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CHEVY CHASE BANK

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Manager, Dissemination Branch
Information Management and Services Division
Office of Thrift Supervision
1700 G Street, NW
Washington, D.C. 20552
Attn: Docket No. 2000-70

Re: Residual Interests In Securitizations

Ladies and Gentlemen:

Chevy Chase Bank ("Chevy Chase") is pleased to have the opportunity comment on the September 27, 2000 Notice of Proposed Rulemaking relating to residual interests in securitizations (the "Proposal").

Chevy Chase is the largest banking institution headquartered in the Washington, D. C. metropolitan area with $11 billion of assets. We have been active in the securitization market since 1988, securitizing credit card, home equity, home loan, and automobile receivables. We are also an active servicer of residential mortgage loans, an activity which will be adversely impacted by the Proposal if it is adopted in its current form.

As drafted, the Proposal will (a) modify the "low-level" recourse rule by requiring dollar-for-dollar capital be held on the amount of recourse related to securitization transactions and (b) require a deduction from Tier 1 capital if the amount of residual interests exceeds certain levels. As explained below, we believe the first element of the Proposal is unnecessary to address the legitimate regulatory concerns raised by residual interests, will result in inconsistent capital requirements for pools of assets with similar risks and will have adverse implications for the availability of credit, including CRA and subprime credit. Moreover, the second element of the Proposal will have significant adverse consequences on other aspects of the business of financial institutions and will result in excessive capital requirements under certain circumstances.

Dollar-for-dollar Capital Requirement

Asset-backed securitization transactions are structured to provide investors with a degree of predictability about the timing and amount of the payment of principal and interest on the asset-backed securities. To achieve that predictability and the resulting credit rating, various credit enhancement devices are often employed, including retention of recourse by the originator of the transaction through the creation of various forms of residual interests. In any particular transaction, while the nominal amount of the risk retained by an originator of a securitization transaction may exceed the regulatory capital requirement for the securitized asset pool, in such circumstances the amount of the risk borne by the originator has not been increased by the transaction.

Consider two pools of assets that are identical in every way, especially inherent risk. One of the pools is securitized, and the other is not. Assume that the originator of the securitization retained residual interests in an amount that exceeded the otherwise required capital amount. As drafted, the Proposal would have the effect of imposing a higher capital requirement on the originator of the securitized pool than would have been required if the pool had not been securitized, even though the risk inherent in the underlying pool of assets is unchanged.

The underlying assumption of the Proposal must therefore be either that (a) the amount of capital required on the unsecuritized pool is not commensurate with the underlying risks, (b) increased levels of residual interests on financial institution balance sheets require higher levels of capital or (c) the amount of exposure to the originator's balance sheet is increased as a result of each securitization transaction. We believe that current regulatory authority to require financial institutions to hold additional capital where appropriate is sufficient to address those situations where the first or second of these concerns may be present. Furthermore, except in cases where additional balance sheet assets are created as a result of "gain on sale" transactions, we believe that the third assumption is unfounded.[1] Where gain on sale assets are created, we also believe that current regulatory authority to require financial institutions to hold additional capital where appropriate is sufficient or, alternatively, that a more tailored regulation could be crafted to address that specific circumstance.

Moreover, implementation of the Proposal would have the consequential effect of eliminating securitizations as a viable financing option for many asset types that may require relatively greater levels of credit enhancement by increasing the cost of securitizations to originators. This effect will necessarily limit sources of liquidity which, in turn, could result in less credit being available to the population at large. The types of credit that fall into this category include subprime credits which, in turn, include many CRA credits. Thus, the Proposal could significantly diminish funding for subprime and CRA loans.

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[1] Prior to a securitization, the originator's maximum risk of loss is the outstanding principal amount of the underlying assets. Securitization of the assets reduces the originator's exposure to the amount of contractual recourse retained. In effect, securitization transfers the risk of catastrophic losses on a pool of loans from the originator to the investors.

Accordingly, we urge the OTS and the other banking regulators to implement capital requirements based on the risk profile of the underlying assets, regardless of whether those assets had been securitized. Further, we believe that if an institution is able to mitigate that risk through one or more transactions, the mitigation should be taken into account when determining required regulatory capital. Lastly, the amount of capital required to be held in support of a pool of assets should be increased as a result of a securitization only if and when that securitization transaction actually increases the risk to the institution. We believe that the existing low-level recourse rules, combined with regulatory powers currently in effect, accomplish this approach and should not be changed.

On the other hand, if the regulators are concerned about the carrying value of residual interests, then guidance regarding the computation of the carrying value should be considered. Such guidance already exists for mortgage servicing rights ("MSRs"). It could easily be adapted for residual interests. However, because residual interests vary from transaction to transaction, and are not homogenous like MSRs, any guidance regarding the determination of value of residual interests will necessarily need to be broad to allow for discretion to account for various structures. In that regard, the valuation process should be subjected to field review by the examination team and calculation adjustments proposed at the individual institution level.

Tier 1 Capital Deduction

As drafted, the Proposal places two limits on the amount of residual interests which an institution may hold on its balance sheet. We believe that these limits (a) will result in an unnecessary doubling of the capital requirement for residual interests in light of the proposed dollar-for-dollar capital requirement contained in the Proposal and (b) will result in the unintended and inappropriate consequence of limiting the amount of MSRs that an institution may hold.

The 25% of Tier 1 capital limitation will effectively require a dollar-for-dollar capital requirement for the portion of total residual interests that exceeds 25% of Tier 1 capital. Because the amount of usable Tier 2, or supplementary, capital is limited to the amount of Tier 1 capital, this requirement, in turn, results in a total capital requirement equal to two times the amount of that excess. This requirement will further unjustly penalize institutions that securitize loans by unnecessarily requiring more capital be held post-securitization than pre-securitization.

Most troubling about this aspect of the Proposal is its effect on the ability to acquire and hold MSRs (which would be included in the same 25% basket), particularly in light of the well-developed market to buy and sell such assets. It is inconsistent to effectively treat MSRs, assets whose values can be determined by observable market prices, that can be readily sold and which do not provide credit support for other assets, in the same manner as residual interests, assets whose value cannot be determined by an active market, are illiquid and which provide support for other assets. Moreover, Congress recently granted authority to the banking regulators to remove the 10% haircut that has been historically applied to the valuation of MSRs. The adoption of this Proposal would be contrary to that authority and impose an undue burden on institutions which service mortgage loans.

We believe that any capital requirement imposed on residual interests should not result in double capital requirements or adverse consequences on other aspects of the business of financial institutions. Accordingly, we strongly urge the agencies not to include residual interests in the same basket that limits the amount of servicing rights, both mortgage and nonmortgage, held by an institution. Furthermore, if the dollar-for-dollar capital requirement is adopted as proposed, we urge the agencies not to impose any additional limitation on the amount of residual interests maintained on the balance sheet.

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We appreciate the opportunity to comment on the Proposal. Should you have any questions, please feel free to contact me at 301-986-6864.

Sincerely,

Joel A. Friedman
Senior Vice President and Controller

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