organizations with a more efficient regulatory capital framework that is based on better measurement of credit risks. This would incent banking organizations to hold lower risk assets and give them greater flexibility to manage credit exposure using a variety of investments, credit enhancement activities and securitization strategies.

The current proposal would expand to five, from three in the 1997 proposal, the number of risk rating categories. This in line with ABA's 1997 recommendations and will help address the so-called "cliff effect" experienced with using a limited number of categories. However, ABA believes that the five rating categories still lack sufficient granularity to accurately reflect the risk. By adding more categories, the Agencies can avoid the anomaly in the current proposal in which a small distinction between Aa3 and A1 creates a thirty-percent difference in capital charges. ABA urges the Agencies to further differentiate risk.

ABA agrees with the proposed approach to split ratings: when two or more NRSROs rate a traded position differently, the highest rating would apply. However, ABA would like the Agencies to clarify that only one NRSRO rating is required for traded positions.

ABA also believes that the proposed 200 percent risk weighting is too high for recourse obligations, DCS, and traded asset-backed securities that are rated Ba. An increase from a risk weighting of 100 percent for Baa-rated exposures to 200 percent for Ba-rated exposures does not reasonably reflect the increase of risk between these two ratings. Moreover, the 200 percent risk weighting does not conform with the 150 percent risk weighting that has been proposed by the Basel Committee. Therefore, we urge the Agencies to adopt a lower risk weighting for Ba-rated exposures.

Capital Treatment of Rated, Non-Traded and Unrated Positions. Whenever verified internal ratings are not available, supervisory risk classification should take full advantage of qualified ratings from one or more NRSROs. In this regard, the current proposal has taken one step in the right direction and one step in the wrong direction. First, the 1997 proposal for externally rated non-traded positions included a criterion that one position in the securitization had to be traded. The current proposal drops this criterion. ABA agrees with this amendment. Second, the proposal would require two NRSRO

ratings for a non-traded position to qualify for the ratings-based approach. Requiring two NRSRO ratings represents a cost and time burden that will impact the availability of credit. Therefore, ABA recommends that a rating from a single NRSRO should qualify a non-traded position for ratings-based capital treatment.

In addition, ABA opposes the proposed approach of using the lowest rating for non-traded positions where two or more NRSROs rate the position differently. ABA sees no reason to treat untraded positions differently from traded positions, and so recommends that the highest rating be used.

ABA agrees with the proposal's clarification of the authority of the Agencies to assign risk weights on a case-by-case basis for novel transactions that do not conform to the risk weighting categories in the proposal. This authority is needed due to the increasing complexity of securitization structures. However, we have two caveats. First, the Agencies need to use this authority to assign either higher or lower capital charges, depending on the risk in a particular structure, and not simply to increase capital requirements. Rewarding lower risk structures with lower capital charges will encourage banks to create structures that reduce risk. Second, the Agencies need to ensure that similar transactions are treated similarly by all of the agencies.

Managed Assets Approach. ABA strongly disagrees with the proposed twenty percent risk weighting for securitized assets that contain early amortization features. ABA believes that banking organizations that have incorporated sophisticated internal credit, liquidity and interest rate risk management strategies to evaluate and protect against the risks related to securitized assets should not automatically be penalized with increased capital requirements.

We disagree with the Agencies' assumption that securitizations with an early amortization feature create additional credit or other risks for the selling bank that cannot be controlled as part of a bank's internal risk management process. While early amortization does provide a certain amount of liquidity risk to sellers, well run banks have several alternatives and contingency plans for managing liquidity. Capital charges for this specific risk are not appropriate for banks that are well prepared to handle them. Therefore, the liquidity risk should not be handled through the risk-based capital framework. This type of liquidity planning and contingency management is best managed through existing regulatory authority in supervisory examinations.

One of the reasons given by the Agencies for this treatment of securitizations with early amortization is that the early amortization feature creates "an incentive for the seller to provide implicit recourse – credit enhancement beyond any pre-existing contractual obligation – to prevent early amortization." However, ABA member institutions indicate that implicit recourse is not provided as a standard course of business in securitizations with early amortization features. For example, a bank that is confronted with early amortization in a securitized portfolio of credit card receivables has a number of options to consider, including repricing or adjusting credit limits. Providing additional recourse is another option, but not one that will always be selected. When a bank does provide implicit recourse, however, the Agencies already have the authority to increase capital requirements or take other

actions. Therefore, ABA believes that existing regulatory powers are sufficient to deal with this issue on a case-by-case basis, so there should be no presumption of implicit recourse.

The proposal also expresses concern that the seller's interest in securitized assets is effectively subordinated to the interests of the investors through the payment allocation formula applied during early amortization. We believe that the current regulatory treatment of treating retained residual interests and subordinated interests as sold with recourse is adequate for this risk. As a result, the securitizing bank must hold capital against the carrying amount of the retained interests as well as the outstanding amount of all senior interests, subject to the low-level recourse rule. There is no need for an additional capital charge on the seller's interest.

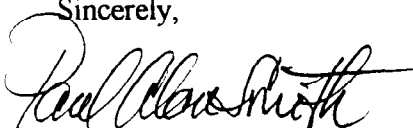
Timing. As we stated above, the proposal differs from the current Basel Committee's Capital Adequacy Framework, which assigns a one hundred percent risk weighting to the face amount of direct credit substitutes. Therefore, adoption of this proposal in the United States would put domestic banks at an unfair disadvantage in competition with foreign banks – unless and until the Basel Committee includes similar provisions in the global risk-based capital guidelines. Therefore, ABA urges the Agencies to modify the proposal in accordance with these recommendations and then place the proposal before the Basel Committee and amend the International Capital Adequacy Framework.

ABA strongly agrees that should the proposed rule result in increased risk-based capital requirements for banking organizations, then such rules will apply only to transactions entered into or acquired after the effective date of those final rules. Conversely, any final rules that result in reduced risk-based capital requirements for banking organizations should be applied to all transactions outstanding as of the effective date of those final rules, as proposed by the Agencies. The Agencies still propose to allow only two years for banking organizations conducting ongoing securitization conduits to implement the new capital requirements. ABA continues to recommend that banking organizations have up to five years to implement additional capital requirements to ongoing securitization conduits.

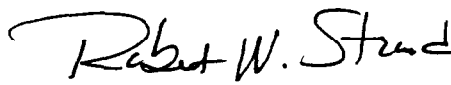
Conclusion

ABA appreciates the opportunity to comment on the proposed rule and the Agencies' efforts to modify capital requirements to truly reflect the relative risk associated with various types of assets. If the staff of the Agencies have any questions about these comments, please call the undersigned.

Sincerely,



Paul A. Smith



Robert W. Strand