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TO: Comment File--Interagency NPR to amend Regulatory Capital Treatment of Residual Interests in Asset Securitizations or Other Transfers of Financial Assets

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SUBJECT: Interagency Meeting with Bank Representatives

On November 3, 2000 the interagency working group on the residual interest NPR met with bank representatives at their request. The meeting was held at the Board of Governors of the Federal Reserve. Attendees representing the banks included Jason Kravitt and Mary Barry of Mayer, Brown &Platt; Gwinneth Berexa of Providian Bank; Christopher Carey of The Provident Bank; David Kerns of Capital One; David Nunn of Bank One; and Vernon Wright of MBNA (the "Bank Group").

After introductions and opening remarks, Messrs. Wright and Carey provided an overview of the nonmortgage securitization market. Their remarks included the following:

- The market size is now approximately $440 billion. $335 billion of this is within the U.S. $196 billion of this represents public securitizations.

- There will be $575 billion of asset backed commercial paper in the market by the end of the year.

- Fifty-five to sixty-five percent of securitization transactions are conducted by U.S. banks.

- Benefits of securitization include, liquidity, flexibility, reduction of risk and global distribution. Benefits also include reducing banks' reliance on retail brokered deposits.

Mr. Kerns next spoke concerning the effect of the NPR on the banking industry. His remarks included the following:

- This securitization market is often the only one available to a bank. The NPR could force reductions in the use of the securitization market, making banks more reliant on other markets, thus, effectively closing this market.

- Cost of wholesale funding will increase and thereby weaken the banking system.

- The greater capital required to be held by banks will result in an increased cost of credit that will be passed on to consumers.
- Consumers will have fewer choices. Minority and small business lending by banks will be reduced. Credit Access will be limited for marginal debtors. Many banks will curtail or eliminate their securitization activities rather than pay the added costs imposed by the NPR.

- The NPR imposes higher costs for regulated institutions as compared to non-regulated institutions.

- Another concern is that the proposal has no grandfathering provision for existing transactions. This will require that institutions increase capital on these existing transactions.

Mr. Kravitt next spoke. His remarks included the following:

- The definition of residual interest is too broad. More specifically, if the concern is excessive valuation, there is no reason to include traditional credit enhancements, such as cash collateral accounts, in the definition of residual interest.

- The Federal banking agencies concern seems to be that residual interests are overvalued and that the credit risk is greater than 8%. These concerns can be addressed by the Bank Group's proposal.

- **Bank Group's Proposal**

  a. Treatment of residual interests under proposal rules for Recourse and Direct credit substitutes are generally adequate to address risks of residual interests that satisfy ratings condition for reduced capital treatment.

  b. Proposed rules should be narrowed for treatment of residual interests that do not satisfy ratings condition for reduced capital treatment.

    (i) Only the new assets created in a securization, specifically the "gain-on-sale assets," should be subject to additional capital requirements as they are the only possible source of increased incremental risk to a bank.
    (ii) Required capital should never exceed the lesser of (I) the sum of (a) the amount of capital that would be required if the transferred assets were held on balance sheets and (b) the amount of related gain on sale assets and (II) the size of the residual interest.
    (iii) Application of the 25% of Tier 1 capital limit is unnecessary if capital is held against the gain-on-sale assets as proposed.

- Current and proposed regulatory oversight will allow regulators to specifically address situations where an individual institution may be inappropriately valuing residual interests.

- The NPR requirement of banks to hold "dollar for dollar" capital does not adequately match risk to capital. Moreover, NPR will create a hardship for sophisticated well-run institutions and eliminate this form of financing.

- The Bank Group's proposal is more rational and precise.

The meeting concluded with a discussion among the participants. In the discussion the Bank Group reiterated many of the foregoing points.