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2000 DEC 27 A 8:49

December 22, 2000

Docket No. 00-17
Communications Division
Third Floor
Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20219

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Attn: Docket No. R-1080

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

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

Re: Proposed Rule Concerning Capital Treatment of Residual Interests in Asset Securitizations or Other Transfers of Financial Assets

Dear Ladies and Gentlemen:

We thank the Office of the 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, the "Agencies") for the opportunity to comment on the September 27, 2000 proposed rule concerning the regulatory capital treatment of residual interests in assets securitizations or other transfers of financial assets (the "Proposed Rule"). 65 Fed. Reg. 57993. Our comments reflect the concerns of clients actively engaged in asset securitization.

We do not believe that the Proposed Rule is necessary to address the specific supervisory concerns the Agencies have raised. The Agencies have sufficient existing tools to deal with these issues. The December 1999 Interagency Guidance on Asset Securitization (the "Securitization Guidance") and

the Agencies' existing supervisory authority provide the Agencies with an adequate basis to target flexibly and precisely risks associated with certain residual interests in securitizations.

The Proposed Rule would require "dollar-for-dollar" capital to be held against the amount of the residual interest (*i.e.*, residual interests that are structured to absorb more than a pro rata share of credit loss related to the securitized or sold assets through subordination provisions or other credit enhancement techniques) retained on the balance sheet, even if this capital charge exceeds the capital charge that would ordinarily apply to the transferred assets. The Proposed Rule would also include residual interests, together with nonmortgage servicing assets and purchased credit card relationships, in the 25 percent of Tier 1 capital sublimit. Any amounts above this limit are deducted from Tier 1 capital. Finally, the Proposed Rule would clarify that each Agency has the authority to determine, on a case-by-case basis, the appropriate risk weight for novel instruments that nominally fit into a particular risk weight category, but that impose risks on the banking organization that are not commensurate with that risk-weight category.

The Agencies are concerned that where a banking organization retains a residual interest in connection with a securitization and books the residual interest in accordance with GAAP gain-on-sale accounting, the gain-on-sale can increase the banking organization's capital and thereby allow the bank to leverage the capital created from the securitization. In addition, excessively aggressive estimates of the fair value of a residual interest can exacerbate the risks posed by such leveraging. Inappropriately valued residual interests can skew a banking organization's capital and thereby mask weaknesses in the quality of capital available to support the banking organization.

We acknowledge that determining the fair value of any gain-on-sale of a residual interest in some circumstances can be difficult, the booking of the gain can result in increased leverage, and that if the valuation of the residual interest is inappropriately high it can lead to greater risk-taking by the institution. However, what is not clearly supported by experience or statistical studies is that losses to a banking organization that retains more than pro rata loss exposure through the residual interest will exceed the standard minimum risk-based capital charge of 8 percent. Nor does the rule distinguish among asset classes, securitization structures or the nature of residual interests, all of which may affect the extent of risk assumed by the bank.

The Agencies have generally recognized both the benefits of securitization and the benefits of internationally comparable capital standards. Consistent with these policies, the rules adopted by the Agencies should depart from the Basel Committee on Banking Supervision's standards only to the extent clearly warranted by risks presented. In this context, the Securitization Guidance already clearly expresses the Agencies' concerns about proper and safe and sound valuation of residual interests. The one-size-fits-all approach taken in this Proposed Rule would not allow a banking organization the flexibility to tailor the level of capital it holds against a particular type of residual interest in a way that most accurately corresponds with the level of risk that residual interest poses to the banking organization. We propose that, if the Agencies believe their current tools are clearly inadequate, a more appropriate way to address the Agencies' principal concerns is with a limited and focused change in the capital requirements.

Specifically, one of our clients has proposed that where a banking organization bears more than a pro rata share of risk in retained residual value, at most, the banking organization could be required to maintain capital "dollar-for-dollar" against the gain. In that way, the gain-on-sale would effectively

be available to meet any future losses. In this context, we also recommend that the Agencies revise the "net-of-tax" approach in the Proposed Rule to permit the gain-on-sale subject to "dollar-for-dollar" treatment to be determined on a basis that is net of any associated deferred tax effect. The banking organization would not have to maintain "dollar-for-dollar" capital otherwise in excess of the standard 8 percent risk-based capital level. This more limited change to the capital requirements should eliminate any incentive to a banking organization to value gains inappropriately, as well as removing the Agencies' leverage concern.

No additional change to the current capital treatment of residual interests (including the proposal in respect of concentration limits) appears to have support in experience. We note that the Agencies recently issued a joint notice of proposed rulemaking addressing the regulatory capital treatment of recourse obligations and direct credit substitutes, 65 Fed. Reg. 12320 (March 8, 2000), which would have a substantial impact on securitization activities. Also, the Basel Committee on Banking Supervision is expected to release a revised capital standards in January. Accordingly, the issues addressed in this Proposed Rule can be addressed in a more comprehensive and orderly way once those initiatives have been implemented. Instead of attempting to reconcile on an ad hoc basis any final rules the Agencies issue, the Agencies should strive to develop a unified and consistent regulatory capital treatment of asset securitizations that will not require affected banking organizations to readjust continually their operations. Moreover, in this context, further changes to the capital rules should be considered only if experience demonstrates that a higher capital charge is necessitated by particular forms of securitization, asset classes, or types of retained interest.

Accordingly, if the Agencies decide a rule is necessary, a more limited and focused supervisory response to gain-on-sale concerns is preferable. We believe that the more focused capital requirement change referred to above, coupled with the Agencies' Interagency Guidance on Asset Securitization, should provide a sufficient means of addressing the principal concerns discussed in the Proposed Rule and should not result in undue disruption to the securitization market.

Should you have any questions regarding this comment letter, please call either Nancy Jacklin at (212)878-8244 or Jerry Marlatt at (212)878-3063.

Very truly yours,

Clifford Chance Rogers & Wells LLP