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-----Original Message-----
From: mbarry@mayerbrown.com [mailto:mbarry@mayerbrown.com]
Sent: Wednesday, June 07, 2000 5:49 PM
To: regs.comments@occ.treas.gov; comments@fdic.gov;
public.info@ots.treas.gov
Cc: rhugi@mayerbrown.com
Subject: Comment Letter: Risk-Based Capital Standards

We are pleased to submit the attached letter on behalf of the organizations identified on Schedule I to the letter. This letter comments on several aspects of the March 8, 2000 Joint Notice of Proposed Rulemaking relating to Risk-Based Capital Standards; Recourse and Direct Credit Substitutes to the extent relating to multi-seller asset-backed commercial paper programs. We are also sending a copy via air courier.

Should you have any questions about the attached, please feel free to contact any of the following individuals:

Jason Kravitt, Co-Chairman and Partner, Mayer, Brown & Platt (312/701-7015)
Robert Hugi, Partner, Mayer, Brown & Platt (312/701-7121)
Mary Barry, Associate, Mayer, Brown & Platt (312/701-8460).

Yours very truly,

Mary R. Barry

Text of Comment Letter:

Appendix B for Comment Letter:

June 7, 2000

TO: Board of Governors of the Federal Reserve System
Attention: Jennifer J. Johnson, Secretary
Docket No. R-1055

Federal Deposit Insurance Corporation
Attention: Robert E. Feldman, Executive Secretary

Office of the Comptroller of the Currency
Communications Division
Docket No. 00-06

Office of Thrift Supervision
Attention: Manager, Dissemination Branch, Records Management and Information Policy
Docket No. 2000-15

Re: Risk-Based Capital Standards; Recourse and Direct Credit Substitutes–Multi-Seller Conduit Comment

Ladies and Gentlemen:

The banking organizations listed on Schedule I (the "*Commenting Banks*" or "*we*") wish to thank the member agencies (the "*Agencies*") of the Federal Financial Institutions Examination Council for this opportunity to comment on the March 8, 2000 Joint Notice of Proposed Rulemaking relating to Risk-Based Capital Standards; Recourse and Direct Credit Substitutes[1/] (the "*Release*"). In this letter we comment on the aspects of the Release that would affect United States banks and thrifts (collectively, the "*banks*") included in the Commenting Banks as a result of their participation in an important segment of the United States capital markets: the asset-backed commercial paper ("*ABCP*") markets.

Approximate overall outstandings in the international ABCP markets as of December 31, 1999 were $521 billion. Approximately $340 billion (65%) of that ABCP was issued by multi-seller ABCP programs ("*Multi-Seller Conduits*"). Multi-Seller Conduits administered by United States entities, including the Commenting Banks, collectively accounted for approximately $193 billion (57%) of the approximately $340 billion outstanding ABCP issued by Multi-Seller Conduits.

While the Commenting Banks and their respective affiliates also account for a significant percentage of the other ABCP outstanding as well as term asset-backed securities issued by banks, this comment

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1/ 65 Fed. Reg. 12320.

addresses only the potential impact of the proposals set forth in the Release upon Multi-Seller Conduits and the banks that administer and provide credit enhancement to them. The term "*credit enhancement*" is used in this Comment Letter to refer to third party credit enhancements and recourse provided by banks in securitizations of their own assets. The term "*third party credit enhancements*" is used to refer to direct credit substitutes issued or otherwise assumed by banks in securitizations (including purchased subordinated interests).

Appendix A describes how Multi-Seller Conduits operate, including a description of credit enhancement that may be provided in full or in part by the bank that administers a Multi-Seller Conduit.

Executive Summary

The Commenting Banks support the Agencies' goal of modifying capital requirements to better reflect the relative risk associated with various assets and off-balance sheet positions. In particular, the Commenting Banks appreciate and strongly support the inclusion of an internal risk ratings alternative for unrated credit enhancement positions.

We have four principal comments on the proposals set forth in the Release:

- Based on our experience and our analysis of statistical information discussed below, we are concerned that the Agencies' expectation as to the amount of capital required for securitization positions generally arising in Multi-Seller Conduit transactions substantially exceeds the amount that is justified by the credit risk inherent in these positions.

- We believe that the Agencies should recognize more ratings categories and corresponding risk weights than the five contemplated by the Proposal.

- We would strongly encourage the Agencies to expand the scope of the internal credit ratings approach to permit the assignment of risk weights at all credit levels based on an internal rating and not limit the treatment of positions internally rated higher than BBB to that of the risk weight assigned to BBB positions. If the Agencies were unwilling to expand the scope of the internal ratings approach at this time, we believe that, at a minimum, credit enhancement positions that are internally rated BBB and above should be treated the same as positions with an external rating of BBB, regardless of whether the risk weight ultimately adopted by the Agencies for these positions is less than 100%. We also believe that this treatment is appropriate at each level below BBB that is assigned a risk weight based on the face amount of the position (as opposed to being grossed up).

- We believe that appropriate standards should be developed for approval of banks' internal credit ratings systems so that individual banks would be able to have their systems

approved as soon as possible, but in any event, prior to the end of the transition period contemplated by the Release.

Section 3 of this Comment Letter sets forth several additional comments on the Release.

The remainder of this Multi-Seller Conduit Comment is organized as indicated in the following outline and discusses the Commenting Banks' key areas of concern in more detail.

1. Comments on Proposed Capital Requirements.

A. Appropriate Capital Requirements

We are concerned that the amount of capital prescribed for securitization positions generally arising in Multi-Seller Conduit transactions substantially exceeds the amount that is justified by the credit risk inherent in these positions. To demonstrate this point, we have prepared and present as *Appendix B* to this comment an internal risk ratings-like capital grid with buckets that map to the rating system of one of the nationally recognized external credit rating agencies: Moody's Investors Service, Inc. In doing so, we do not mean to suggest that internal risk ratings approaches used by any of the Commenting Banks do or should likewise map to any external rating agency's system. Nor is the grid on *Appendix B* used or proposed for use by any particular bank. We believe that each bank should be free to develop its own internal risk ratings approach, consistent with regulatory supervision as contemplated by the Release.

Our purpose in preparing and presenting *Appendix B* was instead to allow a direct comparison between the Agencies' proposed securitization risk weights and example risk weights based upon an internal

risk ratings-type application of the available statistical evidence. We used Moody's ratings because that enabled us to link directly into various studies of default and ratings transition experience for obligors with various Moody's ratings. The table below provides a side-by-side comparison of the Agencies' proposed risk weights with our example risk weights. The table maps the Moody's categories that we used as benchmarks to the generally equivalent Standard & Poor's benchmarks used by the Agencies in the Release. For purposes of this table, we have assumed that the Agencies intended to include the plus and minus subcategories of each rating grade within the same risk rate requirement for that rating grade.

	Risk Weights	
Credit Rating	**Agencies' Proposed Risk Weight**	**Commenting Banks' Risk Weight Example**
AAA/Aaa	20%	7.50%
AA+/Aa1	20%	8.63%
AA/Aa2	20%	9.63%
AA-/Aa3	20%	10.38%
A+/A1	50%	12.50%
A/A2	50%	15.38%
A-/A3	50%	22.63%
BBB+/Baa1	100%	30.88%
BBB/Baa2	100%	39.88%
BBB-/Baa3	100%	59.63%
BB+/Ba1	200%	82.50%
BB/Ba2	200%	107.75%
BB-/Ba3	200%	135.25%
B+/B1	gross-up*	165.75%
B/B2	gross-up*	194.25%
B-/B3	gross-up*	229.25%
Unrated	gross-up*	NA

*subject to the application of the low-level recourse rule.

The methodology we used to derive our risk weight examples is summarized below:

- For each bucket, we assigned a probability of default (referred to as "*PD*") based upon idealized default statistics developed by Moody's, specifically the idealized two year default rate. The two year idealized default rate was chosen for several reasons. First, the two year period generally corresponds to or exceeds the average life of the assets held in the Multi-Seller Conduits administered by the Commenting Banks. Second, the idealized default rates were used rather than actual default rates to smooth out anomalies found in the actual default rates (e.g., the voluntary bankruptcy in 1988 of the then AA-rated Texaco in response to an unexpectedly large verdict against Texaco in a price-fixing lawsuit). These idealized default rates are used by Moody's to establish appropriate credit enhancement levels in collateralized loan obligation and collateralized bond obligation securitizations. We have included both the idealized and actual default rate statistics provided by Moody's in *Appendix B* for comparison. Although the Moody's default figures relate to defaults by rated corporate obligors, rather than securitizations, we believe the findings provide a reasonable, and conservative, basis for assigning a PD to securitization positions with equivalent ratings. In fact, many securitization industry participants believe that a securitization position with a given external rating tends to be a better credit risk than a corporation with the same rating. This is supported by the fact that the number of negative rating transitions remain extremely low for securitization positions.[2/]

- We used a loss severity assumption (referred to as "loss given default," or "LGD") of 15%. This assumption was drawn primarily from a default study by Citibank of its portfolio over a 24 year period.[3/] The average LGD for "structured loans" was 12.75%, with a sample size of 89 defaulted structured loans. "Structured loans" are defined as highly structured, highly collateralized loans, where lending is done on a formula basis (e.g. an advance rate against collateral).[4/] The 15% assumption is further supported by the results of a recent Moody's study[5/] on bank loan recoveries in corporate bankruptcies. The 15% LGD generally corresponds to the loss rate for facilities secured by receivables, inventory or cash. Virtually all securitization positions are effectively secured by receivables or other assets that

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2/ *See* Joseph Hu, Ph.D., Standard & Poor's, *U.S. ABS Credit Ratings Show Solid Performance, 1985-1999* (December 1999); and Moody's, *Rating Changes in the U.S. Asset-Backed Securities Market: August 1999 Update.*

3/ Elliot Asarnow & David Edwards, Citibank, Portfolio Strategies Group, "*Measuring Loss on Defaulted Bank Loans--A Twenty Four-Year Study*", December 1994.

4/ *Ibid.* at p.3.

5/ Moody's Special Comment, *Bankrupt Bank Loan Recoveries* (June 1998).

convert into cash. The average recovery rate for senior secured facilities of this type in the Moody's study was 88.77%, with a sample size of 24 bankruptcies and a standard deviation of 20.87%. The median recovery rate was 100% or more. The Commenting Banks feel that an 85% recovery rate is very conservative for securitizations given the results of the Citibank Study showing an average LGD of 12.75% for structured loans and the comparable results of the Moody's study for secured loans, neither of which have all of the structural protections found in securitizations.

- The expected loss for each risk rating bucket is calculated as the product of PD *times* LGD.

- We calculated unexpected losses using a statistical methodology described in the notes to *Appendix B*.

- Our example risk weights are based on minimum capital gradients. We calculated the minimum capital gradients as double the unexpected loss, subject to a floor derived from a survey of actual economic capital ratios used by various banks for assets in the various buckets.[6/] Among other reasons, we chose a factor of two because that resulted in an average regulatory capital requirement of about 8% for positions in the Ba2/BB rating level. We centered our example at this level because we believe that the Ba2/BB rating level approximates the average rating of borrowers in banks' corporate credit portfolios.

- We have not included indicative capital requirements for the four impaired categories of "watch," "OAEM," "substandard" and "doubtful" because these categories are not included in the Release.

Based on the historically low losses in securitizations, including credit enhancement positions, and our analysis of available statistical information, we are concerned the Agencies' proposed risk weights substantially exceed the amount that is justified by the credit risk inherent in securitization positions generally arising in Multi-Seller Conduit transactions and encourage the Agencies' to reconsider the risk weights to be applied at each ratings level.

In light of our analysis, we oppose the proposed higher standard for securitization positions than what applies to bank's unsecured corporate loan portfolios. The average corporate credit is generally

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[6/] It is worth noting that these internal bank economic capital ratios generally are set in part by reference to a desired credit rating of the bank itself and that the target ratings for a number of the banks that participated in the survey may well have been higher than the rating that should correspond with the risk weight requirement.

thought to be in the range of a BB equivalent. Indeed, in its recent paper on capital adequacy, the Basel Committee on Banking Supervision proposed a 100% risk weight for unsecured corporate credits rated at the BB+ to BB- level.[7/] Because of the secured nature of securitization positions, which makes anticipated LGD smaller than that for unsecured positions, the Commenting Banks believe that regulatory capital requirements for securitizations should be *lower* at each rating level (whether external or based on internal credit rating levels) than regulatory capital requirements assigned to unsecured corporate credits. At a minimum, risk weights assigned to securitization positions should be gauged so that positions rated BB would be assigned a 100% risk weight.

We believe that a further reduction in minimum capital requirements would better achieve the Agencies' goal of aligning capital requirements with the relative risks associated with a particular position.

B. Finer Tuning of Capital Requirements.

We appreciate the increase to five ratings levels in the Release from the three levels initially proposed by the Agencies in 1997. However, we strongly believe that there should be more credit ratings levels to more appropriately reflect real differences between differently rated positions. In particular, we believe that there should be at least one additional credit level below the BB- level with a direct risk weight assignment prior to using the gross-up method for determining capital requirements. While our indicative capital grid appearing in *Appendix B* includes 16 categories for non-impaired assets, we recognize that 16 may exceed the optimal number from the perspective of administrative convenience. We note that survey results in a recently released report by the Basel Committee on Banking Supervision indicate that the average number of grades used by banks in their internal risk ratings covering non-impaired loans is 10, with less than 15% of banks using five or fewer grades.[8/]

The use of finer distinctions between rating levels would avoid anomalies where a small distinction (e.g., between AA- and A+ or between BBB- and BB+) creates a large difference in risk-based capital requirements, and would reduce the incentives to game the system that are created by such anomalies. The Commenting Banks' approach to finer gradients is consistent with that suggested by Standard & Poor's in recently commenting on the capital requirement proposals issued by the Basel Committee on Banking Supervision. Standard and Poor's also advocates a system of finer gradients to better reflect the varying default probabilities at different ratings levels.[9/]

7/ "*Consultative Paper on a New Capital Adequacy Framework*," Basel Committee on Banking Supervision, June 1999, p.24.

8/ "*Range of Practice in Banks' Internal Ratings Systems*," Basel Committee on Banking Supervision (January 2000), p. 14.

9/ "*Basel Committee's New Capital Standards Could Strengthen Banking,*" Standard & Poor's Counterparty Ratings Guide, Fourth Quarter (1999), p.16.

2. Comments on the Internal Risk Ratings Approach.

A. General Comments.

The Commenting Banks strongly support the inclusion of an internal risk ratings alternative in this Release. We thank the Agencies for its inclusion as requested in our comment to the 1997 proposal of the Agencies. The proposed internal risk ratings alternative will take advantage of the substantial and ongoing advances in banks' ability to measure and analyze credit risks of various activities. It should also be an administratively efficient form of regulation, as it builds on processes that many banks already have in place for various management purposes. The Commenting Banks agree with the Agencies that an internal risk ratings alternative is an important first step in revising regulatory capital requirements. Ultimately, the Commenting Banks believe that regulatory capital requirements should be based upon banks' economic capital models. We look forward to working with the Agencies in the future towards developing this system.

We encourage the Agencies' to expand the scope of the internal ratings approach to recognize that approved internal risk ratings systems at sophisticated banks are the most efficient and effective means of calculating credit risk for a particular securitization position. If the Agencies were unwilling to expand the scope of the internal ratings approach, we believe that credit enhancement positions that are internally rated BBB and above should be treated the same as positions with an external rating of BBB, even if the risk weight ultimately adopted by the Agencies for these positions is less than 100%. We also believe that this treatment is appropriate at each level below BBB that is assigned a risk weight based on the face amount of the position (as opposed to being grossed up). These points are discussed more fully in *Paragraph B* below.

The Commenting Banks would strongly oppose the adoption of an external ratings approach for determining capital requirements for credit enhancement positions without the adoption of an internal ratings approach. We believe that an important component of such an internal ratings approach will be the establishment of an appropriate review system for the approval of the internal risk rating systems that would permit banks to have their internal systems approved (if appropriate) as soon as possible, but in any event, prior to the end of the transition period contemplated by the Release.

There would be serious practical problems with adopting an external ratings-based approach prior to the time that banks' internal risk ratings systems can be approved by the regulators. Requiring banks to obtain ratings on currently unrated transactions to avoid higher capital requirements would have serious ramifications for the orderly flow of the market. Currently banks provide credit enhancement in the normal course of business without obtaining external ratings for a transaction. The increased flow of transactions submitted to rating agencies for review under a system requiring external review for favorable capital treatment would be tremendous and would threaten to overload an already burdened system. Delays that are likely to arise because of increased transaction flow could have a great impact on the cost and availability

of funds to borrowers under a regulatory scheme that penalizes banks for entering into unrated credit enhancement positions. Finally, as private, profit-oriented enterprises, the rating agencies have their own motivations, which may not always be consistent with regulatory goals, and regulatory agencies would have no way of bringing the rating agencies into line with such goals as they do with banks which are subject to regulatory review.[10/]

B. Expansion of Scope of Internal Risk Ratings Approach

The Commenting Banks believe that once a bank's internal system has been approved by its regulators, risk weights should be assigned based upon internal credit ratings without the investment grade limitation set forth in the current Release. Even if the Agencies were unwilling to expand the scope of the internal risk ratings alternative for all ratings levels, we believe that credit enhancement positions that are rated BBB and above should be treated the same as positions with an external rating of BBB, even if the risk weight ultimately adopted by the Agencies for these positions is less than 100%. We also believe that this treatment is appropriate at each level below BBB that is assigned a risk weight based on the face amount of the position (as opposed to being grossed up).

The traditional regulatory approach presumes that banks are competent to perform an analysis of the credit risk of a particular transaction, subject to regulatory review. There is no reason to reverse this normal presumption upon the introduction of appropriately monitored capital requirements for securitization positions that rely on this core function. Banks (including all Commenting Banks) providing credit enhancement to Multi-Seller Conduits have generally developed sophisticated internal systems for grading and monitoring the credit risk of each securitization to which they are a party. Indeed, it has become the market standard for rating agencies to use internal bank risk scores as proxies for ratings of otherwise unrated borrowers in collateralized loan and debt obligation securitizations.

Providers of program credit enhancement have a very strong motivation to be careful, since they actually take the credit risk and will bear the consequences of bad credit decisions (both at the institutional level and at the level of individual officers that analyze and approve a particular transaction). Additionally, because of ongoing relationships with customers, these banks typically have access to more information about a particular transaction than would an external rating agency. Their credit review generally will include a more complete business due diligence on the customer and other relevant parties than a typical rating agency analysis, including a credit analysis of such parties, discussion with management of such parties and review of such parties' business history and plans. As a result of this access to information and direct incentive to assess risk, sophisticated banks providing credit enhancement to Multi-Seller Conduits provide the most efficient and effective means of assessing the risk of a particular credit enhancement position.

10/ Nothing contained herein is meant to suggest that the Commenting Banks believe that the rating agencies should be subject to regulation.

The Commenting Banks believe that these attributes of internal risk ratings systems should be recognized in adopting an internal risk ratings approach. Subject to appropriate regulatory review prior to approval of any internal bank system, the Commenting Banks believe that an internal risk ratings approach should not limit unrated positions to capital treatment assigned to positions with an external rating of investment grade. Instead, a well-developed internal risk ratings approach should establish comparable capital requirements for internal ratings as those adopted for ratings assigned by external rating agencies. As the Agencies have noted, the key component to the success of the internal ratings approach is the approval of a bank's internal ratings system. Once a system has been approved, there should be no discrimination in the assignment of risk weights because of the use of an internal risk rating.

C. Regulatory Requirements.

The Commenting Banks believe that adopting an internal credit risk ratings system for establishing minimum capital requirements is vital to avoiding the "one-size-fits-all" approach to measuring and affecting bank safety and soundness criticized by Chairman Greenspan.[11/] An important prerequisite to the adoption of an internal credit risk ratings approach is the establishment and implementation of an effective regulatory review procedure for approving a bank's internal credit rating system.

While we understand that the Agencies may be concerned over apparent conflicts of interest for bank credit committees that would be the focal point of any internal risk ratings approach, we emphasize that credit analysis is a core function of every bank. Each and every day credit committees must make informed decisions as to the level of risk to which their institution will be subject. These decisions are already the subject of independent regulatory review. Furthermore, banks are also subject to market discipline as their credit decisions and performance are monitored by rating agencies and investors. To meet regulatory and market standards, sophisticated banks have adopted stringent internal review and monitoring processes for analyzing the performance of their credit committees. Thus, while credit committees may be subject to individual pressures to approve a particular transaction, they are equally, if not more compellingly, subject to the consequences of the ultimate risk of that transaction on the well-being of their institution as a whole, as well as to their continued success within that institution. Coupled with the adoption of more finely-graded credit ratings levels for capital requirements, which would reduce the incentives to game the system, the Commenting Banks feel that these individual, institutional, market and regulatory review processes will safeguard against potential conflicts of interest.

The Commenting Banks believe that any regulatory review process for internal banks' credit review systems should be designed and applied so that there is a reasonable expectation that sophisticated banks will be able to use an internal system prior to the end of the transition period. We do not believe that a

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11/ Remarks by Chairman Alan Greenspan at the Conference on Bank Structure and Competition of the Federal Reserve Bank of Chicago, Chicago, Illinois, May 1, 1997 (as reported in the Federal Reserve Board's web site).

separate internal system should be required for securitizations. Rather, a bank should, subject to regulatory approval, be able to use its overall system for assigning a credit risk rating to a particular credit enhancement position in the internal ratings approach contemplated by the Proposal. We look forward to working with the Agencies in the development and implementation of a well-developed regulatory process designed to preserve the integrity of the regulatory capital requirements as well as enhance the internal credit analysis systems of individual banks.

3. Additional Comments.

A. The Commenting Banks object to what we perceive as a continuing discriminatory perception of securitizations maintained by the Agencies. The Agencies note that banking organizations "take advantage" of an anomaly in capital requirements by providing letters of credit to Multi-Seller Conduits rather than initially making loans on their own books and then selling those loans. We believe that the decision to have a Multi-Seller Conduit lend directly to a customer, backed by credit enhancement provided by a bank, is an efficient and legitimate structure choice for a bank. Subject to our comments on the Release set forth in this letter, while we do not disagree with the proposed changes to the capital requirements for letters of credit, we do believe that the current regulations sufficiently addressed the credit risks of credit enhancement positions.

B. The Commenting Banks wish to clarify the meaning of "mapping" an internally assigned credit rating to that of an external credit rating agency. The Commenting Banks believe that "mapping" should not require the application of an internal credit analysis that is identical to that of any external credit rating agency. Instead, the Commenting Banks believe that mapping should involve the use of the best available statistical information by an internal credit rating system (e.g., rating agency's statistical information, specific bank's portfolio information, etc.) for the internal analysis of a particular position. Additionally, until Agencies adopt a full internal ratings approach that does not tie risk weight assignments to external ratings, "mapping" should require only a reasonable method for establishing a relationship between internal ratings grades and the external ratings levels used to assign risk weights generally, rather than direct verification of the external rating that would apply to each position. In the collateralized loan and debt securitization markets where use of internal ratings as a proxy for unrated borrowers has become the market standard, a rating agency does not require strict adherence to its particular set of statistical data or credit approval process. Instead it focuses on the verification of statistical information used in an internal process and approval of the overall ratings process itself. The Commenting Banks believe a similar system should be adopted for an internal risk rating approach.

C. The table indicating the risk weights for each ratings level set forth in the Release[12/] does not indicate whether the "plus" and "minus" subcategories for each ratings level are included in that risk weight category. While we advocate a greater number of ratings levels, we would appreciate the Agencies

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12/ 65 Fed. Reg. at 12328.

clarifying that each ratings level includes its respective "plus" and "minus" subcategories. For example, we interpret the Agencies' proposal to include positions rated A+, A and A- in the 50% risk weight category.

D. The Release states that an unrated position can be deemed to have the same rating as a rated, traded position that is junior to it.[13/] As discussed in *Paragraph 2.B.* above, the Commenting Banks believe that risk weights for unrated positions should be assigned based upon a bank's internal credit rating for those institutions whose systems have been approved by bank regulators. For other institutions, we believe that the "deemed rating" treatment should also be available for unrated positions that are *pari passu* to a rated, traded position. For purposes of this comment, "*pari passu*" means that each position absorbs losses pro rata at the same level of priority. Because the credit risk for both rated and unrated positions that are *pari passu* is identical, the unrated positions should be entitled to equal treatment with the rated, traded position.

4. Conclusion.

The Commenting Banks support the Agencies' continuing efforts to modify capital requirements to truly reflect the relative risk associated with various assets. We appreciate the Agencies' responsiveness to comments on earlier proposals in preparing this Release and believe that our continuing dialogue will result in regulatory requirements that provide for the maintenance of prudent levels of capital without disadvantaging banks in the fiercely competitive global capital markets. We look forward to continuing to work with the Agencies on the proposals set forth in this Release and on more wide-ranging proposals currently being contemplated by the Basel Committee on Banking.

With your permission, we would appreciate the opportunity to add to the institutions included as Commenting Banks as additional institutions have an opportunity to obtain internal approval for support of the positions discussed in this letter.

* * *

Respectfully submitted.

13/ 65 Fed. Reg. at 12328.

Schedule 1

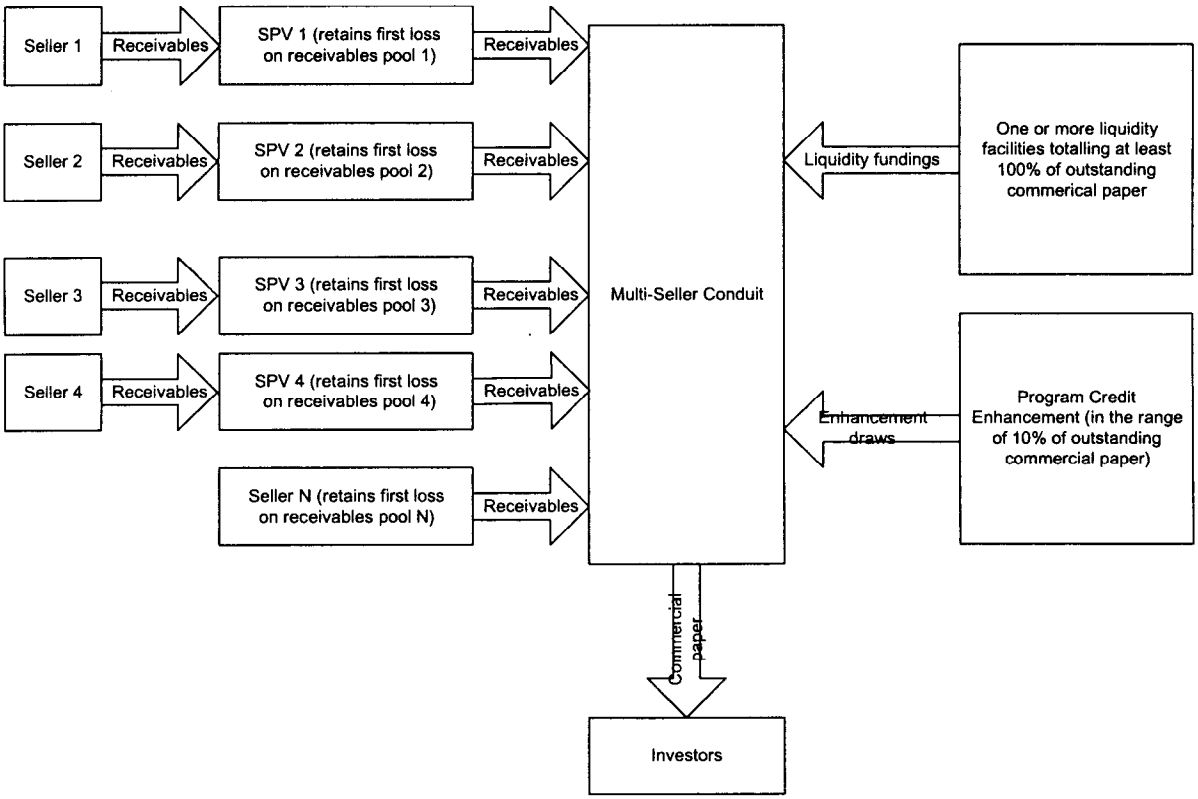
List of Commenting Banks

BANC OF AMERICA SECURITIES LLC
BANC ONE CORPORATION
BANK OF AMERICA, NATIONAL ASSOCIATION
BANK OF MONTREAL
THE CHASE MANHATTAN BANK
CITIBANK, N.A.
FIRST UNION CORPORATION
FLEET NATIONAL BANK
MBNA CORPORATION
SOCIÉTÉ GÉNÉRALE
STATE STREET CAPITAL MARKETS, LLC
WACHOVIA BANK, N.A.

Appendix A
Description of Multi-Seller Conduits

Multi-Seller Conduits administered by banks provide the banks' customers with access to funding at attractive commercial paper rates. These conduits compete with other capital market financing products, including term asset-backed executions.

The commercial paper issued by Multi-Seller Conduits is generally supported by liquidity commitments. Typically, a Multi-Seller Conduit is not permitted to issue commercial paper with an outstanding principal balance greater than available liquidity commitments. In addition to liquidity commitments, commercial paper issued by Multi-Seller Conduits is generally partially enhanced, meaning that it is supported by a letter of credit or other unconditional form of credit enhancement in an amount equal to less than 100% of the outstanding commercial paper (often in the neighborhood of 10%). Many times (but not always) this partial credit enhancement ("*Program Credit Enhancement*") is provided in full or in part by the bank that administers the Multi-Seller Conduit. The following diagram illustrates how Multi-Seller Conduits are structured:



Although Program Credit Enhancement absorbs losses on underlying receivables ahead of the commercial paper issued by a Multi-Seller Conduit, that does not mean that Program Credit Enhancement tends to be a particularly risky credit position. In fact, the Commenting Banks who are Program Credit Enhancers believe that their exposures on these positions are better than the exposure on an average unsecured corporate credit because of the collateral supporting their positions. There are a number of reasons for this, including:

1. Program Credit Enhancement is virtually never in a first loss position. Rather, the first loss position is always taken by the customer, through overcollateralization or, in some cases (with strong sellers), recourse. The amount of first loss protection varies from transaction to transaction, based upon the characteristics of the receivables pool. As a general matter, however, the first loss protection covers a multiple of the historical loss rate, as well as significant obligor concentrations. Thus, first loss protection is sized to cover not merely expected losses on the receivables pool, but also unexpected losses, based upon modeling of stress scenarios or other statistical analysis.

This first loss position provided by sellers effectively takes the place of the regulatory capital that would be required if these assets were on the bank's own balance sheet. This observation is supported by the fact that the first loss protection in these transactions (which is meant to cover both expected and unexpected losses) typically exceeds by far the loss reserves maintained on the books of the seller (which, consistent with generally accepted accounting principles, are meant to cover expected losses).

2. The existence of a discrete pool of assets related to a diverse pool of obligors in any securitization (as opposed to the credit risk of a single obligor) serves to reduce the likelihood of downward migration of the credit quality of, and the impact of the occurrence of negative events (e.g. bankruptcy of an obligor) on, a particular transaction. Securitizations typically further separate the receivables pools from the overall risk of their originator through transfer to a bankruptcy remote entity prior to funding. Multi-Seller Conduit transactions also have other structural features designed to allow an administering bank to maintain the stability of a receivables pool and mitigate the effect of defaults. These include frequent pool reporting requirements, amortization triggers for revolving facilities that allow for the liquidation of a receivables pool once it fails to meet specified performance requirements, audit mechanisms that allow an administering bank to inspect its customer's operations and ensure proper servicing of the receivables pool and the ability when warranted of an administrator to take control of payment systems to provide for direct payments to the Multi-Seller Conduit alleviating bankruptcy and fraud risk of its customers.

3. A provider of Program Credit Enhancement will not be affected by losses unless and until they exceed the first loss positions of sellers of receivables to the related Multi-Seller Conduit. Experience to date shows that draws of Program Credit Enhancements (if any) have been very rare, and ultimate losses (if any) are not believed to have been statistically significant.

Appendix B

Examples of Minimum Capital Gradients

Notes

1. The 16-point scale is not the actual scale currently in use by any of the banks. It has been chosen as a model reporting standard for purposes of this proposal.

2. While the methodology used applies Moody's credit ratings and statistical information, the Commenting Banks note that this is exemplary and that comparable information is available from other established rating agencies.

3. The median ECR (economic capital requirement) was derived by Mayer, Brown & Platt from institution-specific data that were provided to Mayer, Brown & Platt on a confidential basis by nine of the banks that participated in the preparation of a comment letter on the Agencies' proposed credit recourse rules in 1997. Included among the nine responding banks were U.S. banks that administered Multi-Seller Conduits that collectively accounted for about 85% of the outstanding ABCP issued by Multi-Seller Conduits administered by United States banks as of December 31, 1997. None of the participating banks was given any information about the institution-specific economic capital data provided by any other bank.

Each of the banks was asked to provide (in basis points) its internal economic capital allocation ratio for credit risk of a pool of term loans with the following characteristics at various credit grades:

Transaction size:	$100 million in a portfolio of $5 billion
Collateral:	Secured (trade receivables, if this detail is required)
Duration:	One year
Industry:	Diversified/industry neutral
Region:	U.S.A.
Draw status:	Fully funded

Each bank was asked to use confidence level and severity assumptions consistent with its own internal policy, so that the data submitted by each bank should reflect the actual economic capital ratio that it would assign to each level of the specified gradient.

All data provided by the participating banks is reflected in the mean, with no screening or selection. One adjustment was made because some banks reported two or three different ECRs that could apply to a particular level of the gradient. In these cases, the mean of the potential ECRs identified by a bank for a particular level of the gradient was treated as the ECR of that bank for that level, with no attempt to weight the various potential ECRs on any basis.

The figures shown reflect the mean of the responses received with respect to each level of the gradient. The figures give equal weight to the data submitted by each reporting bank. No attempt has been made to weight the averages to reflect the relative size of various institutions, their market share in the Multi-Seller Conduit market or any other factor.

4. For each bucket, we assigned a probability of default (referred to as "*PD*" in the Supplemental IRB Paper and below) based upon idealized default statistics established by Moody's, specifically the idealized two year default rate. The two year idealized default rate was chosen for several reasons. First, the two year period generally corresponds to or exceeds the average life of the assets held in the Multi-Seller Conduits administered by the Commenting Banks. Second, the idealized default rates were used rather than actual default rates to smooth out anomalies found in the actual default rates.

5. A 15% loss severity assumption was used. This assumption was drawn primarily from a default study by Citibank of its portfolio over a 24 year period.[14/] The average LGD for "structured loans" was 12.75%, with a sample size of 89 defaulted structured loans. "Structured loans" are defined as highly structured, highly collateralized loans, where lending is done on a formula basis (e.g. an advance rate against collateral).[15/] The 15% assumption is further supported by the results of a recent Moody's study[16/] on bank loan recoveries in corporate bankruptcies. The 15% LGD generally corresponds to the loss rate for facilities secured by receivables, inventory or cash. Virtually all securitization positions are effectively secured by receivables or other assets that convert into cash. The average recovery rate for senior secured facilities of this type in the Moody's study was 88.77%, with a sample size of 24 bankruptcies and a standard deviation of 20.87%. The median recovery rate was 100% or more. The Commenting Banks feel that an 85% recovery rate is very conservative for securitizations given the results of the Citibank Study showing an average LGD of 12.75% for structured loans and the comparable results of the Moody's study for secured loans, neither of which have all of the structural protections found in securitizations.

6. Unexpected losses have been calculated to determine the standard deviation from expected losses by combining the expected losses and severity distributions using the Beta-Bernoulli method. Using the Beta-Bernoulli method (which serves as a proxy for a standard deviation calculation for a statistical pool too small to generate a reliable standard deviation using a conventional formula), the unexpected loss factor is calculated as follows: Unexpected Loss=(((default rate x (1-default rate) x (severity^2)) + ((default rate x severity x (1-severity)))/4))^(½). Although the Commenting Banks may use other, more precise methods to calculate unexpected loss in their own internal models, we believe that the Beta-Bernoulli formula provides a conservative estimate of unexpected losses. It was also a convenient method to use in this standardized approach given the difficulty of combining the Commenting Banks' internal historical loss data. The unexpected loss methodologies employed by the various Commenting Banks are reflected indirectly in the Median ECR column.

[14/] Elliot Asarnow & David Edwards, Citibank, Portfolio Strategies Group, "*Measuring Loss on Defaulted Bank Loans--A Twenty Four-Year Study*", December 1994.

[15/] *Ibid.* at p.3.

[16/] Moody's Special Comment, *Bankrupt Bank Loan Recoveries* (June 1998).

7. The minimum capital gradient example for each ratings category is calculated as two times the unexpected losses for each of the non-impaired categories, subject to a floor based upon the mean economic capital ratio for assets in that risk category based upon a survey of the Commenting Banks.

8. The risk weight equivalent of each of our minimum capital gradients was calculated by dividing each minimum capital gradient by 8%.

Risk Weight Examples

Moody's Rating	Median E	Loss Severity	Moody's 2 year Actual Default Rate	Moody's 2 year Idealized Default Rate	Expected Loss	Unexpected Loss	Minimum Capital Gradient	Risk Weight Examples
Aaa	0.60%	15.00%	0.00%	0.0002%	0.00003%	0.03%	0.60%	7.50%
Aa1	0.69%	15.00%	0.00%	0.0030%	0.00045%	0.13%	0.69%	8.63%
Aa2	0.77%	15.00%	0.00%	0.0080%	0.00120%	0.21%	0.77%	9.63%
Aa3	0.83%	15.00%	0.11%	0.0190%	0.00285%	0.32%	0.83%	10.38%
A1	1.00%	15.00%	0.03%	0.0370%	0.00555%	0.45%	1.00%	12.50%
A2	1.10%	15.00%	0.03%	0.0700%	0.01050%	0.62%	1.23%	15.38%
A3	1.18%	15.00%	0.15%	0.1500%	0.02250%	0.90%	1.81%	22.63%
Baa1	1.66%	15.00%	0.29%	0.2800%	0.04200%	1.23%	2.47%	30.88%
Baa2	1.76%	15.00%	0.28%	0.4700%	0.07050%	1.60%	3.19%	39.88%
Baa3	2.19%	15.00%	0.75%	1.0500%	0.15750%	2.38%	4.77%	59.63%
Ba1	2.95%	15.00%	2.14%	2.0200%	0.30300%	3.30%	6.60%	82.50%
Ba2	4.22%	15.00%	2.84%	3.4700%	0.52050%	4.31%	8.62%	107.75%
Ba3	6.01%	15.00%	6.95%	5.5100%	0.82650%	5.41%	10.82%	135.25%
B1	7.10%	15.00%	9.17%	8.3800%	1.25700%	6.63%	13.26%	165.75%
B2	8.89%	15.00%	13.83%	11.6700%	1.75070%	7.77%	15.54%	194.25%
B3	11.50%		20.97%	16.6100%	2.49150%	9.17%	18.34%	229.25%