October 21, 2010

Office of the Comptroller of the Currency
250 E Street, SW, Mail Stop 2-3
Washington, DC 20219

Docket No. OCC-2010-0016

Ms. Jennifer Johnson
Board of Governors of the
Federal Reserve System
20th Street and Constitution Ave
Washington, DC 20551

Docket No. R-1391

Mr. Robert Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th St, NW
Washington, DC 20429

RIN # 3064-AD62

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552

Attention: OTS-2010-0027

Re: Advanced Notice of Proposed Rulemaking Regarding Alternatives to the Use of Credit Ratings in the Risk-Based Capital Guidelines of the Federal Banking Agencies

Ladies and Gentlemen:

The Mortgage Bankers Association[1] (MBA) welcomes the opportunity to comment on the proposed changes to regulatory capital requirements for financial institutions (hereby banks) set forth in the recent Advanced Notice of Proposed Rulemaking (ANPR), *Regarding Alternatives to the Use of Credit Ratings in the Risk-Based Capital Guidelines of the Federal Banking Agencies*.

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

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Background

The regulations issued by the Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (Fed), Federal Deposit Insurance Corporation (FDIC), and Office of Thrift Supervision (OTS) (collectively, the agencies) include various references to the use of credit ratings issued by nationally recognized statistical rating organizations (NRSROs). Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Act) requires the agencies to review their regulations to identify those that require the use of an assessment of the creditworthiness of a security or money market instrument and make reference to or have requirements regarding those NRSRO ratings. Once identified, the agencies must then modify their respective regulations to remove any reference to such NRSRO ratings and substitute in their place other standards of creditworthiness that the agencies deem appropriate for such regulations.

General Comments

Agencies Should Study Recent Changes Made By NRSROs

The proposed rulemaking is meant to address the issues attributed to NRSROs in the recent credit crisis. Some of MBA's recommendations below are based upon an assumption that some NRSROs have modified their business models to address these issues, especially with regards to potential conflicts of interest. In formulating a final rule with respect to use of NRSROs, MBA recommends that the agencies study the effectiveness of these changes especially in light of the fact that other Basel accord nations will likely continue to use NRSRO ratings in their respective risk-based capital rules.

Principles of Reform

The Act ushers in the most significant financial regulatory reforms since those that were enacted in the wake of the Great Depression. The 2,315 page bill creates new regulatory agencies, expands several existing ones, and calls for hundreds of new rules that will add up to tens of thousands of pages. This undertaking will require a massive amount of resources and time over the coming years.

Many of these new rules will be developed jointly by multiple agencies. Scores of rules will need to be synchronized with other simultaneous or sequential rulemakings. It is essential that this process unfold in a way that balances necessary reforms with the need for preserving an efficient financial system.

MBA recently published its *8 Principles for Implementing Financial Regulatory Reform* in response to the massive rulemaking that will occur as a result of the Act. Some of these principles are similar to the principles contained in the ANPR. MBA's principles are:

1. Seek comprehensive, coordinated solutions
2. Foster certainty in the marketplace
3. Increase transparency

4. Balance the ability of the private marketplace to control lending with the application of new regulation
5. Ensure market liquidity
6. Appropriately tailor solutions to the current market environment
7. Maximize competition to lower costs
8. Promote uniformity

With respect to principle 1, MBA notes that the approach that the agencies are taking in the ANPR would cause a major deviation from provisions in the current Basel accord. It will be difficult, if not impossible, for the agencies to convince other Basel accord nations to adopt risk-based capital rules that contain no references to NRSRO ratings.

With respect to principle 2, the current use of NRSRO ratings in the risk-based capital rules does add a level of certainty in the marketplace, facilitating, globally, banks' weighting a given exposure in a similar fashion.

With respect to principle 3, as demonstrated in MBA's response to specific questions below, the alternatives that score the highest on transparency generally score lower on distinguishing credit risk within an asset class, measuring timely and accurately changes in creditworthiness, and fostering prudent risk management.

With respect to principle 5, MBA notes that changes that unnecessarily add costs or other burdens to the real estate financing process will reduce liquidity and increase costs for borrowers. Several of the alternatives presented in the ANPR would require banks to dramatically add to infrastructure and cost in order to implement a risk-based capital regimen that replaces the use of NRSROs in the risk-based capital rules.

With respect to principle 8, efficient markets rely on consistent and predictable standards. Rules that differ markedly across geographic boundaries or other jurisdictions can lead to higher costs for borrowers. The elimination of NRSROs in the risk-based capital rules would not promote uniformity with rules in other Basel accord nations where NRSROs are still used in risk-based capital rules, thus possibly putting U.S. domiciled banks at a significant competitive disadvantage.

These general observations highlight the conflict between the Dodd-Frank Act's mandate to purge regulations of all credit rating references and the fact that, under certain circumstances, credit ratings are a useful tool to assist in making investment decisions. For example, so long as rigorous conflict of interest firewalls are in place, credit ratings provide third-party evidence to support or refute an investor's own due diligence review.

One approach the banking agencies could consider in reconciling the Dodd-Frank Act's requirements with the practical utility of credit ratings is to remove all regulatory references to credit ratings but issue guidance to clarify instances where the use of credit ratings is permissible. Such guidance could prohibit the use of credit ratings as a standalone determination of an investment's creditworthiness. However, the guidance

also could authorize the use of credit ratings in conjunction with internal due diligence protocols.

Consider Taking an Approach Similar to Proposed SEC Rule
MBA notes that reliance on NRSRO ratings in the federal regulations has been an area of active interest of the federal regulatory agencies, including the Securities and Exchange Commission (SEC). In 2008, the SEC exposed for comment a proposed rule (the proposal) that would prohibit money market funds from relying on NRSRO ratings for securities purchase eligibility.[2] Instead, the proposal would require that the money market fund's board of directors determine that each portfolio investment present minimum credit risk and verify that the security is a "First Tier Security" or "Second Tier Security" for the purposes of the proposal. The board could then rely on its internal analysis or that of an outside source, including an NRSRO rating, if it determines the rating to be credible, to make the determination if the security was in the First or Second Tier. The proposal would require the management of money market funds to make their own determination relating to the credibility of the NRSRO ratings and if they should be used in the analysis process for identifying First and Second Tier Securities. This would require management to affirm an NRSRO rating versus using it as a qualification test. This rule was intended to address the lack of due diligence and the heavy reliance on NRSRO ratings by some purchasers.

The SEC proposal strikes the appropriate balance between securities purchasers performing independent due diligence without eliminating the substantial amount of due diligence and analysis that went into developing NRSRO ratings. MBA believes that such an approach would be consistent with the intent of the Dodd-Frank legislation of eliminating overreliance on NRSRO in securities purchase decisions.

In addition, recent regulations have been enacted that require the underlying property level data used in the ratings process to be provided to other credit rating agencies. This allows for non-solicited ratings to be compared with solicited ratings for discrepancies. This would serve as an important new check for the accuracy of solicited NRSRO ratings. MBA recommends that the agencies consider these approaches notwithstanding the Dodd-Frank Act's mandate to remove any reference to or requirement of reliance on credit ratings.

Responses to Specific Questions

Question 1: The agencies seek comment on the principles that should guide the formulation of creditworthiness standards. Do the principles provided above capture the appropriate elements of sound creditworthiness standards? How could the principles be strengthened?

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[2] (1) Reference to Ratings of Nationally Recognized Statistical Rating Organizations, File Number S7-17-08 , (2) Security Ratings, File Number S7-18-08, (3) Reference to Ratings of Nationally Recognized Statistical Rating Organizations, File Number S7-19-08

MBA's Response: MBA agrees that the principles provided capture the appropriate elements of sound creditworthiness standards. MBA notes that the existing use of NRSROs in the risk-based capital standards would appear to satisfy all or most of these principles. MBA also notes that the fifth principle, *Be reasonably simple to implement and not add undue burden on banking organizations,* will often be in conflict with the other five principles. MBA further points out that the fourth principle, *Minimize opportunities for regulatory capital arbitrage,* is probably not achievable unless other Basel accord participants also drop the use of NRSROs in their respective capital rules.

Question 2: What are the advantages and disadvantages for each of these general approaches? What, if any, combination of the approaches would appropriately reflect exposure categories and the sophistication of individual banking organizations? What other approaches do commenters believe would meet the agencies' suggested criteria for a creditworthiness standard? If increasing reliance is placed on banking organizations to assign risk weights for credit exposures using the types of approaches described above, how would the agencies ensure consistency of capital treatment for similar exposures? How could the use of third-party providers be implemented to ensure quality, transparency, and consistency?

MBA's Response: MBA provides the following analysis of its conclusions with respect to whether each suggested approach fulfills the six principles that the agencies state should guide the creditworthiness standards:

- **Risk Weights Based Upon Exposure Category:** Would be less effective in distinguishing credit risk within an asset class; would be transparent, unbiased and replicable; would not be timely and accurate for measurements of changes in creditworthiness; and would not necessarily foster prudent risk management. However, this approach probably scores the highest for simplicity and minimization of undue burden. A likely result of the use of broad exposure categories would be for risk weightings to error on the high, conservative size. As to regulatory arbitrage, this would depend on what other, foreign jurisdictions implement since they are not required to eliminate reference to NRSROs.

- **Exposure Specific Risk Weights to Individual Exposures Using Specific Qualitative and Quantitative Standards:** Would be very effective in distinguishing credit risk within asset class and fostering prudent risk management. Would not be transparent, unbiased or replicable; may not be timely and accurate in the measurement of changes in creditworthiness unless a bank spends a great deal of money to do so; and would not be the least bit simple. In contrast, such an approach would require expensive infrastructure and cost to implement and maintain. As to regulatory arbitrage, this would depend on what other, foreign jurisdictions implement since they are not required to eliminate reference to NRSROs.

- **Assign Exposures Based Upon Probabilities of Default:** Would be effective in distinguishing credit risk within asset class and would foster prudent risk management. However, would not be transparent, unbiased, and replicable unless risk of default is established for all banks based upon an independent third party source. May not be timely and accurate in the measurement of changes in creditworthiness unless a bank spends a great deal of money to do so and would not be the least bit simple. Such an approach would require expensive infrastructure and cost to implement and maintain. As to regulatory arbitrage, this would depend on what other Basel accord jurisdictions do to implement since they are not required to eliminate reference to NRSROs.

- **Use Approach Similar to NAIC Ratings:** Like the current use of NRSRO ratings, this approach would distinguish credit risk within asset class; would be transparent, unbiased and replicable; if properly implemented, could be timely and accurate in measuring changes in creditworthiness; and would be simple with no undue burden. It would not be as likely to foster prudent risk management since individual banks would not necessarily be doing independent reviews of each credit's risk. As to regulatory arbitrage, this would depend on what other, foreign jurisdictions implement since they are not required to eliminate reference to NRSROs. This would also depend if risked-based capital requirements based upon an independent credit assessment closely align with the current ratings-based risk-based capital buckets.

MBA points out that the approach similar to the use of NAIC ratings appears to score the highest with respect to the principles outlined by the agencies in the ANPR. MBA points out that the national credit rating agencies have re-vamped their assumptions, models and approach as a result of the recent credit crisis. The agencies may want to deploy them in developing NAIC-type ratings by creating an infrastructure that would ensure their independence and objectivity. This analysis could potentially be assigned on a blind and rotating basis among qualified organizations and funded from a surcharge on NRSRO rating fees.

MBA further points out that many large, multi-national firms may prefer to continue to use a granular approach similar to the Advanced Approach under Basel II because it fosters prudent risk management and better distinguishes asset level credit risk.

Question 3: What are the advantages and disadvantages of these alternative methods? How can the agencies ensure consistent and transparent implementation? Should the agencies consider other international organizations? Which financial and economic indicators should the agencies consider? What are the implications or potential unintended consequences? Are there other methods for assessing risk-based capital requirements for sovereign exposures that would meet the principles described in section III? Commenters are asked to provide quantitative as well as qualitative support and/or analysis for proposed alternative methods.

MBA's Response: These alternatives relate to assessing creditworthiness of sovereign entities and are generally not applicable to mortgage banking.

Question 4: What are the advantages and disadvantages of these alternative methods for calculating risk-based capital requirements for PSE exposures? How can the agencies ensure consistent and transparent implementation? Which services and businesses, or financial and economic measures, should the agencies consider? What are the implications or potential for unintended consequences? Are there other methods for assessing risk-based capital for PSE exposures in a relatively risk sensitive manner that would meet the principles described in section III? Commenters are asked to provide quantitative as well as qualitative support and/or analysis for proposed alternative methods.

MBA's Response: These alternatives relate to both sovereign risk and source of repayment (general obligation bond, revenue bond, or industrial revenue bond). They are generally not applicable to the mortgage industry.

Question 5: What are the advantages and disadvantages of these alternative methods for calculating risk-based capital requirements for bank exposures? How can the agencies ensure consistent and transparent implementation? Which financial and market indicators should the agencies consider? What are the implications or potential for unintended consequences? Are there other methods for assessing risk-based capital for bank exposures in a relatively risk sensitive manner that would meet the principles described in section III? Commenters are asked to provide quantitative as well as qualitative support and/or analysis for proposed alternative methods.

MBA's Response: The alternatives generally relate to evaluating the creditworthiness of bank exposures. This does not generally relate to mortgage banking.

Question 6: What are the advantages and disadvantages of these alternative methods? What are the implications or potential for unintended consequences? If all banking organizations are allowed to calculate their own capital requirements for corporate exposures, how can the agencies ensure consistent and transparent implementation (for example, where there may be material differences in how financial statements are typically presented or differences in chosen financial ratios)? What different approaches or other financial or market criteria would commenters recommend? Are there other methods for assessing risk-based capital for corporate exposures in a relatively risk sensitive manner that would meet the principles described in section III? Commenters are asked to provide quantitative, as well as qualitative, support and/or analysis for proposed alternative methods.

MBA's Response: This section relates to corporate exposures and is applicable to warehouse lines of credit that support the inventory of mortgage loans held for sale for independent mortgage bankers. Presently such exposures are risk-weighted at 100 percent. MBA believes that the agencies should consider the use of the "simple approach" that was proposed in the exposure draft of the "Standardized Approach" on

July 29, 2008. Generally under the simple approach, the collateralized portion of the exposure would receive the risk weight of the underlying collateral. MBA believes that the agencies should consider this simple approach when establishing rules for commercial exposures backed by highly liquid financial collateral such as conforming mortgage loans.

Question 7: What are the advantages and disadvantages of these approaches for calculating risk-based capital requirements for securitization exposures? How can the agencies ensure consistent and transparent implementation? Which parameters or measures of subordination and structure should the agencies consider? What are the implications or potential for unintended consequences? How can the agencies ensure that an alternative approach meets the criteria for a creditworthiness standard? What other approaches or specific financial and structural parameters that would be appropriate standards of creditworthiness for securitization exposures? Commenters are asked to provide quantitative as well as qualitative support and/or analysis for proposed alternative methods.

MBA's Response: MBA provides the following analysis of its conclusions with respect to whether each suggested approach fulfills the six principles that the agencies state should guide the creditworthiness standards:

- **All securitizations receive same risk weighting:** Would be transparent, unbiased and replicable and would be simple, with no undue burden. However, would not be at all effective in distinguishing credit risk within asset class or in accurately measuring changes in creditworthiness. It would also not minimize opportunities for regulatory arbitrage since other Basel committee countries will continue to use NRSROs. Likewise, this method would not foster prudent risk management.

- **Gross-up Method:** Would be transparent, unbiased and replicable and would be simple, with no undue burden. Would not provide for timely and accurate measurement of changes in creditworthiness. It would also not minimize opportunities for regulatory arbitrage since other Basel committee countries will continue to use NRSROs. Would be a step above all securitizations receiving the same risk weight in terms of distinguishing credit risk within asset class and fostering prudent risk management.

- **Assign risk weights based upon overcollateralization level, interest coverage, or priority in cash flows:** Would be effective in distinguishing credit risk within asset class and in fostering prudent risk management. Would not necessarily be transparent, unbiased, or replicable because of bank latitude in determining relative importance of collateral coverage, interest coverage, and cash flow priority. Would not be simple, with no undue burden.

- **For senior tranches- assign risk weight based on underlying exposure and subordination amount:** Would do a reasonably effective job in distinguishing credit risk within asset class and fostering prudent risk management. Would not

be very transparent, unbiased or replicable. Depending on how conscientious the reporting entity is, this approach could be timely and accurate in reporting changes in creditworthiness. Would not necessarily be simple with no undue risk. It would also not minimize opportunities for regulatory arbitrage since other Basel committee countries will continue to use NRSROs.

- **Concentration ratio:** Would be reasonably effective in distinguishing credit risk within asset class and fostering prudent risk management. Would be reasonably transparent and replicable. Would be somewhat effective in the timely and accurate measurement of changes in creditworthiness and would be somewhat simple with moderate burden. It would also not minimize opportunities for regulatory arbitrage since other Basel committee countries will continue to use NRSROs.

- **Supervisory formula approach:** Would be reasonably effective in distinguishing credit risk within asset class and fostering prudent risk management. Would be moderately transparent and replicable. Would be reasonably effective in measuring changes in creditworthiness on a timely and accurate basis. Would not be simple and would require significant burden to implements, especially for small to mid-size banks. It would also not minimize opportunities for regulatory arbitrage since other Basel committee countries will continue to use NRSROs.

Question 8: What are the advantages and disadvantages of the alternative approaches? What are the implications or potential for unintended consequences? Are there other approaches that would more appropriately capture the risk-mitigating effects of collateral and/or guarantees without adding undue cost or burden? Commenters are asked to provide quantitative as well as qualitative supporting data and/or analysis for proposed alternative methods.

MBA's Response: MBA notes that asset-backed securities are generally credit-enhanced in one or a combination of the following:

- A securitization could have a senior/ subordinate lien structure whereby the subordinate holder suffers first losses.
- A securitization could have over-collateralization where the amount of loans transferred exceeds the amount of beneficial interests issued with the transferor retaining the first risk of loss.
- A securitization could be credit-enhanced by a third party surety.

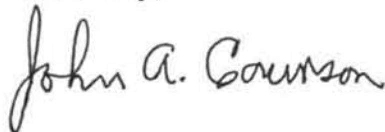
MBA acknowledges that certain of the alternatives proposed for securitizations exposures factor in the senior/subordinate structure and the over-collateralization structure. However, there does not appear to be anything in the securitization alternatives or the guarantees and collateral alternatives that appear to address surety-enhanced structures. MBA recommends that this be addressed in the proposed rules.

Question 9: What burden might arise from the implementation of alternative methods of measuring creditworthiness at banking organizations of varying size and complexity? Commenters are asked to provide quantitative as well as qualitative support for their burden estimates. In addition to the cost burden, the agencies seek comment on the feasibility of implementing various alternatives, particularly for community and mid-sized banks.

MBA's Response: MBA expects that removing references to NRSRO ratings in the risk-based capital rules will create a significant burden for all banks. This burden will be greatest for small, community banks that lack the infrastructure to do the analysis required by many of the alternatives discussed above. MBA believes that the agencies need to develop a structure along the lines of the Basel "Advanced Approach" for large banks and the "Standardized Approach" for smaller banks. Conversely, banks could be afforded a "cafeteria approach" to use the appropriate method in their particular circumstances.

MBA greatly appreciates the opportunity to share its comments with the regulators on the ANPR. Any questions about MBA's comments should be directed to Jim Gross, Associate Vice President and Staff Representative to MBA's Financial Management Committee, at (202) 557-2860 or jgross@mortgagebankers.org.

Yours truly,



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