March 26, 2007

Board of Governors of the Federal Reserve System
Docket No. R-1261

Federal Deposit Insurance Corporation
RIN 3064-AC73

Office of the Comptroller of the Currency
Docket No. 06-09

Office of Thrift Supervision
Attn: 2006-33

Re: Risk-Based Capital Standards; Advanced Capital Adequacy Framework

Ladies and Gentlemen:

The American Securitization Forum[1] is writing to comment on the proposed securitization framework set out in the joint notice of proposed rulemaking (the "Basel II NPR") published by your agencies (the "Agencies") on September 25, 2006.[2] We have also included one comment on the joint notice of proposed rulemaking relating to "Basel IA" that the Agencies published on December 26, 2006.[3] Various members of the ASF will comment separately on either or both of these notices and may have differing views on their non-securitization aspects. This letter is not meant as a comment on any aspect of the notices outside of their respective securitization frameworks.

Most of our comments on the Basel II NPR relate to the proposed treatment of exposures to asset-backed commercial paper ("ABCP") programs, which are set out in Part I below. Our comments on other aspects of the proposed securitization framework are set out in Part II. The following is a table of contents for the balance of this letter:

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[1] The American Securitization Forum (the "ASF") is a broadly-based professional forum of participants in the U.S. securitization market. Among other roles, the ASF members act as issuers, underwriters, dealers, investors, servicers and professional advisors working on securitization transactions. This comment letter was developed principally in consultation with the ASF's ABCP Conduit Sponsors Subforum and Legal, Regulatory, Accounting and Tax Committee, with input from other ASF members, subforums and committees. More information about the ASF, the ABCP Conduit Sponsors Subforum, the Accounting and Tax Subcommittee and their respective members and activities may be found at the ASF's internet website, located at www.americansecuritization.com.
[2] Federal Register, Vol. 71, p. 55830.
[3] Federal Register, Vol. 71, p. 77446. See comment 16 below.

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Attachment A. Cross Reference of ASF Comments to Securitization Questions on Which the Agencies Requested Comment

Attachment B. Suggested Changes to Regulatory Text

Our comments are numbered and followed by supporting discussion. Attachment A lists all of the questions asked by the Agencies in the Basel II NPR relating to the securitization framework and cross-references any relevant discussion within the body of the letter. Attachment B provides suggested language changes to implement our comments. Unless otherwise indicated, section references below relate to the text of the common appendix, beginning at page 55911 of the Basel II NPR, and references to "banks" or "U.S. banks" relate to depository institutions (and bank holding companies) that will be subject to the Agencies' final rules relating to the advanced internal ratings-based approach (the "IRB"), whether on a core or opt-in basis.

I. Comments Relating to Exposures to ABCP Programs

We strongly support the inclusion of the internal assessment approach (the "IAA") relating to exposures to ABCP programs. We have a number of comments relating to the details, but these comments should not be taken as a criticism of the IAA in general.

Comments Relating to the Scope of the IAA and Interaction with Other Approaches

1. *A bank should be able to (a) apply its IAA to the bank's qualifying exposures to securitizations funded through more than one conduit sponsored by the bank as well as the bank's exposures to securitizations funded through conduits sponsored by other banks or non-banks and (b) exclude the bank's exposures to a conduit's ineligible transactions from the bank's IAA without affecting otherwise qualifying exposures to transactions funded through the conduit.*

Proposed section 44(a)(2) specifies several IAA eligibility criteria that apply to an "ABCP program." The phrase "ABCP program" is not defined for this purpose, but based on the way the phrase is otherwise used in the proposed rules it appears to refer to a particular conduit. For

instance, section 42(l) discusses situations where a bank "must consolidate an ABCP program as a variable interest entity under GAAP". We use the phrase "ABCP program" below as essentially meaning a particular conduit.

Some of the IAA eligibility criteria in section 44(a)(2) seem to imply an all-or-nothing approach to exposures to particular ABCP programs: if the program is not eligible, then it appears that no exposures to transactions funded by that program could be eligible. In order for the IAA to provide the substantial benefits that it can potentially provide, it is essential that the final rules take a more flexible approach to the relationship between a bank's IAA and exposures to various ABCP programs.

Banks participate in ABCP programs in many ways, including as sponsors or administrators, and as providers of liquidity facilities and credit enhancements. Besides working with ABCP programs that they sponsor themselves, banks also provide liquidity facilities and credit enhancements to programs sponsored by other institutions. The IAA should be flexible enough to cover these varying situations efficiently.

In order for the IAA to cover a bank's exposures to ABCP programs sponsored by others in an appropriate and risk sensitive manner, it is essential to minimize eligibility criteria that relate to the ABCP program as a whole. A non-sponsor bank will not be in a position to control (or even review) all of the activities of a non-sponsored ABCP program. Fortunately, this does not require that any of the proposed ABCP program eligibility criteria be deleted. Rather, we request that three of those criteria simply be restated as criteria applicable to the bank's exposures subject to the IAA. For other reasons, we do request that two program eligibility criteria be deleted in comments 6 and 7 below. To the extent that the Agencies decide to retain those eligibility criteria in some form, we request that they also be stated as requirements for the particular exposures that are subject to the IAA, rather than requirements of any ABCP program as a whole.

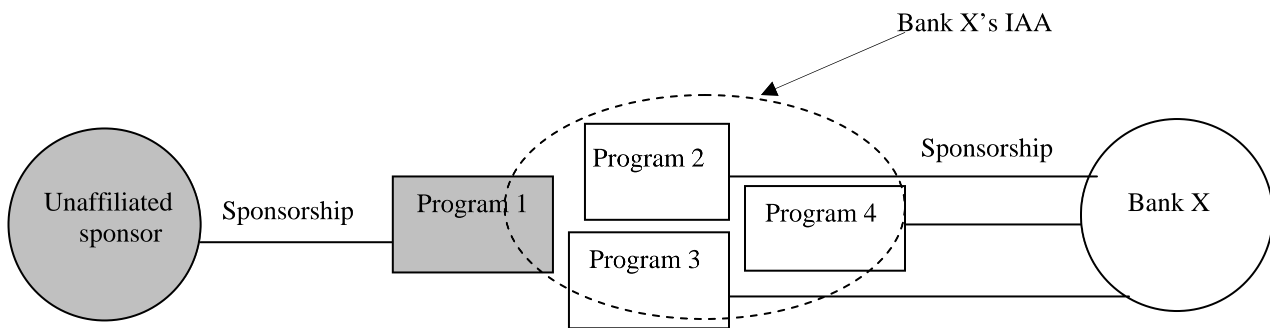
There is another strong reason for minimizing the eligibility criteria that apply to an ABCP program as a whole. All of the transactions funded in a particular ABCP program (and the program itself) should not be rendered ineligible if the program funds one or more transactions that are ineligible. Those ineligible transactions should simply be viewed as falling outside of the IAA. In other words, exposures to the ineligible transactions would not be covered by the IAA, but exposures to eligible transactions funded in the same program would be covered. This point can also be addressed by making most of the proposed eligibility criteria for ABCP programs instead apply to the particular exposures that are covered by the IAA.

The diagram below illustrates our proposed relationship between particular ABCP programs (represented by the rectangles) and a bank's IAA (represented by the oval). The diagram is meant to illustrate the following points:

- Exposures to more than one ABCP program may be covered by a bank's ("Bank X") IAA. These programs may be sponsored by Bank X, by other banks or by non-banks and should not have to all be identified (or even in existence) when the IAA is approved.

- Bank X's exposures to transactions funded by each ABCP program that meet the IAA requirements are subject to the IAA. For some sponsored programs all of Bank X's exposures may qualify and thus fall within Bank X's IAA. For other programs, a greater or smaller percentage of exposures may fall within the IAA, with the smallest percentage generally applying when Bank X does not sponsor the program and is not involved in most of its transactions. The exposures that fall within the IAA are represented by the portion of each rectangle that falls within the oval.

- Bank X's exposures to transactions funded by each program that do not satisfy the requirements for the IAA will be subject to the ratings-based approach (the "RBA") or the supervisory formula approach (the "SFA").



Our suggested approach adequately addresses the credit and policy reasons for limiting the availability of the IAA. The appropriate criteria would apply to the exposures covered by the IAA. Other exposures that are covered by the RBA or the SFA are not relevant to the risk weighting of IAA exposures. We believe our approach is also more risk sensitive than an all-or-nothing approach to ABCP programs, which could create significant cliff risks if one transaction was permitted to disqualify an entire program. It would also facilitate syndication of exposures in this market. We believe that it is also generally consistent with the approach being taken by the Financial Services Authority (the "FSA") in the United Kingdom.

2. *Qualifying banks should be permitted to use the IAA on some exposures for which there are no publicly available NRSRO rating criteria.*

Proposed section 44(a)(1)(i) requires that the internal credit assessments used in the IAA "must be based on publicly available rating criteria used by an NRSRO." While this is consistent with ordinary business procedures for many asset types and structures, it does not adequately reflect the dynamic relationship between bank sponsors and rating agencies in ABCP programs. Transactions often include features that are not addressed by pre-existing criteria. These features may range from new asset types to relatively modest tweaks to prior structures. In any of these circumstances, bank sponsors have consulted with the applicable rating agencies to supplement or substitute for published criteria. History shows that the sophisticated banks that will be subject to these rules have been able to maintain an extremely favorable credit experience while operating in this manner. The final rules should permit banks to continue this practice. Like comment 1 above, this comment is crucial to the overall value of the IAA.

In the United Kingdom, the FSA has provided flexibility on this point, which also makes this a competitive equality issue. The FSA's proposed language to implement the IAA includes the following:

> "If a firm's IRB permission permits this, a firm need not comply with the requirement for the assessment methodology of the ECAI to be publicly available where it can demonstrate that due to the specific features of the securitisation – for example its unique structure – there is as yet no publicly available ECAI assessment methodology."[4]

The FSA language contemplates the sort of supplemental flexibility that we request for U.S. banks. As indicated by the reference to a firm's IRB permission in the FSA excerpt above, banks that qualify for the IAA should be authorized to fill in criteria gaps with NRSRO consultation on an umbrella basis. They should not have to ask for regulatory permission on a case-by-case basis.

3. *Qualifying banks should be permitted to use the IAA on an unrated exposure that is senior to a rated exposure, even if the unrated exposure would otherwise have an inferred rating based on the junior rated exposure.*

Proposed section 43 makes the RBA apply when the required number of ratings can be inferred, and proposed section 42(a)(3) restricts the IAA to circumstances where the RBA does not apply. The interaction of these two provisions creates a problem for the following arrangement, which is common in ABCP conduit transactions. Often tranches purchased by conduits are not rated, while a junior tranche placed with one or more other investors is rated. The conduit's position could have been rated, and if rated would generally have been at least one full rating category higher than the junior tranche. For instance, a junior tranche rated BBB (or the equivalent) is often placed with a non-conduit investor, while the conduit purchases an unrated tranche that could have been rated single A (or the equivalent). For purposes of this example, please assume that the junior tranche was rated BBB (or the equivalent) by two NRSROs.

In these circumstances, the interaction of sections 43 and 42(a)(3) would apparently require a bank with an exposure to the unrated (but single A equivalent) tranche to use the inferred rating of BBB equivalent to risk weight the exposure. This clearly yields an excessively high capital requirement. The fact that a junior tranche has been rated demonstrates that the transaction has met all the applicable NRSRO criteria for a single A equivalent other than credit enhancement size, which is generally an objective number.

The IAA should be viewed as a stand-alone IRB approach that is not trumped by an inferred rating under the RBA. Accordingly, section 43 should be revised to let a bank use the IAA on a senior position, even where inferred ratings would otherwise make the RBA available. Failure to make this revision would substantially reduce the value of the IAA.

4. *Qualifying banks should be permitted to use the IAA on exposures to securitizations of non-IRB exposures, so long as there are publicly available rating criteria (or the*

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[4] Draft text of BIPRU 9.11.9(7) (Appendix 2 to Consultation Paper 06/3.)

exception discussed in comment 2 above applies) and the other requirements of the IAA are satisfied.

Proposed section 42(g) sets out special rules for the treatment of exposures to securitizations of non-IRB exposures (i.e., underlying exposures that are not wholesale exposures, retail exposures, securitization exposures or equity exposures). Essentially, section 42(g) requires that these exposures be deducted from capital unless the RBA applies and provides a lower capital requirement. The discussion of these proposed rules earlier in the Basel II NPR (p. 55882) says that music concert and film receivables are examples of non-IRB exposures.

We believe that section 42(g) is missing a step: it should permit qualifying banks to apply the IAA to exposures of this type where the RBA does not apply and the other requirements of the IAA are satisfied. If there are publicly available NRSRO criteria (or the bank appropriately consults with NRSROs), we see no reason why assets of this type should be treated differently from asset types that have an IRB framework. The NRSROs provide the same independent check on bank credit assessments here as with IRB asset types.

We also believe that if the IAA does not apply to a particular exposure to music concert or film receivables, then the exposure should be analyzed as a wholesale exposure. An exposure of this type is a form of "object finance," where the "object" is some set of entertainment properties. Like other object finance, the SPE is a wholesale obligor with a limited product line, and the exposures are generally secured by the revenue-generating properties and their proceeds. Advanced IRB banks should be able to assign the necessary inputs to this type of exposure in the same way that the Basel II NPR contemplates for other object finance.[5] Besides permitting the use of the IAA when appropriate, we also request that the Agencies retract any implication that these types of exposures are not wholesale exposures.

5. *Qualifying banks should be permitted to apply the IAA to exposures "related to" ABCP programs, rather than only exposures "to" such programs.*

This is a technical wording comment but still an important one. The first sentence of section 44(a) permits a bank to apply the IAA to "a securitization exposure that the [bank] has to an ABCP program (such as a liquidity facility or credit enhancement) if the [bank] and the exposure qualify for the IAA." We request that this sentence be modified to cover exposures "related to" a program, rather than just exposures to the program. The current formulation could be read as implying that the IAA is available only where the ABCP program is the party to which the bank has an exposure.

Such a reading would seem to exclude parallel purchase facilities, which banks provide as a committed back-up to sellers in programs where the conduit's purchase facility is uncommitted. As the Agencies are aware, parallel purchase facilities are a very common form of facility that banks provide in connection with ABCP programs. It has long been understood between the

[5] Basel II NPR p. 55859: "The sophisticated banks that would apply the advanced approaches in the United States should be able to estimate risk parameters for specialized lending exposures, and therefore the agencies are not proposing a separate treatment for specialized lending beyond the separate IRB risk-based capital formula for HVCRE exposures specified in the New Accord."

Agencies and banks that are active in this market that parallel purchase facilities are very similar to liquidity facilities and generally receive the same risk-based capital treatment.

Comments Relating to the IAA Approval Process and Eligibility Requirements

6. *The IAA eligibility criteria should not flatly prohibit the purchase of assets that are significantly past due or defaulted. This issue, as well as concentration and tenor limits, should be subsumed within the IAA's general reliance on NRSRO criteria.*

Proposed section 44(a)(2)(iv) requires that an ABCP program "establish minimum asset eligibility criteria that include the prohibition of the purchase of assets that are significantly past due or defaulted, as well as limitations on concentration to individual obligor or geographic area and the tenor of the assets to be purchased". Given the experience with the current eligible liquidity rules, we hope that the Agencies recognize the need for flexibility as to past due and defaulted assets. Without repeating all of the considerations that we have discussed with the Agencies in connection with eligible liquidity, we note that competitive and other market forces limit banks' ability to dictate particular definitions of "defaulted receivable," and a variety of structural features may mitigate risks associated with past due assets. Given the reliance on NRSRO criteria in the IAA, we request that those criteria (or consultation with NRSROs, as contemplated by comment 2 above) govern the eligibility of past due or defaulted assets. For the same reasons, issues relating to obligor and geographic concentrations and tenor of the assets purchased should be left to NRSRO criteria, as opposed to requiring separate criteria in the underwriting policy for the program.

7. *Similarly, the IAA eligibility should not require that every transaction in a bank's program incorporate structural features to mitigate potential credit deterioration of the underlying exposures.*

Proposed section 44(a)(2)(vi) contains such a requirement. Although this requirement is appropriate for many or most transactions, it should not be stated as an absolute. For instance, sometimes the initial credit protection (such as a governmental guaranty) may be adequate without the need for enhancements triggered by deterioration. FSA's BIPRU9.11.19R(11) excludes the word "each" in its version of this requirement, which seems to provide additional flexibility compared to the language in the Basel II NPR. We request that this issue also be left to the applicable NRSRO criteria (or consultations with the NRSROs).

8. *We request clarification on the required credit analyses of asset sellers.*

Proposed section 44(a)(2)(iii) requires that "The ABCP program must perform a detailed credit analysis of the asset sellers' risk profiles." We request clarification on three points relating to this criteria:

- First, we understand the reference to "asset sellers" in this requirement to mean the customers of the bank that originate the assets, as opposed to any special purpose entities used in the transaction. The originator/bank customer is the appropriate credit focus. Given the limited activities, assets and liabilities of

SPEs, diligence on SPEs is mostly legal, focusing on their restrictions and their isolation from operating entities.

- Second, the credit analysis of the asset seller may be made by some part of the bank separate from the ABCP conduit group. Often, this would be the group that has a pre-existing relationship with the asset seller, and/or the group that covers the asset seller's industry. We expect that this is acceptable and within the Agencies' intent.

- Third, in some transactions (such as many collateralized debt obligation ("CDO") transactions) there is no single asset seller (or group of asset sellers) whose credit is material to the transaction. In these circumstances, banks generally diligence the portfolio management experience of the entity that selects the assets, rather than performing a credit analysis on any asset seller. We believe this is a prudent application of the spirit of section 44(a)(2)(iii).

In Attachment B, we have suggested language changes that would confirm each of these points.

9. *We request that the Agencies promptly commence and expeditiously carry out the IAA approval process, using a submission and non-objection approach similar to the one used in connection with program-wide credit enhancements.*

The ABCP conduit business remains an important one for U.S. banks. It is imperative that the IAA become available in a timely manner that creates no gaps or dislocations in the ability of U.S. banks to participate in this market without incurring unreasonable capital burdens. Consequently, we request that the IAA approval process work through submission and non-objection, like the process used in implementing the existing internal assessment approach for program-wide credit enhancements:

- the Agencies request information;

- banks respond by submitting information; and

- in the absence of objection from their principal supervisor, banks proceed to use their internal assessments.

10. *If the Agencies decide to make the standardized approach available in the US, banks that select the standardized approach should still have the opportunity to qualify for the IAA.*

We recognize that the notice of proposed rulemaking relating to Basel IA would not "allow a non-Basel II banking organization to use internal risk ratings or to use its internal risk measurement processes to calculate risk-based capital requirements for any new categories of exposures".[6] However, we view the IAA as a relatively modest expansion on the existing permission for approved banks to use internal ratings of credit enhancements provided to ABCP

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[6] Federal Register, Vol. 71, p. 77446, 77449 (December 26, 2006).

programs, which the Agencies have indicated would continue under Basel IA.[7] This is much different from and more straightforward than the Basel II IRB.

We assume that a change like this would lead to re-publication and another comment period, during which we would have the opportunity to address the implementation of the IAA in the context of the standardized approach. Consequently, we have not provided detailed comments on how the IAA should be implemented in the context of the standardized approach or included language to implement this change in Attachment B.

Comments Relating to ABCP Liquidity Facilities

11. *The final rules should provide a look-through approach for transaction-specific liquidity facilities where (a) the underlying asset has an external rating and (b) upon a draw the liquidity bank obtains a contractual first priority claim on collections from the underlying asset, disregarding the claims of a service provider to fees from the securitization.*

In the IAA, we believe that a liquidity facility of this type would naturally have the same risk weight as the underlying asset. The liquidity commitment is an obligation to step into the funded position. It is hard to see how that obligation could subject a bank to greater risk than if the bank had already funded the position. Given the compelling economic logic of this approach, it would be helpful to have it spelled out as a separate rule that would be available even for banks that do not qualify for the IAA. This would facilitate syndication of these facilities.

12. *The final rules should clarify that a liquidity facility can be a "senior securitization exposure" without impairing the seniority of the ABCP or other securitization exposure that benefits from the liquidity facility.*

The definition of "senior securitization exposure" in proposed section 2 includes the following statement:

> "A liquidity facility that supports an ABCP program is a senior securitization exposure if the liquidity facility provider's right to reimbursement of the drawn amounts is senior to all claims on the cash flows from the underlying exposures except claims of a service provider to fees."[8]

We strongly support this rule and agree that in most cases ABCP liquidity facilities should be treated as senior securitization exposures. Our only concern on this point is to avoid any suggestion that the status of a liquidity facility as a senior securitization exposure would be inconsistent with also treating as a senior securitization exposure either the related ABCP or the securitization exposure that the liquidity provider would purchase or otherwise fund if the liquidity facility was drawn. As stated above, a liquidity commitment is an obligation to step into a funded position. It is not really a separate tranche. If the tranche that the liquidity facility would purchase or otherwise fund if drawn is itself a senior securitization exposure, then generally the

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[7] Ibid.
[8] As discussed in comment 18, we also request that the reference to "fees" of service providers be broadened consistent with the EU's approach and market conventions.

liquidity should also be viewed as a senior securitization exposure under the conditions described above.

Our concern stems from the fact that Basel II contained language which suggests that in any particular transaction there can only be one "senior" securitization exposure. We believe that liquidity should be an exception to any such principle in the circumstances discussed above, and we request confirmation on this point.

13. *The final rules should provide a credit conversion factor of zero for market disruption facilities that satisfy eligible liquidity standards.*

The Agencies requested comment on the prevalence of market disruption facilities and the use of the SFA to calculate K_{IRB} on them.[9] While we have not conducted a survey, we understand that these facilities are used in some U.S. programs. As to calculating a risk weight, we would expect that the IAA would generally be used, rather than the SFA. The risk weight would not be relevant if the Agencies accept our request below.

Regardless of the current prevalence of these facilities, we request that the Agencies provide a credit conversion factor of zero for eligible liquidity facilities that can only be drawn on account of general market disruptions, not related to the credit quality of the particular issuer or its assets. This is the treatment afforded under the standardized approach in Basel II, and it is justified by the extremely low probability of draw. That likelihood does not vary between standardized and IRB banks, since it is driven by general market conditions. For this purpose, we suggest that the Agencies use their current eligibility standards for ABCP liquidity (which are substantially similar to the Basel II eligibility standards) in order to take advantage of the work the Agencies and affected banks have put into fine tuning those standards.

If the Agencies decline to make the change requested above, we request that the Agencies implement the Basel II advanced IRB provisions relating to market disruption facilities (preferably still using the Agencies' existing eligibility standards). It is impossible to predict how the ABCP market may evolve in the future, whether as a direct result of implementation of Basel II or otherwise. If the Agencies do not implement these provisions, they leave U.S. banks at a potential competitive disadvantage vis-à-vis banks whose home jurisdictions do implement the provisions, if the market evolves in a way that makes these facilities attractive. Banks that already use these facilities could face a more immediate competitive disadvantage.

<u>Other Comments Relating to ABCP Conduit Exposures</u>

14. *Banks should be permitted to base the "amount" of ABCP program exposures that are commitments on the outstanding amount of ABCP, rather than a maximum potential draw concept.*

We appreciate the fact that proposed section 42(e) permits a bank to set the "amount" of a commitment, such as a liquidity facility extended to an ABCP program, based on the maximum

[9] Question 50, Basel II NPR, p. 55890.

potential amount that could be drawn, as opposed to the notional amount of the facility. We agree that this is a more appropriate measure than the notional amount. However, we request that the Agencies shift to a third definition of "amount", which would equal the lesser of (a) the notional amount of the facility (i.e., the commitment amount) and (b) the amount of outstanding ABCP covered by the facility. Clause (b) would generally be the controlling figure for conventional ABCP programs with 100% liquidity coverage. Clause (a) would control in programs with only partial liquidity support.

For conventional programs with 100% liquidity coverage, a definition based on outstanding ABCP would have at least two benefits. First, it would be consistent with the treatment of the assets of conduits consolidated under FIN 46R that a bank elects to include directly in its risk-weighted assets. The Agencies have generally taken the approach that consolidation or non-consolidation should not affect the risk-based capital for these transactions. Our requested change would eliminate a disparity between consolidated and non-consolidated treatment.

Second, a definition based on outstanding ABCP would make up in part for the loss of the 10% credit conversion factor for short term ABCP liquidity commitments. We continue to believe that a 10% credit conversion factor is appropriate for these facilities to reflect the extremely low incidence of draws. Defining the "amount" of these facilities based on outstanding ABCP would not usually make up entirely for the loss of the 10% credit conversion factor, but it would bring the overall capital requirements for these exposures closer to the level that we view as appropriate. It would also help offset the significant disparity between the effective risk weights for liquidity facilities under the proposed new rules vs. the existing U.S. rules and proposed Basel IA, which are set out in the following table.

Long Term Ratings[10]	**Current Effective Risk Weights for Short Term Liquidity**[11]	**Effective Basel IA Risk Weights for Short Term Liquidity**[11]	**Basel II NPR Risk Weights**		
			Granular Pool		*Non-Granular Pool*
			Senior Exposure	*Non-Senior Exposure*	
AAA	2%	2%	7%	12%	20%
AA			8%	15%	25%
A+	5%	3.5%	10%	18%	35%
A			12%	20%	
A-			20%	35%	
BBB+	10%	5%	35%	50%	
BBB		7.5%	60%	75%	
BBB-		10%	100%		
Unrated senior[12]	10%	10%	NA		

[10] Ratings under Basel I and Basel IA must be external (or inferred) ratings on the underlying exposure. Ratings under the Basel II NPR may be external, inferred or internal assessments (for IAA banks).
[11] Determined as product of 10% credit conversion factor and applicable risk weight.
[12] This refers to the look through treatment for senior exposures under the current rules and assumes the underlying assets have a risk weight of 100%.

This table above is not meant as a comparison between the capital required for most transactions in practice. We recognize that the favorable risk weights for liquidity related to rated exposures under the current rules and proposed Basel IA usually do not apply, since most exposures held by ABCP programs are not rated. Nevertheless, banks using the IAA are required to map their internal assessments to external rating categories, and an exposure slotted to a particular rating in the IAA should have substantially the same level of credit risk as an exposure with the equivalent external rating. It is hard to see why the required capital under Basel II should be so much higher than the effective requirement for substantially equivalent positions under the other frameworks.

While 100% liquidity coverage is still prevalent, there has been substantial growth in structures that have only partial coverage by liquidity facilities and otherwise depend upon the inherent liquidity of the underlying assets. Clearly, liquidity banks should not be required to hold capital based on outstanding ABCP if the liquidity facility only covers a portion of outstanding ABCP. In these circumstances, our proposal would define the exposure amount as the notional amount of the commitment.

15. We do not believe that sponsors should be treated as "originators."

Treating sponsors as originators has two apparent consequences, although we believe one may have been unintentional. First, it subjects sponsors to a two-rating requirement under the RBA. As indicated in comment 19 below, the ASF believes that originators should be treated like investors and permitted to apply the RBA on the basis of a single external rating from an NRSRO. If the Agencies retain the two-rating requirement for originators, then the ASF requests that sponsors be removed from the definition of "originator" and treated like investors.

Bank-sponsored ABCP conduits predominantly fund assets originated (or aggregated) by customers of the sponsor. The terms of each transaction are negotiated between the sponsor, the customer and other interested parties. The sponsoring bank acts as an investor vis-à-vis the customer, and the involvement of the customer provides the same assurance of arms length dealing as in other transactions in which banks invest in securitization exposures. When a bank provides liquidity to a conduit sponsored by some other bank or non-bank, the liquidity bank is in the position of an investor vis-à-vis both the conduit and the originator (or aggregator) of the underlying receivables.

The second possible consequence, which we believe to have been unintentional, is that as originators sponsors would be subject to the operational requirements for traditional securitizations. However, those requirements do not fit sponsors (except in the rare case where a conduit was funding assets originated by the sponsor, in which case the operational requirements would already apply to the bank in its role as the true originator). For instance, the requirements of GAAP sale and risk transference do not apply, since sponsors generally are not in the chain of title for assets funded in the conduits they sponsor.

16. The definition of "external rating" should be modified so as to require ratings only of interest and principal payments and not to require a rating of indemnities and other additional amounts that may be payable under ABCP liquidity and credit enhancement facilities.

The RBA applies only where an exposure has the requisite number of "external ratings," either directly or by inference. Proposed section 2 defines "external ratings" and includes a number of requirements, including that "The credit rating fully reflects the entire amount of credit risk with regard to all payments owed to the holder of the exposure." We have no objection to this requirement insofar as it covers all interest and principal payments owed to a holder.

Our issue is that liquidity and credit enhancement facilities provided in connection with ABCP programs often provide for payments in addition to principal of and interest on any fundings under the facility. Often there are periodic non-use or commitment fees, as well as rights to indemnity payments for increased reserve or capital costs and miscellaneous unexpected liabilities arising from the transaction.

These rights to fees and indemnities are incremental to the rights a bank would have as the holder of a rated term market security. They also may be hard to rate because their amount is not known (in the case of indemnities) or because they are not proportional to the amount of assets funded (in the case of fees). Since other positions do not even have these rights, a conduit exposure should not be penalized for having them but not at a rated level of certainty.

This same issue arises under the new criteria for external credit ratings that are proposed in the Agencies' Basel IA notice, and we request the same change there.

17. *We request confirmation that the special rules for purchased wholesale receivables would be available to a bank that was required to apply the SFA to an exposure to an ABCP program, where the underlying exposures were purchased wholesale receivables.*

At one point, the Agencies and affected banks discussed the possibility of looking to the purchased wholesale receivables rules as the main way to deal with unrated ABCP program exposures. For a number of reasons, that was not a satisfactory approach, and the IAA was developed as an alternative. We appreciate the Agencies' flexibility in developing the IAA and fully support these developments.

Nevertheless, situations may arise where an ABCP program exposure is not eligible for the IAA, e.g., because the transaction is not structured in accordance with applicable rating agency criteria. In these circumstances, the SFA will apply, and it appears to be wholly consistent with the wholesale framework in general, and with the purpose of the special rules for purchased wholesale receivables in particular, for banks to use those special rules. We request confirmation that this would be permitted. In particular, the definition of "eligible purchased wholesale receivable" in proposed section 2 refers to receivables purchased by the subject bank, which generally would not literally be the case in this context. The fact that a bank is exposed through a conduit rather than direct ownership does not seem to provide an economic reason for treating the two situations differently.

II. Comments on Other Aspects of the Proposed Securitization Framework

18. *With respect to "senior securitization exposures," we request (a) provisions paralleling those being implemented in Europe which provide a 6% risk weight for some exposures*

and (b) appropriately broad language relating to swap payments, fees and other similar payments.

The Agencies requested comment on "the appropriateness of basing the risk-based capital requirement for a securitization exposure under the RBA on the seniority level of the exposure".[13] We do not fundamentally object to this feature of the Basel II NPR, but we do have two related comments.

First, we understand that EU's Capital Requirements Directive (the "CRD") provides a 6% risk weight for some super senior exposures and sometimes permits other exposures to be treated as senior, notwithstanding the presence of these super senior exposures.[14] We also understand that the final terms on these points may still be under deliberation. On grounds of competitive equality, we request that the Agencies adopt parallel provisions.

Second, the definition of "senior securitization exposure" in section 2 uses a short-hand reference to "fees" of service providers that could be seen as excluding other similar payments (notably swap payments) that are referenced in the parallel provisions in Basel II itself[15] and the CRD. We believe the CRD has the language that best reflects the appropriate exclusion: "When determining whether a tranche is the most senior, it is not required to take into consideration amounts due under interest rate or currency derivative contracts, fees due, or other similar payments."[16] We request similar language and have provided suggested language in Attachment B.

19. *We request that the Agencies' version of the RBA be made consistent with the version of the RBA in the CRD in terms of the number of ratings required for originators and the treatment of inconsistent ratings.*

In almost all respects, the capital requirements proposed under the Basel II NPR are the same regardless of whether the bank holding a securitization exposure is the originator of the underlying assets or an investor in the securitization. We strongly support this neutral, risk-driven approach. The Agencies requested comment on an aspect of the RBA that they identify as the only material exception to this neutrality: the requirement that originating banks have two external ratings to use the RBA as compared to one rating for investing banks.[17]

We do not believe that originating banks should be treated differently from investing banks on this point. Normal NRSRO processes provide adequate assurance of the reliability of external ratings. Among other things, an NRSRO could never be certain that a security that was initially retained would not subsequently be sold, based in part on its rating. We note that neither Basel II itself, nor the CRD, require this additional rating for originators to use the RBA. U.S. banks should not be singled out for the special additional requirement.

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[13] Question 47, Basel II NPR p. 55884.
[14] CRD, Annex IX (Securitisation), Part 3, par. 48.
[15] See Basel II, par. 613.
[16] CRD, Annex IX (Securitisation), Part 3, par. 47.
[17] Question 45, Basel II NPR p. 55884.

Also, the CRD contains different decision rules from the Basel II NPR as to split ratings when an exposure has more than two ratings. Under the CRD, if an exposure has more than two ratings, the two most favorable ratings are to be used.[18] Consistent with the Basel II NPR, within those two most favorable ratings, the lower governs. For international consistency, we request that the final rules permit banks to use the lower of the two highest ratings if an exposure has more than two ratings.

20. *We request that the definition of "securitization exposure" be modified to include lease securitizations.*

The Agencies requested comment on "the appropriate treatment of tranched exposures to a mixed pool of financial and nonfinancial underlying exposures."[19] The market segment most directly affected by this issue is lease securitizations, since leases often combine a financial exposure (rights to rental payments) with residual rights to the nonfinancial leased property after the applicable lease expires. The market applies similar credit analysis methods to lease securitizations and securitizations of purely financial exposures. Rating agency criteria for the two asset classes are also similar. We believe it is both analytically appropriate and administratively convenient to treat lease securitizations like securitizations of purely financial exposures.

The Securities and Exchange Commission reached a similar conclusion when it included lease securitizations in the definition of "asset-backed securities" for purposes of Regulation AB and related rules.[20] In doing so, the Commission imposed quantitative limits on the portion of the securitized pool balance attributable to residual values and differentiated between motor vehicle leases and other leases for this purpose. The Agencies might want to consider similar limits, in which case it would be most convenient if the Agencies used the same limits as the Commission.

21. *We request that the final rules be revised to be more consistent with the current U.S. risk-based capital rules in the treatment of non-cash gain-on-sale and interest-only strips.*

Proposed section 42(a)(1) would require banks to deduct from tier 1 capital any after-tax, non-cash gain-on-sale resulting from a securitization and also to deduct from total capital in accordance with section 42(c) the portion of any credit-enhancing interest only strip ("CEIO") that does not constitute gain-on-sale. These requirements differ from the Agencies' current risk-based capital rules, which apply a concentration limit on CEIOs as a percentage of tier 1 capital but otherwise permit them to be deducted 50/50 from tier 1 and tier 2 capital, rather than solely from tier 1 capital. The Basel II NPR does not discuss the reasons for these proposed changes.

The proposed requirements differ from existing rules both in the breadth of the category of assets that must be deducted from capital and in the allocation of deductions between tier 1 and tier 2 capital. We request that the final rules conform to the existing rules on both of these dimensions. As to the first, the proposed broader category of assets to be deducted could include assets for which deduction is clearly not justified, as evidenced by the treatment of those assets when held

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[18] CRD, Annex IX (Securitisation), Part 3, par. 6.
[19] Question 26, Basel II NPR p. 55860.
[20] See Item 1101(c)(2)(iv) of Regulation AB, 17 CFR 229.1101(c)(2)(iv).

by investing banks, rather than originators. For instance, some banks that securitize residential mortgages retain non-subordinated interest only strips, which are rated investment grade and are not CEIOs. If held by an investor, these assets would have a risk weight of not less than 100%, but would not be deducted from capital. Another adversely affected asset type would be servicing assets.

As to the allocation of deductions between tier 1 and tier 2 capital, the Basel II NPR does not state the reason for this change from the existing rules. We believe the proposed requirement to deduct 100% of after tax, non-cash gain-on-sale from tier 1 capital is excessive.

On a related point, the regulatory discussion in the Basel II NPR states that "Over time, as the bank, from an accounting perspective, realizes the increase in equity capital and tier 1 capital that was booked at the inception of the securitization through actual receipt of cash flows, the amount of the required deduction would shrink accordingly."[21] We do not, however, see this concept carried through into the text of the proposed rules in the common appendix. It is important that this gap be filled, so that it is clear that the required deduction from capital is not permanent.

22. *We request clarifying language as to how the definition of "eligible clean-up call" applies to securities issued by master trusts.*

Proposed section 2 defines "eligible clean-up call" partly in terms of when the call becomes exercisable. For traditional securitizations, the call may only be exercisable "when 10 percent or less of the principal amount of the underlying exposures or securitization exposures (determined as of the inception of the securitization) is outstanding."

In master trusts, a clean-up call often applies to each series or tranche of securities issued by the trust, and is exercisable when the outstanding principal balance of the securities in that series or tranche fall below 10 percent or some lower specified percentage. We request that the Agencies confirm that this type of exercise threshold would be consistent with and eligible clean-up call.

23. *We request changes to the treatment of securitization exposures in the form of non-credit OTC derivatives.*

Market participants have generally understood that the securitization framework in the Basel II NPR would not apply to trading book exposures, such as non-credit OTC derivatives. However, section 42(e) seems to indicate that the Agencies expect banks to apply the securitization framework to some aspects of non-credit derivatives, where the bank's counterparty is a securitization SPE. That section, which defines the "amount" of exposures subject to the securitization framework, states that the "amount" of an OTC derivative contract that is not a credit derivative is the EAD of the derivative contract (as calculated in section 32).

Because banks had understood that OTC derivatives would not be affected by the securitization framework, there has not been sufficient dialogue between banks and the Agencies about how the framework should be applied to exposures of this type. Consequently, the existing

[21] Basel II NPR p. 55857.

approaches for determining risk-weighted assets within the framework will not provide an appropriate answer for many of these exposures. An example of particular concern is where the risk weight on an unrated OTC derivative exposure that is pari passu with a rated tranche will have to be inferred from a junior tranche with a significantly higher risk weight than the pari passu tranche or possibly be subject to full deduction. Such regulatory treatment would not align with the economic risk of the position as reflected in a bank's internal risk management systems.

We understand that a significant dialogue relating to this issue in underway between the FSA and various UK banks. We request that the Agencies participate in this dialogue, together with affected banks, in order to arrive at an appropriate near-term international solution for this overlooked issue.

24. *We wish to alert the Agencies to potential future issues relating to the operational requirement of a GAAP sale for traditional securitizations.*

Proposed section 41(a)(1) makes GAAP sale treatment one of the operational requirements for capital reductions as a result of a traditional securitization. While this is not a change from the Agencies' current rules, we hope that the Agencies will be prepared to consider relaxing this requirement if necessary as GAAP changes in the future. As the Agencies are aware, the Financial Accounting Standards Board has for years now been deliberating possible changes to Statement No. 140, which governs sale treatment. We cannot predict the timing and scope of the ultimate changes, but some of the changes under discussion could have the effect of denying sale treatment to many securitizations that currently achieve sale treatment.

We also note that FASB has a project underway to converge GAAP with international accounting standards, which are much more stringent that Statement 140 as to sale treatment for securitizations. In fact, we understand that outside of the U.S. many securitizations do not achieve accounting sale treatment. This may be one of the reasons why neither Basel II nor the CRD includes accounting sale treatment as an operational requirement for traditional securitizations.

If FASB changes GAAP to limit the availability of sale treatment, we hope the Agencies will consider independently whether that change should apply for risk-based capital purposes. The Agencies took action similar to this in connection with FASB's FIN 46, as to the risk-based capital treatment of both consolidated ABCP conduits and trust preferred securities. As with FIN 46, the Agencies should consider both the correct economic analysis and international competitiveness in connection with any change of this type.

* * *

The ASF appreciates the opportunity to provide the foregoing comments. Should you have any questions or desire any clarification concerning the matters addressed in this letter, please do not hesitate to contact Tom Deutsch, Associate Director of the ASF (646/637-9235), or Rob Hugi (312/701-7121) or Jason Kravitt (212/506-2622), each of Mayer, Brown, Rowe & Maw LLP, who have acted as special counsel to the ASF on this matter.

Sincerely,

Cameron L. Cowan
Chairman
Legal, Regulatory, Accounting and Tax Committee

Cross Reference of ASF Comments to Securitization Questions on Which the Agencies Requested Comment

Definition of "securitization exposure"

Question 26: The agencies request comment on the appropriate treatment of tranched exposures to a mixed pool of financial and nonfinancial underlying exposures. The agencies specifically are interested in the views of commenters as to whether the requirement that all or substantially all of the underlying exposures of a securitization be financial exposures should be softened to require only that some lesser portion of the underlying exposures be financial exposures. (Basel II NPR, p. 55860)

See comment 20.

RBA

Question 45: The agencies seek comment on this differential treatment [requiring two ratings for originators to use RBA] of originating banks and investing banks and on alternative mechanisms that could be employed to ensure the reliability of external and inferred ratings of nontraded securitization exposures retained by originating banks. (Basel II NPR, p. 55884)

See comment 19.

Question 46: The agencies seek comment on whether they should consider other bases for inferring a rating for an unrated securitization position, such as using an applicable credit rating on outstanding long-term debt of the issuer or guarantor of the securitization exposure. (Basel II NPR, p. 55884)

See comments 3 and 11.

Question 47: The agencies seek comment on the appropriateness of basing the risk-based capital requirement for a securitization exposure under the RBA on the seniority level of the exposure. (Basel II NPR, p. 55884)

See comments 12 and 18.

Question 48: The agencies seek comment on how well this approach captures the most important risk factors for securitization exposures of varying degrees of seniority and granularity. (Basel II NPR, p. 55884)

No comment.

SFA

Question 49: The agencies seek comment on suggested alternative approaches for determining the N of a re-securitization. (Basel II NPR, p. 55889)

No comment.

Eligible Disruption Liquidity Facilities

Question 50: The agencies have not included this concept in the proposed rule but seek comment on the prevalence of eligible disruption liquidity facilities and a bank's expected use of the SFA to calculate risk-based capital requirements for such facilities. (Basel II NPR, p. 55890)

See comment 13.

Early Amortization Features (Basel II NPR, p. 55893)

Question 51: The agencies seek comment on the appropriateness of these additional exemptions[22] in the U.S. markets for revolving securitizations.

See below.

Question 52: The agencies solicit comment on the distinction between controlled and non-controlled early amortization provisions and on the extent to which banks use controlled early amortization provisions. The agencies also invite comment on the proposed definition of a controlled early amortization provision, including in particular the 18-month period set forth above.

See below.

Question 53: The agencies seek comment on the appropriateness of the 4.5 percent excess spread trapping point and on other types and levels of early amortization triggers used in securitizations of revolving retail exposures that should be considered by the agencies.

See below.

Question 54: The agencies seek comment on and supporting empirical analysis of the appropriateness of a more simple alternative approach that would impose at all times a flat CF on the entire investors' interest of a revolving securitization with a controlled early amortization provision, and on what an appropriate level of such a CF would be (for example, 10 or 20 percent).

We endorse the comments submitted by the Risk Management Association Capital Working Group in response to questions 51-54.

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[22] Refers to the following: "Under the New Accord, a bank is also not required to hold regulatory capital against the investors' interest if (i) the securitization has a replenishment structure in which the individual underlying exposures do not revolve and the early amortization ends the ability of the originating bank to add new underlying exposures to the securitization; (ii) the securitization involves revolving assets and contains early amortization features that mimic term structures (that is, where the risk of the underlying exposures does not return to the originating bank); or (iii) investors in the securitization remain fully exposed to future draws by borrowers on the underlying exposures even after the occurrence of early amortization."

Attachment B

Suggested Changes to Regulatory Text

We have reprinted below only those paragraphs from the proposed common appendix where we are requesting language changes and some additional paragraphs to provide context. Proposed additions are underscored, and proposed deletions are struck through.

Section 2. Definitions

Eligible clean-up call means a cleanup call that:
(1) Is exercisable solely at the discretion of the servicer;
(2) Is not structured to avoid allocating losses to securitization exposures held by investors or otherwise structured to provide credit enhancement to the securitization; and
(3) (i) For a traditional securitization, is only exercisable when 10 percent or less of the principal amount (determined as of the inception of the securitization) of the underlying exposures or securitization exposures (which may a specified series or tranche) ~~(determined as of the inception of the securitization)~~ is outstanding; or
(ii) For a synthetic securitization, is only exercisable when 10 percent or less of the principal amount (determined as of the inception of the securitization) of the reference portfolio of underlying exposures (which may a specified series or tranche) ~~(determined as of the inception of the securitization)~~ is outstanding.[1]

External rating[2] means a credit rating that is assigned by an NRSRO to an exposure, provided:
(1) The credit rating fully reflects the entire amount of credit risk with regard to all principal and/or interest payments owed to the holder of the exposure. If a holder is owed principal and interest on an exposure, the credit rating must fully reflect the credit risk associated with timely repayment of principal and interest. If a holder is owed only principal on an exposure, the credit rating must fully reflect only the credit risk associated with timely repayment of principal; and
(2) The credit rating is published in an accessible form and is or will be included in the transition matrices made publicly available by the NRSRO that summarize the historical performance of positions rated by the NRSRO. An external rating need not cover fees, indemnities other miscellaneous or contingent amounts that may be payable in addition to principal and interest.

Inferred rating[3]. A securitization exposure has an *inferred rating* equal to the external rating identified as the "reference rating" below if all of the conditions in either paragraph (A) or (B) below is satisfied ~~referenced in paragraph (2)(i) of this definition if~~:
(A) Unrated senior exposures:
(1) The securitization exposure does not have an external rating; and
(2) Another securitization exposure issued by the same issuer and secured by the same underlying exposures:
(i) Has an external rating (the reference rating);
(ii) Is subordinated in all respects to the unrated securitization exposure;
(iii) Does not benefit from any credit enhancement that is not available to the unrated securitization exposure; and
(iv) Has an effective remaining maturity that is equal to or longer than that of the unrated securitization exposure.
(B) Unrated liquidity facilities:
(1) The securitization exposure is a liquidity facility extended to an ABCP program and the facility itself does not have an external rating;
(2) The securitization exposure that would be acquired or funded upon a draw under the liquidity facility has an external rating (the reference rating); and
(3) Upon such a draw, the bank would have a contractual first priority claim on the cash flows from the securitization exposure that would be acquired or funded, disregarding amounts due under interest rate or currency derivative contracts, the claims of a service provider (such as a trustee, custodian, or paying agent for the securitization) to fees from the securitization and other similar payments.

Originating [bank], with respect to a securitization, means a [bank] that~~:~~
~~(1)~~ d~~D~~irectly or indirectly originated or securitized the underlying exposures included in the securitization.[4]~~;~~
~~(2) Serves as an ABCP program sponsor to the securitization.~~

Senior securitization exposure means a securitization exposure that has a first priority claim on the cash flows from the underlying exposures, disregarding amounts due under interest rate or currency derivative contracts, the claims of a service provider (such as a ~~swap counterparty or~~ trustee, custodian, or paying agent for the securitization) to fees from the securitization and other similar payments.[5] A liquidity facility that supports an ABCP program is a senior securitization exposure if the liquidity facility provider's right to reimbursement of the drawn amounts is senior to all claims on the cash flows from the underlying exposures, disregarding amounts due under interest rate or currency derivative contracts, the claims of a service provider (such as a trustee, custodian, or paying agent for the securitization) to fees from the securitization and other similar payments~~except claims of a service provider to fees~~. The senior status of such a liquidity facility does not impair the senior status of either the related ABCP or any securitization exposure that a bank would acquire or fund upon a draw under the liquidity facility.[6] Similarly, the presence in a transaction of an exposure that carries a 6% risk weight pursuant to section 43(c) does not impair the senior status of any securitization exposure in the same transaction that would have been considered a senior securitization expsosure

[1] See comment 22.
[2] See comment 16.
[3] See comment 11.
[4] See comment 15.
[5] See comment 18(b).
[6] See comment 12.

if not for the presence of such 6% risk weight exposure.[7]

Synthetic securitization means a transaction in which:
(1) All or a portion of the credit risk of one or more underlying exposures is transferred to one or more third parties through the use of one or more credit derivatives or guarantees (other than a guarantee that transfers only the credit risk of an individual retail exposure);
(2) The credit risk associated with the underlying exposures has been separated into at least two tranches reflecting different levels of seniority;
(3) Performance of the securitization exposures depends upon the performance of the underlying exposures; and
(4) All or substantially all of the underlying exposures are financial exposures (such as loans, commitments, credit derivatives, guarantees, receivables, asset-backed securities, mortgage-backed securities, other debt securities, or equity securities); provided that where the underlying financial exposures include rights to payment under leases, the underlying exposures may include residual interests in the physical property underlying such leases.[8]

Traditional securitization means a transaction in which:
(1) All or a portion of the credit risk of one or more underlying exposures is transferred to one or more third parties other than through the use of credit derivatives or guarantees;
(2) The credit risk associated with the underlying exposures has been separated into at least two tranches reflecting different levels of seniority;
(3) Performance of the securitization exposures depends upon the performance of the underlying exposures; and
(4) All or substantially all of the underlying exposures are financial exposures (such as loans, commitments, credit derivatives, guarantees, receivables, asset-backed securities, mortgage-backed securities, other debt securities, or equity securities).; provided that where the underlying financial exposures include rights to payment under leases, the underlying exposures may include residual interests in the physical property underlying such leases.[9]

Section 42. Risk-Based Capital Requirement for Securitization Exposures

(a) *Hierarchy of approaches.* Except as provided elsewhere in this section:
(1) After applying the concentration limit set out in [REFERENCE CEIO CONCENTRATION LIMIT IN APPLICABLE AGENCY'S RULES], [bank] must deduct from tier 1 capital any after-tax gain-on-sale resulting from a securitization and must deduct from total capital in accordance with paragraph (c) of this section the portion of any CEIO that does not constitute gain-on-saleresulting from a securitization.[10]
(2) If a securitization exposure does not require deduction under paragraph (a)(1) of this section and qualifies for the Ratings-Based Approach in section 43, a [bank] must apply the Ratings-Based Approach to the exposure.
(3) If a securitization exposure does not require deduction under paragraph (a)(1) of this section and does not qualify for the Ratings-Based Approach, the [bank] may either apply the Internal Assessment Approach in section 44 to the exposure (if the [bank] and the relevant ABCP program qualify for the Internal Assessment Approach) or the Supervisory Formula Approach in section 45 to the exposure (if the [bank] and the exposure qualify for the Supervisory Formula Approach).
(4) If a securitization exposure does not require deduction under paragraph (a)(1) of this section and does not qualify for the Ratings-Based Approach, the Internal Assessment Approach, or the Supervisory Formula Approach, the [bank] must deduct the exposure from total capital in accordance with paragraph (c) of this section.
. . .
(c) *Deductions.* (1) If a [bank] must deduct a securitization exposure from total capital, the [bank] must take the deduction 50 percent from tier 1 capital and 50 percent from tier 2 capital. If the amount deductible from tier 2 capital exceeds the [bank]'s tier 2 capital, the [bank] must deduct the excess from tier 1 capital.
(2) A [bank] may calculate any deduction from regulatory capital for a securitization exposure net of any deferred tax liabilities associated with the securitization exposure.
(3) Deductions of exposures from capital will generally be reflected by a line item on the bank's call report, which will call for the insertion of the amount of the deducted exposure as of the applicable reporting date (which amount will then be subtracted consistent with paragraph (c)(1) above in determining the bank's tier 1 capital and tier 2 capital). As a result, over time, as the bank realizes any increase in equity capital and tier 1 capital that was booked at the inception of the securitization through actual receipt of cash flows, the amount of the required deduction will shrink accordingly.[11]
. . .
(e) *Amount of a securitization exposure.* (1) The amount of an onbalance sheet securitization exposure is:
(i) The [bank]'s carrying value, if the exposure is held-to-maturity or for trading; or
(ii) The [bank]'s carrying value minus any unrealized gains and plus any unrealized losses on the exposure, if the exposure is available-for-sale.
(2) The amount of an off-balance sheet securitization exposure is the notional amount of the exposure. For a commitment, such as a liquidity facility extended to an ABCP program, the notional amount may be reduced to the amount of outstanding ABCP or other exposures supported by such facility (if less than the notional amount of the facility).[12]maximum potential amount that the[bank] currently would be required tofund under the arrangement's documentation. Notwithstanding the prior two sentences, the amount of a liquidity facility that meets the requirements of [REFERENCE APPLICABLE AGENCY'S CURRENT STANDARDS FOR ELIGIBLE LIQUIDITY] and can only be drawn in the event of a general market disruption (i.e., where more than one ABCP program across different transactions is unable to roll over maturing ABCP, and that ability is not the result of an impairment in the ABCP programs' credit quality or in the credit quality of the underlying exposures) is zero.[13] For an OTC derivative contract that is not a credit derivative,

[7] See comment 18(a).
[8] See comment 20.
[9] See comment 20.
[10] See comment 21.
[11] See comment 21.
[12] See comment 14.
[13] See comment 13.

the notional amount is the EAD of the derivative contract (as calculated in section 32).[14]

(f) *Overlapping exposures*—(1) *ABCP programs.* If a [bank] has multiple securitization exposures to an ABCP program that provide duplicative coverage of the underlying exposures of a securitization (such as when a [bank] provides a program-wide credit enhancement and multiple pool-specific liquidity facilities and parallel purchase facilities[15] to an ABCP program), the [bank] is not required to hold duplicative risk-based capital against the overlapping position. Instead, the [bank] may apply to the overlapping position the applicable risk-based capital treatment that results in the highest risk-based capital requirement.

(2) *Mortgage loan swaps.* If a [bank] holds a mortgage-backed security or participation certificate as a result of a mortgage loan swap with recourse, and the transaction is a securitization exposure, the [bank] must determine a risk-weighted asset amount for the recourse obligation plus the percentage of the mortgage-backed security or participation certificate that is not covered by the recourse obligation. The total risk-weighted asset amount for the transaction is capped at the risk-weighted asset amount for the underlying exposures as if they were held directly on the [bank]'s balance sheet.

(g) *Securitizations of non-IRB exposures.* Regardless of paragraph (a) of this section, if a [bank] has a securitization exposure where any underlying exposure is not a wholesale exposure, retail exposure, securitization exposure, or equity exposure, the [bank] must:

(1) If the [bank] is an originating [bank], after applying the concentration limit set out in [REFERENCE CEIO CONCENTRATION LIMIT IN APPLICABLE AGENCY'S RULES], deduct from tier 1 capital any after-tax gain-on-sale resulting from the securitization and deduct from total capital in accordance with paragraph (c) of this section any CEIO resulting from the securitizationthe portion of any CEIO that does not constitute gain-on-sale;[16]

(2) If the securitization exposure does not require deduction under paragraph (g)(1), apply the RBA in section 43 to the securitization exposure if the exposure qualifies for the RBA;

(3) If the securitization exposure does not require deduction under paragraph (g)(1) and does not qualify for the RBA, apply the IAA in section 44 to the securitization exposure if the exposure qualifies for the IAA;[17] and

(43) If the securitization exposure does not require deduction under paragraph (g)(1) and does not qualify for the RBA or the IAA, apply the wholesale framework in section 31 or, if not applicable, deduct the exposure from total capital in accordance with paragraph (c) of this section.

. . . .

Section 43. Ratings-Based Approach (RBA)

(a) *Eligibility requirements for use of the RBA*—*(1) Originating [bank].* An originating [bank] must use the RBA to calculate its risk-based capital requirement for a securitization exposure if the exposure has two or more external ratings or an inferred rating based on two or more external ratings (and may not use the RBA if the exposure has fewer than two external ratings or an inferred rating based on fewer than two external ratings).[18] [Note: changes conforming to the ones made in the paragraph below would be needed if the Agencies retain this paragraph and continue to treat sponsors of ABCP conduits as originators.]

(2) Investing [bank]. An investing [bank] must use the RBA to calculate its risk-based capital requirement for a securitization exposure if the exposure has one or more external or (if the IAA does not apply)[19] inferred ratings (and may not use the RBA if the exposure has no external or inferred rating).

(b) *Ratings-based approach.* (1) A [bank] must determine the risk-weighted asset amount for a securitization exposure by multiplying the amount of the exposure (as defined in paragraph (e) of section 42) by the appropriate risk weight provided in the tables in this section.

(2) The applicable rating of a securitization exposure that has moretwo than one external or inferred ratings is the lowest rating. The applicable rating of a securitization exposure that has more than two external or inferred ratings is determined based on the lower of the two highest ratings.[20]

. . .

(c) *Super Senior Positions.* A risk weight of 6 % may be applied to an exposure in the most senior tranche of a securitization where that tranche is senior in all respects to another tranche of the securitization which would receive a risk weight of 7% under paragraph (b)(3), provided that:

(i) this is justified due to the loss absorption qualities of subordinate tranches in the securitization; and

(ii) either the position has an external credit assessment in the highest investment grade category or, if it is unrated, the requirements for inferring a rating under paragraph (A) or (B) of the definition of "inferred rating" are satisfied where the 'reference rating' is also in the highest investment grade category.[21]

. . .

Section 44. Internal Assessment Approach (IAA)

(a) *Eligibility requirements.* A [bank] may apply the IAA to calculate the risk weighted asset amount for a securitization exposure that the [bank] has related[22] to an ABCP program (such as a liquidity facility or credit enhancement) if the [bank] and the exposure qualify for use of the IAA.

(1) *[Bank] qualification criteria.* A [bank] qualifies for use of the IAA if the [bank] has submitted all materials requested by the [AGENCY] and has not received notice of disqualification from the prior written approval of the [AGENCY]. To receive such approvalavoid notice of disqualification[23], the [bank] must demonstrate to the [AGENCY]'s satisfaction that the [bank]'s internal assessment process meets the following criteria:

(i) The [bank]'s internal credit assessments of securitization exposures must be based on publicly available rating criteria used by an NRSRO, as supplemented by consultations between the bank and the NRSRO.[24]

(ii) The [bank]'s internal credit assessments of securitization exposures used for risk-based capital purposes must be consistent with those used in the [bank]'s internal risk management

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[14] See comment 23.
[15] See comment 5.
[16] See comment 21.
[17] See comment 4.
[18] See comment 19.
[19] See comment 3.
[20] See comment 19.
[21] See comment 18(a).
[22] See comment 5.
[23] See comment 9.
[24] See comment 2.

process, management information reporting systems, and capital adequacy assessment process.

(iii) The [bank]'s internal credit assessment process must have sufficient granularity to identify gradations of risk. Each of the [bank]'s internal credit assessment categories must correspond to an external rating of an NRSRO.

(iv) The [bank]'s internal credit assessment process, particularly the stress test factors for determining credit enhancement requirements, must be at least as conservative as the most conservative of the publicly available rating criteria of the NRSROs that have provided external ratings to the commercial paper issued by the ABCP program.

(A) Where the commercial paper issued by an ABCP program has an external rating from two or more NRSROs and the different NRSROs' benchmark stress factors require different levels of credit enhancement to achieve the same external rating equivalent, the [bank] must apply the NRSRO stress factor that requires the highest level of credit enhancement.

(B) If one of the NRSROs that provides an external rating to the ABCP program's commercial paper changes its methodology (including stress factors), the [bank] must consider the NRSRO's revised rating methodology in evaluating whether the internal credit assessments assigned by the [bank] to securitization exposures must be revised.

(v) The [bank] must have an effective system of controls and oversight that ensures compliance with these operational requirements and maintains the integrity and accuracy of the internal credit assessments. The [bank] must have an internal audit function independent from the ABCP program business line and internal credit assessment process that assesses at least annually whether the controls over the internal credit assessment process function as intended.

(vi) The [bank] must review and update each internal credit assessment whenever new material information is available, but no less frequently than annually.

(vii) The [bank] must validate its internal credit assessment process on an ongoing basis and at least annually.

(2) *ABCP-program qualification criteria.* An ABCP program qualifies for use of the IAA if the ABCP program meets the following criteria:

(i) All commercial paper issued by the ABCP program must have an external rating.

~~(ii)~~ [Moved to exposure qualification criteria. See comment 1.]~~The ABCP program must have robust credit and investment guidelines (that is, underwriting standards).~~

~~(iii)~~ [Moved to exposure qualification criteria. See comment 1.]~~The ABCP program must perform a detailed credit analysis of the asset sellers' risk profiles.~~

~~(iv)~~ [Deleted in reliance on rating agency criteria. See comment 6.] ~~The ABCP program's underwriting policy must establishminimum asset eligibility criteria thatinclude the prohibition of the purchase of assets that are significantly past due or defaulted, as well as limitations on concentration to individual obligor or geographic area and the tenor of the assets to be purchased.~~

~~(v)~~ [Moved to exposure qualification criteria. See comment 1.~~The aggregate estimate of loss on an asset pool that the ABCP program is considering purchasing must consider all sources of potential risk, such as credit and dilution risk.~~

~~(vi)~~ [Deleted in reliance on rating agency criteria. See comment 7.] ~~The ABCP program must incorporate structural features into each purchase of assets to mitigate potential credit deterioration of the underlying exposures. Such features may include wind-down triggers specific to a pool of underlying exposures.~~

(3) *Exposure qualification criteria.* A securitization exposure qualifies for use of the IAA if:

(i) T~~t~~he [bank] initially rated the exposure at least the equivalent of investment grade.

(ii) The bank applied robust credit and investment guidelines (that is, underwriting standards) to the exposure.

(iii) The bank performed a detailed credit analysis of the risk profile of any operating asset seller (as opposed to special purpose entities) whose credit is material to the transaction. This analysis may be performed by any appropriate group within the bank.[25]

(iv) The aggregate estimate of loss on the underlying asset pool must consider all material sources of potential risk, such as credit and dilution risk.[26]

(b) *Mechanics.* A [bank] that elects to use the IAA to calculate the risk-based capital requirement for any securitization exposure must use the IAA to calculate the risk-based capital requirements for all securitization exposures that qualify for the IAA approach. Under the IAA, a [bank] must map its internal assessment of such a securitization exposure to an equivalent external rating from an NRSRO. Under the IAA, a [bank] must determine the risk-weighted asset amount for such a securitization exposure by multiplying the amount of the exposure (as defined in paragraph (e) of section 42) by the appropriate risk weight in the RBA tables in paragraph (b) of section 43.

Section 45. Supervisory Formula Approach (SFA)

(a) *Eligibility requirements.* A [bank] may use the SFA to determine its risk-based capital requirement for a securitization exposure only if the [bank] can calculate on an ongoing basis each of the SFA parameters in paragraph (e) of this section. Where otherwise applicable, for purposes of determining K_{IRB} a bank may apply the rules relating to eligible purchased wholesale receivables in section 31, notwithstanding that the receivables are purchased by an ABCP program rather than the bank.[27]

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[25] See comment 8.

[26] See comment 1.

[27] See comment 17.