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Regulation Comments
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Re: Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance: Regulatory Capital; Impact of Modifications to Generally Accepted Accounting Principles; Consolidation of Asset-Backed Commercial Paper Programs; and Other Related Issues

OCC (Docket number OCC-2009-0012)
Board (Docket No. R-1368)
FDIC (RIN 3064-AD48)
OTS (OTS-2009-0015)

Ladies and Gentlemen:

Capital One appreciates the opportunity provided by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision (collectively, the "agencies") to comment on the above-mentioned proposal. We have outlined our response to the proposal by providing an executive summary of our significant concerns, followed by our detailed analysis and response to the specific questions (Appendix 1) you have posed in the proposal.

Executive Summary

We believe this proposal will have significant ramifications on the performance and capital strength of individual banking institutions and thus broad implications for the overall cost and availability of credit. This can greatly impact the resilience of the broader economy. The significant implications of the proposal include:

- With the implementation of Statement of Financial Accounting Standards No. 166, *Accounting for Transfers of Financial Assets - an Amendment of FASB Statement No. 140* ("FAS 166") and Statement of Financial Accounting Standards No. 167, *Amendments to FASB Interpretation No. 46(R)* ("FAS 167") (together, "FAS 166 and 167"), banks will potentially have to hold hundreds of billions of dollars of additional risk-based capital and loan loss allowances against securitized assets, exacerbating the pro-cyclical tendencies within our financial system that impede this economic recovery, as well as causing banks to hold an allowance for loan loss when there is no contractual risk of loss.

- This is a very difficult time for banks to efficiently raise additional capital and if they cannot do so they will be required to reduce the size of their balance sheets. Therefore, such actions will have a negative impact on the economy by increasing the cost or reducing the supply of credit at a time when capital markets are needed most. This runs counter to the government's attempts to increase available liquidity and capital to the industry.

- Banks will be required to build additional loan loss reserves during a period when they are already at historically high levels and institutions' earnings are similarly depressed. This will cause the creation of additional deferred tax assets ("DTAs") on bank balance sheets, which will not be allowable for regulatory capital purposes. Therefore, not only are these DTAs being built at the worst point in the economic cycle, they are also being built in part for losses that banks are not contractually required to absorb.

- From a global banking perspective, this proposal will put U.S. banks at a competitive disadvantage. Foreign banks will now be able to produce a greater return on capital than U.S. banks for the same margin product. In this global landscape, U.S. banks will therefore be operating at a competitive disadvantage, impacting economic returns and ultimately cost of capital. Over time this will leave U.S. banks in a relatively weakened position versus their foreign counterparts.

- Finally, we recommend that the agencies consider a six-month grandfathering period, whereby all off-balance sheet transactions outstanding on December 31, 2009 continue to be considered off-balance sheet for regulatory capital purposes until June 30, 2010. Such grandfathering should allow for adjustment to capital for any accounting-driven consolidation of risk-weighted assets and adjustment to capital to compensate for any additional loan loss allowance created after FAS 166 and 167 become effective. This simple measure would provide the agencies sufficient time to develop a more comprehensive set of principles and rules, with full industry participation.[1]

Detailed Response

Capital One Financial Corporation (www.capitalone.com) is a financial holding company whose subsidiaries, which include Capital One, N.A. and Capital One Bank (USA), N.A., had $116.7 billion in deposits and $146.3 billion in managed loans outstanding as of June 30, 2009. Headquartered in McLean, Virginia, Capital One offers a broad spectrum of financial products and services to consumers, small businesses and commercial clients. Capital One, N.A. has approximately 1,000 branch locations primarily

[1] Assuming such rules can be developed within the 6-month grandfathering period, a subsequent transition period may also be necessary to allow full implementation of these new rules without placing an undue burden on banks and causing an associated strain on the economy.

in New York, New Jersey, Texas, Louisiana, Maryland, Virginia, and the District of Columbia. A Fortune 500 company, Capital One trades on the New York Stock Exchange under the symbol "COF" and is included in the S&P 100 Index.

Capital One has securitized several consumer asset types, notably credit card receivables, auto loans, residential mortgages, home equity lines of credit and some manufactured housing loans. We have also sold many residential mortgage loans in the form of "whole loan" sales to independent third-party purchasers and governmental agencies including Fannie Mae and Freddie Mac. As discussed in more detail below, Capital One expects to consolidate many of these transactions onto its balance sheet upon the implementation of FAS 166 and 167.[2]

Historically, the criteria for determining sale treatment of an off-balance sheet transaction under regulatory accounting principles ("RAP") has been linked to the criteria used to determine sale treatment under generally accepted accounting principles ("GAAP"). Should such a linkage continue to be applied in the wake of FAS 166 and 167, a significant amount of the $11.5 trillion[3] of currently outstanding asset-backed securities ("ABS") and mortgage-backed securities ("MBS") will be returned to bank balance sheets. **This will potentially require banks to hold hundreds of billions of dollars of additional risk-based capital and loan loss allowances against those assets, exacerbating credit availability concerns and the pro-cyclical tendencies within our financial system that impede this economic recovery.**

To mitigate this impact, many banks - whose risk profiles in substance will not change from December 2009 to January 2010 - will be forced to either raise additional capital or further reduce loan balances. **Such actions will have a negative impact on the economy by increasing the cost and reducing the supply of credit at a time when access to capital markets and bank balance sheets are needed most.**[4]

In addition to depressing regulatory capital ratios by significantly increasing risk-weighted assets in the denominator of the ratio calculation, consolidation will also impact the numerator of the ratio calculation by requiring recognition of future losses in the form of larger loss allowance. This could result in the FAS 166 and 167 accounting change having an even more severe impact on capital ratios than anticipated. Alternatively, banks may elect to bring assets and securities on-balance sheet at fair value, which absorbs

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[2] Although this letter is focused on "bank holding companies" and "banks" as defined in the Bank Holding Company Act, the Treasury Department's recent whitepaper on financial regulatory reform recommends that all companies that control insured depository institutions, including holding companies of industrial loan companies ("ILCs"), should be subject to regulation as bank holding companies. We request that the agencies consider this recommendation and the possibility that these companies may be subject to increased regulation when drafting final rules on capital adequacy. Of the total $1.3 trillion of global ABS and non-agency MBS issuance during 2008, over 87% was issued by banks, mortgage banks, finance companies, credit card banks, auto and student loan financiers (Source: Asset-Backed Alert, Summary of Worldwide Securitization in 2008, http://www.abalert.com/ranking.php?rid=1751). Under the Treasury Department whitepaper guidance on financial regulatory reform, thrifts, ILCs, credit card banks, trust companies and grandfathered "non-bank bank" holding companies would become bank holding companies and presumably required to hold minimum bank holding company capital levels.

[3] The source of this data is SIFMA as of Q2 2009. This included $6,623.3 billion of agency MBS or collateralized mortgage obligations (CMOs), $2,325.3 billion of non-agency MBS, $354.7 billion backed by home equity loans, $307.5 billion backed by credit card loans, $241.5 billion backed by student loans, $132.0 billion backed by automobile loans, $18.9 billion backed by manufactured housing loans and $1,479.0 billion backed by miscellaneous other receivables. The $1,479.0 billion miscellaneous category includes collateralized debt obligations (CDOs) and numerous smaller asset classes. The assets underlying the CDOs include other asset-backed securities (CDOs of ABS), some or all of which might be viewed as double counting with other ABS outstandings.

[4] See Appendix 4.

future loss expectations into the fair value calculation of the asset rather than specifically creating an individual reserve for the losses.

We would infer, based on recent policymakers' statements and the rhetoric within the NPR, that the primary justification for keeping RAP and GAAP aligned – and consequently the primary driver of the aforementioned impacts – is the risk of an issuing bank taking non-contractual support actions. The agencies state that "in the case of some structures that banking organizations were not required to consolidate prior to the 2009 GAAP modifications, the recent turmoil in the capital markets has demonstrated the extent to which the credit exposure of the sponsoring banking organization to such structures (and their related assets) has in fact been greater than the agencies estimated, and more associated with non-contractual considerations than the agencies had expected."

Based on recent market experience, we would agree there is no guarantee that a bank will enforce its contractual rights to have losses pass through to investors. However, we should not ignore the existence of these contractual rights. Nor should we ignore that, in the vast majority of cases across all consumer segments, banks have not sought to provide non-contractual support and there have been many occasions where investors have suffered losses. Specifically, in the case of Capital One, we have not supported any trusts despite having a significant number of outstanding securitizations downgraded in our credit card ABS, auto loan and MBS programs. **We believe a securitization transaction should be viewed as a sale of receivables whereby, if the transaction documents are allowed to run their course, losses will by default be passed through to investors. Only if an issuing bank elects to waive its contractual rights will it absorb losses itself.** The existence of these contractual rights, by their very nature, reduces a bank's risk versus a bank that does not have such rights and is obligated to absorb all losses at all times.

Consequently, while the accounting for these transactions may have changed to an "all or nothing" approach, the associated documents and the contractual obligations of an issuing bank have not changed and require a more nuanced approach in determining regulatory capital. We would urge the agencies to spend more time evaluating the structural features of various ABS and MBS and arrive at a capital framework that more accurately reflects the true economic substance of these transactions.

Accordingly, we make four recommendations in finalizing a new regulatory capital framework:

1) Delay issuance of a final rule until the agencies have fully determined the value of a bank's contractual right to have losses pass through to investors. However, the agencies should issue immediate guidance, such as grandfathering, to prevent banks from having to take actions such as raising capital or reducing balance sheet assets in the interim, which could result in an increased cost and reduced supply of consumer credit.
2) Provide capital relief for loan loss allowances that are created under new accounting principles, as issuing banks are not contractually obligated to absorb losses.
3) Provide capital relief for DTAs that may be created as a consequence of building redundant loan loss allowances.
4) Create a flexible classification of risk weights that reflects the fact that issuing banks are not contractually obligated to absorb losses.

1) Delay issuance of a final rule until the agencies have fully determined the value of a bank's contractual right to pass losses through to investors and issue immediate guidance to minimize the risk of banks unnecessarily raising capital or reducing loan balances.

Given the Financial Accounting Standards Board's ("FASB") new "all or nothing" approach to consolidation of securitized assets and related securities, maintaining the link between RAP and GAAP accounting may require banks to hold hundreds of billions of dollars of additional capital against newly consolidated assets. Therefore, it is likely that many banks may have to either raise additional capital or further reduce loan balances.

Alternatively, some banks might feel compelled to elect fair value accounting under FASB Statement of Financial Accounting Standards No. 159, *Fair Value Option for Financial Assets and Financial Liabilities* ("FAS 159") as the basis for measuring assets and securities that are returned to their balance sheets. This basis of valuation discounts expected losses and accounts for expected revenues.[5] While a fair value election is permitted under FAS 166 and 167, such an approach would present inconsistencies with the current treatment of similar on-balance sheet assets and securities and would require a large-scale overhaul of the current regulatory capital framework.

In a speech at the American Institute of Certified Public Accountants' ("AICPA") National Conference on Banks and Savings Institutions on September 14, 2009, Federal Reserve Governor Elizabeth Duke noted that the inconsistent use of the fair value approach within and across institutions can make prudential supervision more difficult. In discussing the recent "Stress Test", she stated that: "Accounting treatment issues are critically important in the regulatory evaluation of financial institutions' safety and soundness."

FAS 166 and 167 currently offer two primary valuation methodologies which could result in inconsistent application of these standards across the industry. If the current linkage between RAP and GAAP is maintained, there is potential for different capital assessments to be made against identical economic risks, based purely on the elected valuation methodology. For instance, some banks may adopt fair value accounting, recognizing FASB's apparent focus on moving to a fuller fair value environment, while others might choose to maintain status quo (carry value) given the vast operational complexities involved in implementing such sweeping new rules.

We would further note that FAS 166 and 167 mark only the beginning in changes to off-balance sheet securitization accounting. FASB has already announced an overhaul of fair value accounting, due for release in Q4 2009, and efforts are also underway with the International Accounting Standards Board ("IASB") both in the areas of consolidation and fair value. As FASB indicated in their posted summary to FAS 167: "Although this Statement was not developed as part of a joint project with the IASB, the FASB and IASB continue to work together to issue guidance that yields similar consolidation and disclosure results for special-purpose entities....However, the timeline and anticipated effective date of the IASB project is different from the effective date of this Statement...Ultimately, the two Boards will seek to issue a converged standard that addresses consolidation of all entities."

There will inevitably be additional changes to the basis upon which securitized assets are valued and reported over the next few years. Accordingly, we believe it is of paramount importance that any revisions made today to the regulatory capital framework take into account the likelihood of future accounting

[5] For the purposes of this letter we have assumed that most originating banks will elect carry value in preference to fair value accounting and will therefore book loan loss allowance.

changes and provide a capital adequacy framework that will not be subject to repeated modification. We support regulatory capital rules continuing to be based upon risk retention, with any proposed changes to capital based upon an assessment of the economic risk that a particular bank bears. Failure to do so will prevent relief from being given in cases where risk has truly been transferred, potentially causing banks to restrict lending as they comply with regulatory requirements to hold capital against risk that is effectively redundant.

If previous GAAP treatment of securitization has been determined to have understated retained risk, then moves to adopt the new GAAP, which is not even risk-based, are unlikely to produce a fair risk proxy for a regulatory capital framework.

We recommend that the agencies consider a six-month grandfathering period, whereby all off-balance sheet transactions outstanding at December 31, 2009 continue to be considered off-balance sheet for regulatory capital purposes until June 30, 2010. Such grandfathering should allow for adjustment to capital for any accounting-driven consolidation of risk-weighted assets <u>and</u> adjustment to capital to compensate for any additional loan loss allowance created after FAS 166 and 167 become effective. This simple measure would provide the agencies sufficient time to develop a more comprehensive set of principles and rules with full industry participation.

<u>2) Provide capital relief for loan loss allowances that are created under accounting principles, since issuing banks are not contractually obligated to absorb losses.</u>

Banks that choose to value their FAS 167-driven consolidated assets and securities at carry value must ensure that they comply with Statements of Financial Accounting Standards No. 5, *Accounting for Contingencies* ("FAS 5") and No. 114, *Accounting by Creditors for Impairment of a Loan* ("FAS 114"), both of which were written without regard to the relationship between securitized assets and related asset-backed securities.

Application of FAS 5 or FAS 114, as applicable, to securitized assets results in a loan loss reserve being created against a risk of loss for which the issuing bank bears no contractual obligation.[6] We believe the agencies should look through GAAP treatment of the loan loss provision. Recognizing that the default position of the transaction documents is to have losses pass on to the investor, we believe that any related loan loss provision should be treated as capital. We believe that granting such capital relief would also be consistent with current treatment under GAAP for synthetic securitizations which are not subject to loan loss allowance.

We recommend that the agencies increase the Tier 2 "allowable allowance" for all loan loss allowance created as a consequence of consolidating assets post-FAS 166 and 167 implementation.

Furthermore, as such allowances, upon their creation, reduce retained earnings, we recommend the agencies also give consideration to adding back some portion of allowance to Tier 1 capital to cover redundant loss reserves beyond contractual obligations. On the basis that these losses are not contractually realizable, we would envision such a rule working similarly to the existing adjustments to other comprehensive income ("OCI") under Statement of Financial Accounting Standards No. 115, Accounting for Certain Investments in Debt and Equity Securities ("FAS 115").

[6] See Appendix 3 for example of capital required in relation to contractual risk versus capital and loan loss allowances held under FAS 166 and 167.

We also note that increasing Tier 2 allowable allowance for loan losses and providing some amount of Tier 1 add-back related to changes arising as a result of FAS 166 and 167 implementation would be consistent with various policymakers' concerns regarding pro-cyclicality and the quasi-capital nature of loan loss allowance. We are in full agreement with policymakers that the pro-cyclical nature of loan loss allowance must be addressed. Comptroller Dugan suggested in both an address to the Institute of International Bankers and at the August 26, 2009 FDIC board meeting that the amount of allowance for loan losses that can be given Tier 2 credit should be revisited. We agree with this proposition and believe our recommendation above would serve as a useful first step in reaching the appropriate longer-term treatment of loan loss allowances from a capital perspective.

3) Provide capital relief for DTAs which may be created as a consequence of building redundant loan loss allowances.

Most financial institutions carry DTAs on their balance sheets as a consequence of timing differences between taxable losses and book losses recognized under GAAP. Specifically, in the case of loan loss allowances, banks recognize an expense for the full amount of any allowance at the time it is booked. However, banks only receive an income tax deduction for losses at the time they are actually written off. The deferral of this tax deduction is recognized under GAAP as a DTA.

Existing regulatory capital rules restrict the amount of DTAs that may be viewed as Tier 1 capital. DTAs that are dependent upon future taxable income are limited based upon expected earnings over the forthcoming year and 10% of the bank's Tier 1 capital. We believe these restrictions are too limiting as the recognition of DTAs under GAAP is already subject to prudent auditor evaluation.

Upon the implementation of FAS 166 and 167, banks will be required to build additional loan loss reserves during a period where these reserves are already at historically high levels and institutions' earnings are similarly depressed. This will cause the creation of additional DTAs on bank balance sheets, which will not be allowable for regulatory capital purposes. As stated above, in the case of loan loss allowances relating to securitized assets, the allowance is redundant since there is no contractual risk of loss. Therefore, not only are these DTAs being built at the worst point in the economic cycle, they are also being built in part for losses that banks are not contractually required to absorb.

We therefore recommend a blanket inclusion in the calculation of regulatory capital of DTA balances that are specifically created as a consequence of the additional loan loss reserves resulting from FAS 166 and 167, without regard to the aforementioned limitations.

4) The final rule should create a flexible classification of risk weights that reflects the fact that issuing banks are not contractually obligated to absorb losses.

As stated previously, we understand the agencies' concerns regarding the provision of non-contractual support to various ABS and MBS transactions and agree that such support is not within the spirit of full risk transfer contemplated at a transaction's inception. However, the fact that contractual terms of most securitizations pass losses through to investors rather than obligate issuing banks to absorb such losses indicates that the level of risk transfer is greater than zero. This has been demonstrated by the many banks, including Capital One, that have elected to not support their transactions, with such a decision often resulting in investor losses.

We recommend that future regulatory capital guidance differentiates appropriately across the various structures in the marketplace, and appropriately risk weight assets to take account of the aforementioned contractual rights, paying specific regard to:

- Simple structures that transfer risk in a straightforward manner, which should be differentiated from more opaque structures and re-securitizations that carry an increased level of risk.
- Structures that include "mandatory support" obligations, which should be differentiated from "optional support" actions, with a clear distinction between liquidity and true credit support.

Specifically, we recommend that assets be risk-weighted according to the risk of implicit support and propose the following risk-weightings based upon our "directional" view of the likelihood of recourse actions[7]:

Transaction Type	Risk-Weighting
Amortizing Trust	
Prime 1st Lien[8]	10%
Other amortizing	20%
Revolving Trust	
Linked/Tiered	50%
De-linked	80%

The above risk-weightings would be supplemental to risk-weightings that would be assigned to any residual or retained balances held by the issuing bank.

In order to ensure that the sum of any amounts of capital held in relation to amounts sold to third parties and residual and retained balances does not exceed the amount of capital that would be held against non-securitized loans, we also recommend that low-level recourse rules be applied against the total amount of capital that an issuing bank may be required to hold, capping total capital held against such transactions at 8% of the securitized assets.

Conclusion

The forthcoming implementation of FAS 166 and 167 under GAAP changes the criteria for consolidating securitization transactions to be control-based, whereas previously under FAS 140 and FIN 46(R) they had been primarily risk-based.

While we do appreciate that recent recourse actions and some of the control exercised by issuing banks does indicate that prior GAAP treatment failed to assess the full risk that banks bore, the NPR overcorrects this failure and does not account for the fact that many banks have allowed and will continue to allow their contractual rights under the documents to run their course. While there have been some

[7] Proposed risk-weightings are based on a directional view of likelihood of non-contractual support. As noted earlier, we recommend that the agencies delay implementation of any final rule pending the full evaluation of a bank's contractual right to have losses pass to through to investors and the likelihood of such rights being enforced.

[8] Prime first-lien mortgage securitizations are risk-weighted at half of other amortizing securitizations (20%-see above), consistent with current regulatory risk-weightings for non-securitized assets, where prime first-lien mortgages are risk-weighted at 50% and other asset classes are risk-weighted at 100%.

instances of trusts receiving bank support, there have been many more instances where this has not been the case and contractual terms on investor losses were not compromised.

We encourage the agencies to reconsider the existing link between RAP and GAAP and undertake a full review of the risk associated with the various ABS and MBS structures in the marketplace. Such a review will require an extension of the NPR process beyond the date of FAS 166 and 167 implementation and therefore necessitates immediate guidance to banks, in the form of grandfathering, to prevent them from taking actions to protect their balance sheets today which could be detrimental to the longer-term health of the economy. We further encourage the agencies to build a set of principles and rules that are driven by a true "ground-up" assessment of the economic risk behind transactions.

Should this not prove to be the case, we would draw the agencies' attention to our response to Question 4 regarding transition relief and highlight that a one year phase-in compromises the terms under which banks previously issued into the markets, whereby they anticipated capital relief through the full term of the transaction. **In order to prevent banks from raising expensive capital or reducing their lending, we would recommend that any transition relief provide a phase-in period closer to the remaining term of existing market transactions (3 years, for example) and also that such relief extend to both risk-weighted assets and to any loan loss allowance and DTAs created following implementation of FAS 166 and 167.**

Capital One appreciates the opportunity to comment on the NPR. We are encouraged by the agencies' requests to specifically address various questions on the proposed new regulatory capital framework, many of which pertain to the points raised above. We hope that the responses to these questions (see Appendix 1) will prompt a final rule that more appropriately reflects the economic substance of the various transactions within the industry and a more accurate link between the actual risk of loss arising from such transactions and the required regulatory capital levels that banks engaging in such transactions must satisfy.

If you have any questions about this matter or our comments, please contact me at 703-720-1000.

Sincerely,

Gary L. Perlin
Chief Financial Officer

Appendix 1

Q1: Which types of VIEs will banking organizations have to consolidate onto their balance sheets due to the 2009 GAAP modifications, which types are not expected to be subject to consolidation, and why? Which types are likely to be restructured to avoid consolidation?

Capital One has securitized several consumer asset types, notably credit card receivables, auto loans, residential mortgages, home equity lines of credit and some manufactured housing loans. We have also sold many residential mortgage loans in the form of "whole loan" sales to independent third-party purchasers and to governmental agencies including Fannie Mae and Freddie Mac.

We believe all credit card and auto loan securitizations will be reported on Capital One's balance sheet after FAS 166 and 167 become effective.[9] For these transactions, Capital One services the portfolios and would thus be determined to have "power to direct matters that most significantly affect the economic performance of the VIE" under FAS 167. Capital One also retains some form of economic interest, whereby we may have an obligation to absorb some of the losses of the variable interest entity ("VIE") in the form of retained subordinated interests, over-collateralization, spread accounts and excess spread. We believe that most of the risk of these transactions has been transferred to investors in a straightforward fashion. However, the "all or nothing" application of FAS 166 and 167 will likely result in these transactions being consolidated.

The case for consolidation of mortgage assets is less clear and in fact appears to be a major source of industry debate. We believe that many banks are still in a state of deliberation as to whether mortgage-related assets will be consolidated, despite the fact that the effective date for most institutions is less than three months away. Mortgage transactions have a vast array of participants, including originators, servicers, investors, insurers, and residual interest holders. As such, determining which party has the most power and economic exposure is more complex than for more standardized and transparent card or auto transactions.

On the basis that almost all credit card and auto loan issuers are responsible for the origination and continued servicing of their portfolios, the only viable means by which they may avoid consolidation would be to sell their residual or retained interests. We believe this to be extremely unlikely, as these interests are typically of a first-loss nature making their disposal uneconomical even if there were an established market to facilitate such a sale. Additionally, since the trusts were appropriately structured as qualified special purpose entities under FAS 140, the ability to modify the structures to avoid consolidation is limited in the transaction documents. Companies would thus have no option but to implement potentially unsound business practices, such as selling servicing, to avoid consolidation.

For mortgage securitizations, restructuring options are potentially more viable. Many banks do not retain first-loss positions and could potentially sell more senior retained interests with less economic impact, thereby avoiding consolidation. We would highlight the systemic risk that may arise from an accounting standard that encourages mortgage-originating banks to fully divest themselves of any economic interest in a VIE in order to ensure that they secure off-balance sheet treatment. Such an incentive runs contrary to efforts across the G20 nations, in proposed European Union legislation and within the Treasury

[9] Capital One's auto transactions are already reported on-balance sheet. The application of FAS 166 and 167 will require this treatment to continue due to our performance of the servicing function combined with our retention of certain retained and residual interests.

whitepaper on financial regulatory reform, whereby "skin in the game" is encouraged across all lending sectors.

As an alternative to an accounting and rulemaking process that provides banks with an incentive to divest themselves of all risk, we believe that it is possible for banks to transfer some elements of risk while at the same time maintaining an economic interest in a transaction. Such an alignment of interests between investors and issuing banks should not necessarily cause a full loss of risk-based capital benefits, as is currently contemplated in the proposed NPR.

<u>Q2: Are there features and characteristics of securitization transactions or other transactions with VIEs, other SPEs, or other entities that are more or less likely to elicit banking organizations' provision of non-contractual (implicit) support under stressed or other circumstances due to reputational risk, business model, or other reasons?</u>

It is our understanding that non-contractual support has occurred to varying degrees across the full spectrum of ABS and MBS transactions, including credit card ABS, auto loan ABS, MBS, SIVs and ABCP. **However, Capital One has not supported any of its transactions, despite having some outstanding securitizations downgraded in our credit card ABS, auto loan ABS and MBS programs.**

As an issuer of primarily credit card ABS, auto loan ABS and MBS, we limit our comments to these specific structures.

- There may be a perception that there is additional incentive for a bank to support their revolving master trusts, as there is an ongoing obligation to refinance maturing securities. However, we do not believe this presents any additional refinancing risk versus the need by an originator of amortizing assets to replace maturing loans with new originations and secure any associated new financing.

- We have seen evidence that the socialist elements of de-linked trusts make it more likely that an issuing bank will lend support to its transactions. De-linked trusts effectively apply the same credit enhancement structure across the whole trust, with every issuance being implicitly linked to both prior and future issuances. (See Appendix 2 for a brief description of the mechanics of de-linked trusts.) While this structure has been extremely efficient for routine large issuance programs during stable credit environments, it is impossible to raise credit enhancement levels for future issuances without increasing the enhancement levels for existing issuance. Similarly, any yield enhancement mechanisms that may be employed, such as receivables discounting, also need to be applied on a trust-wide basis.

  Therefore, if a bank that utilizes a de-linked structure wants to issue new securities at higher enhancement levels, it will also need to increase enhancement to retrospective deals unless certain structural changes can be made. While we believe that some banks with linked structures have also supported their trusts, we encourage the agencies to consider whether such actions would have been taken had banks with de-linked structures not already set investor and rating agency expectations by doing so.

However, there are some significant mitigating factors that we believe the agencies need to consider in their evaluation of implicit recourse.

- Many banks have not supported their trusts, despite having suffered downgrades and at the risk of investor dissatisfaction. A rule that penalizes those banks that have already demonstrated a commitment to abide by existing implicit recourse rules is unfair. Furthermore, in the case of implicit recourse, we assume that banks that have supported their trusts are already holding additional capital against those transactions.

- There are definitive limits as to how much support any bank would likely give to a transaction. Ultimately, an issuing bank's support of its trust will be capped by one of two variables:

i. The efficiency breakeven point of supporting the trust: at some level of credit enhancement it becomes economically redundant for a bank to support its trust. At this level, any incentive to provide implicit recourse may be eliminated.
ii. The maximum possible enhancement levels that a trust would ever likely need: at some level of credit enhancement, the implicit performance is such that the issuing bank would likely exit the business, thereby removing any deemed incentive to protect its investor base. We suggest that an enhancement level equitable to long-term zero excess spread performance would be the appropriate guide, as any long-term performance below this threshold would cause issuing banks to look for an exit strategy.

- While some banks may have provided non-contractual support, these actions have been entirely at their option. From a capital perspective, there is a measurable difference in the associated risk levels between a bank that may simply elect to circumvent its contractual rights and cover additional losses of an asset and a bank that is contractually obligated to absorb such losses.

We acknowledge that the likelihood of a bank providing optional support to a transaction is greater than zero, and therefore some risk-weighting is appropriate for these assets. However, to risk-weight such assets at 100% does not recognize any transfer of risk when it is indisputable that the issuing bank has the right to enforce its agreements and allow losses to pass through to the investor. Historically, there have been many cases where investors have had to suffer losses as a consequence of poor trust performance, demonstrating that the value of this enforcement right is greater than zero.

As Comptroller Dugan stated at the August 26, 2009 FDIC Board Meeting: "There may be circumstances in which, as we look at the risks, some types of transactions may require a different kind of capital treatment than others...If all securitizations are 100 percent maintained on a balance sheet, or if some of the so-called skin in the game proposals are put in place in ways that will not result in the thing leaving the company's balance sheet, and, yet, we think the risks have shifted in some significant way, we may need to calibrate this."

We agree with Comptroller Dugan's assessment and recommend that future regulatory guidance differentiate appropriately across the various structures in the marketplace and appropriately risk weight assets to account for the value of the aforementioned contractual rights.

Specifically we propose the following scaling of risk-weightings[10]:

Transaction Type	Risk-Weighting
Amortizing Trust	
Prime 1st Lien [11]	10%
Other amortizing	20%
Revolving Trust	
Linked/Tiered	50%
De-linked	80%

[10] Proposed risk-weightings are based on a directional view of likelihood of non-contractual support. As noted earlier, we recommend that the agencies delay implementation of any final rule pending the full evaluation of a bank's contractual right to have losses pass to through to investors and the likelihood of such rights being enforced.
[11] Prime first-lien mortgage securitizations are risk-weighted at half of other amortizing securitizations (20%-see above), consistent with current regulatory risk-weightings for non-securitized assets, where prime first-lien mortgages are risk-weighted at 50% and other asset classes are risk-weighted at 100%.

The above risk-weightings, as they apply specifically to the likelihood of a bank exercising its right to enforce contractual terms and allow losses to pass through to investors, would only apply to amounts sold to third-party investors. We propose that banks maintain additional capital for retained or residual exposures on a similar basis to current risk-based capital treatment. See also Recommendation #4 in our cover letter.

To prevent the combined amount of capital being held in relation to amounts sold to third parties and amount retained from exceeding the amount of capital that would be held against non-securitized loans, we further recommend that low-level recourse rules be applied against the total amount of risk-based capital pertaining to a transaction, thereby capping total capital at 8% of the value of the total securitized assets.

Q3: What effect will the 2009 GAAP modifications have on banking organizations' financial positions, lending, and activities? How will the modifications impact lending typically financed by securitization and lending in general? How may the modifications affect the financial markets? What proportion of the impact is related to regulatory capital requirements?

Impact to financial positions of institutions

The consequence of bringing assets back on-balance sheet for GAAP purposes has several effects on regulatory capital ratios:

1) Increases to GAAP-reported assets will increase risk-weighted assets for regulatory capital purposes.
2) Creation of incremental allowance for loan losses under GAAP will cause a direct reduction to retained earnings, reducing Tier 1 capital and Tier 1 capital ratios.[12]
3) Creation of incremental allowance for loan losses under GAAP will also cause a reduction to bank Tier 2 capital levels and total risk-based capital ratios, assuming the limit on allowable loan loss in the Tier 2 capital base has already been satisfied.[12]
4) Creation of additional allowance for loan losses will also increase the size of bank DTAs, reducing bank Tier 1 capital ratios.[12]

While all of the above effects will reduce bank capital ratios, only the first one is a direct consequence of risk-weighted assets being recognized on regulatory balance sheets subsequent to their consolidation under GAAP (the "denominator effect").

An equally important driver of the reduction to capital ratios is the reduction in reported capital (the "numerator effect") as a consequence of loan loss allowance build. Recognizing that this will occur at a time when loan loss allowances are at their highest, we expect the numerator effect to drive a similar or even greater reduction to risk-based capital ratios than the denominator effect. The relative impacts of numerator and denominator effects will depend on asset risk-weightings and loss expectations at the date of measurement.

As alluded to above, the timing of FAS 166 and 167 implementation exacerbates the pro-cyclical effect of regulatory rules. For most financial institutions, implementation will occur in the first quarter of 2010, a time when unemployment is expected to be at peak levels and banks' loan loss reserves are naturally expected to be at their highest. While there is general acceptance that systemic capital levels need to be increased as a consequence of the increased risk that has materialized within the banking system, we believe that any such capital increases should be based upon the risk characteristics that have demonstrated themselves over the last two years.

To require banks, whose risk profiles remain unchanged, to build additional capital using accounting treatment as a proxy for risk will weaken bank capital positions at a time when some institutions are already in a vulnerable position.

[12] For further detail please see our response to Q10: "Request for comments on differences between loan loss reserve provisioning for securitized versus portfolio loans, how to reflect benefits of risk sharing with investors."

Impact to lending

Banks may seek to mitigate this detrimental impact to their capital ratios either by raising additional capital, further reducing loan balances or both. Such actions will likely have a negative impact on the economy by increasing the cost and reducing the supply of credit, impeding recovery of the housing market and potentially halting the broader economic recovery.[13]

In the context of significant numbers of failing or troubled banks as well as other types of financial institutions (for example, the GSEs), the remaining healthier banks will need to fill this economic void and lend more into the economy. This will prove difficult in the context of a shrinking capital base coupled with an inability to grow assets via a capital-efficient funding mechanism.

Put simply, the regulatory adoption of these accounting standards will heighten the pro-cyclical nature of capital requirements and further strain an already fragile banking industry that is being relied upon to help the economy, **running counter to the government's attempts to increase available liquidity and capital to the industry.**

Impact to securitization and financial markets

The impact of FAS 166 and 167's adoption to the securitization market may be severe. For banks, which are already under the agencies' current capital adequacy guidelines, the absence of any regulatory capital efficiency from securitization may push them to a funding strategy focused primarily on lowest cost of funds. This will put increased pressure on their ability to generate deposits, possibly at the expense of smaller state-regulated banks. This bank migration away from securitization may effectively shrink the securitization market to one primarily for ILCs and smaller financial institutions that have no lower-cost funding alternatives.

As regulatory reform initiatives progress, to the extent that large bank issuers are able to generate deposits they will enjoy a competitive cost advantage over smaller issuers, which will place more reliance on "big banks" to provide consumer credit – a significant unintended consequence from a macro-economic perspective.

Additionally, as banks exit the ABS and MBS markets, total liquidity within the capital markets will decline, creating risk that future stress cycles will be over-reliant on deposits. While we would not advocate that long-term capital adequacy policy be governed by market impact considerations, a failure to give sufficient transition relief could prove extremely damaging to the speed of recovery from the current economic environment.

From a longer-term perspective, the combination of not granting banks any capital benefit for transferring risk, and building punitive loan loss allowance reserves that do not correlate to contractual risk, could cause more permanent damage to market liquidity if issuing banks begin to exit the securitization market in favor of lower cost funding. Not only would long-term debt be sacrificed for short-term deposit funding, but an entire investor base could also be lost.

We agree with comments made by Governor Duke in her AICPA address referenced earlier: "If the risk retention requirements, combined with accounting standards governing the treatment of off-balance sheet

[13] See Appendix 4 for example of potential reduction in lending or increased cost of credit for the credit card industry.

entities, make it impossible for firms to reduce the balance sheet through securitization and if, at the same time, leverage ratios limit balance sheet growth, we could be faced with substantially less credit availability. I'm not arguing with the accounting standards or the regulatory direction. I am just saying they must be coordinated to avoid potentially limiting the free flow of credit."

Excluding the $6.6 trillion of agency MBS[14], even the partial shuttering of the remaining $4.9 trillion securitization market would have very significant impacts on systemic liquidity levels, exacerbating financial markets risk in future economic cycles.

[14] See footnote 2.

Q4: As is generally the case with respect to changes in accounting rules, the 2009 GAAP modifications would immediately affect banking organizations' capital requirements. If there are significant costs and burdens, or other relevant considerations, should the agencies consider a phase-in of the capital requirements that would result from the 2009 GAAP modifications? Additionally, if a phase-in of the impact of the GAAP modifications is appropriate, what type of phase-in should be considered? For example, would a phase-in over the course of a four-quarter period, as described below, for transactions entered into on or prior to December 31, 2009, reduce costs or burdens without reducing benefits?

We recommend that all regulatory impacts – both the "numerator effect" and "denominator effect" – be delayed for a period of at least six months while the rulemaking process is extended. The issuance of an NPR with only a 30-day comment period does not allow full and proper consideration of both the holistic impact to the economy or the multiple and varied arguments that need to be considered in evaluating the true extent of risk transfer pertaining to the many structures across the industry. To this end, we propose that the agencies immediately provide short-term guidance aimed at preventing banks from acting before the rulemaking process has been concluded.

We encourage the agencies to consider providing some degree of permanent relief under the final rule to both the risk-weighting of newly consolidated assets and to the loan loss allowance and related DTA provisions created to cover losses for which the issuing bank has no contractual obligation. Such relief may well make any subsequent transition period redundant. However, should this fail to be the case then we would recommend, in addition to the above-mentioned delay:

i. A transition period of at least three years: A four-quarter phase-in provides the equivalent of just a half-year weighted average life of transition relief. The majority of banks have significantly longer remaining terms to maturity for their outstanding securitization transactions, Capital One's being approximately 2.6 years. Therefore, the proposed four-quarter transition period does not alleviate the short-term capital drain that banks will consequently face. A three-year transition would more effectively align the winding-down of capital benefits with the maturity profile of the securitizations. Using an overly short transition period will penalize banks for valid transactions made in reliance of the then-existing risk-based capital framework.

ii. Transition relief include not only relief against an increase in risk-weighted assets, but also against any build in loan loss allowance: recognizing that this allowance is being created to protect against a risk of loss to which the issuing bank is not contractually exposed and that the creation of such an allowance causes a direct deduction to Tier 1 capital, we ask that the agencies provide the same transition relief on allowance and provide a phase-in period of at least three years. This should include both a simple increase to the "allowable allowance" caps under Tier 2 capital limits and an add-back of capital for Tier 1 purposes.

iii. For any transition relief whereby Tier 2 loan loss allowance limits are increased, the agencies permit a corresponding increase to the Tier 1 DTA cap over a similar transition period.[15]

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[15] See Q10: *"Request for comments on differences between loan loss reserve provisioning for securitized versus portfolio loans, how to reflect benefits of risk sharing with investors"* for detailed commentary on DTAs concerning FAS 166 and 167 related loan loss allowance.

Q5: The agencies request comment on all aspects of this proposed rule, including the proposal to remove the exclusion of consolidated ABCP program assets from risk-weighted assets under the risk-based capital rules, the proposed reservation of authority provisions, and the regulatory capital treatment that would result from the 2009 GAAP modifications absent changes to the agencies' regulatory capital requirements.

Capital One does not issue out of ABCP conduits. However, some of our credit card transactions are structured as private transactions and placed directly within ABCP conduits, with the conduit being the investor in the transaction. It is our understanding that the removal of the exemption for ABCP conduits will require conduit sponsors to hold more capital against the assets in their conduits. Consequently, the cost of such capital may be charged through to issuing banks like Capital One, effectively increasing our cost of funding for various consumer products.

<u>Q6: Does this proposal raise competitive equity concerns with respect to accounting and regulatory capital treatments in other jurisdictions or with respect to international accounting standards?</u>

The NPR would result in a number of competitive equity concerns given that international standards would not require international financial institutions to hold capital against securitized assets to the extent required by the for U.S. banks.

The majority of U.S. consumer ABS issuance is either issued by U.S. banks or by non-bank non-regulated entities. As such, the direct impact from a lack of competitive equity is somewhat muted, as it will not impact the competitive landscape in the United States.

However, from a global banking perspective, foreign banks will now be able to produce a greater return on capital than a U.S. bank for the same margin product. In this global landscape, U.S. banks will therefore be operating at a competitive disadvantage, impacting economic returns and ultimately cost of capital. Over time this will leave U.S. banks in a relatively weakened position versus their foreign counterparts.

Additional secondary impacts where U.S. banks may be disadvantaged include:

i. Foreign loan origination: In the case of a U.S. bank's international portfolio (for this example, European), although capital at the European entity level would not be disadvantaged relative to other European banks due to its subjection to European capital rules at its local domicile, its U.S. holding company would be obligated to hold additional capital under the NPR, thus increasing the "top of the house" cost of funds relative to European issuers and causing competitive disadvantage.
ii. The removal of the FIN 46(R) exemption for U.S. ABCP conduits will consequently increase their capital requirements, causing an increased cost to be borne by issuing banks. This same cost will not be borne by non-U.S. ABCP conduits. Consequently, we would expect to re-allocate our business toward European conduits to the extent they provide a more competitive cost of funding.

We recommend that U.S. and international capital standards ultimately converge. Currently, U.S. regulatory capital rules do not fall in line with Basel II which, given the current financial crisis, has likely proven beneficial. The agencies' decision to not yet fully align with Basel II likely provided U.S. banks with a capital cushion beyond what they would otherwise have had. As FDIC Chairman Sheila Bair stated during a September 29, 2009 Bloomberg interview, "The criticism that we haven't been moving fast enough in implementing Basel II -- I wear that as a badge of honor…[otherwise] our large banks would have had a lot less capital going into this crisis, which would have been very problematic."

However, in a world where there is increased focus on harmonization of international practices - both accounting and regulatory - we respectfully urge the agencies to not take steps that would result in U.S. financial institutions facing a striking competitive disadvantage versus international peers. We would also highlight that these differing regulatory landscapes could create arbitrage incentives, which in turn may present opportunities for abuse – a potential unintended secondary impact of any lack of jurisdictional consistency.

<u>Q7: Among the structures that likely will be consolidated under the 2009 GAAP modifications, for which types, if any, should the agencies consider assessing a different risk-based capital requirement than the capital treatment that will result from the implementation of the modifications? How are commenters' views influenced by proposals for reforming the securitization markets that require securitizers to retain a percentage of the credit risk on any asset that is transferred, sold or conveyed through a securitization?</u>

The agencies state that "in the case of some structures that banking organizations were not required to consolidate prior to the 2009 GAAP modifications, the recent turmoil in the capital markets has demonstrated the extent to which the credit exposure of the sponsoring banking organization to such structures (and their related assets) has in fact been greater than the agencies estimated, and more associated with non-contractual considerations than the agencies had expected."

We recognize that risk cannot be quantified with precision but, as a general rule, is most effectively assessed by measuring the probability of potential losses over a suitable time horizon. We also appreciate that, for any asset or other exposure, this probability function will incorporate a wide array of variables with different relative weights and that, for some securitization transactions, the weight previously assigned to "non-contractual considerations" may have not been sufficient.

We are concerned, however, that the NPR has the effect of assigning no relative weight at all to legally-binding contracts and securities that transfer the risk of loss on securitized assets from a bank to another party. Instead, the sole proxy for the loss-probability assessment would become a unique construct for control that the FASB created for the entirely different purpose of presenting financial statements. The result is an approach to calculating regulatory capital that is no longer directly connected to a bank's credit exposure or other risks and that treats legal rights and obligations as having no bearing on a bank's capital base or its risk profile. This, in our view, is not consistent with the principle or the purpose behind minimum regulatory capital ratios and could set an undesirable precedent.

If the agencies are inclined to elevate non-contractual considerations in the loss-probability assessment for securitized assets, we believe that legal rights and obligations still must be given due weight and that the agencies should not issue regulatory capital standards with a presumption that banks will disregard those rights and obligations. Securitization transactions should continue to be viewed as effecting a transfer of the risk of loss on the underlying assets with, at most, a discount factor that is based on the probability of the bank taking non-contractual actions that could result in risk being shifted back to the bank. Such an approach would recognize that the bank's risk profile has been affected at least to some degree.

In relation to the determination of such aforementioned discount factors, we believe that amortizing discrete trusts, though there have been some isolated incidents of implicit recourse, in general have demonstrated true risk transfer.

Regarding revolving trusts, such as those utilized in credit card ABS, consideration should be given to the fact that contractual exposure to losses is still relevant in the assessment of risk-based capital even in instances where banks have optionally stepped in to support their trusts. Transactions that do not obligate a bank to absorb losses but instead give it the ability to enforce the contractual terms of the transaction which may cause investors to suffer losses are less risky than a structure where the obligation to absorb losses is wholly upon the bank. As a result, we would assert that even for structures where implicit recourse is deemed by the agencies to be a risk, a risk-weighting less than 100% is appropriate.[16]

In determining to what extent a risk-weighting of less than 100% is appropriate for a particular transaction structure, we suggest the agencies consider:

i. Those banks that have demonstrated that they intend to abide by current guidance on implicit recourse.
ii. The degree to which an issuing bank makes "binding" representations that it does not intend to provide non-contractual support to any of its transactions.
iii. Structures that do not obligate a bank to retrospectively provide credit enhancement to existing deals in order to secure future access to the market. Accordingly, it follows that "linked" and "tiered" master trust structures would be subject to lower capital requirements than "de-linked" and "socialist" trust structures.

Current Treasury proposals relating to the need for banks to demonstrate some form of risk retention within their structures run contrary in principle to the FASB requirements that an issuing bank not maintain any significant obligation to absorb losses if the assets are to remain off-balance sheet.

We recognize that for GAAP reporting the concept of risk retention effectively ensures that assets will be consolidated to the balance sheet of any bank issuer that retains the servicing function post-origination. However, this should not preclude the transaction from benefiting from some degree of risk-based capital relief. For the many transactions where banks have allowed investors to share in losses, there has been a clear demonstration that some degree of risk may be retained while transferring a significant amount of risk away from the issuing bank.

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[16] We have included within our answer to Question 2 a proposed scale of asset risk-weightings that takes account of a banks option to absorb losses or pass them through to investors, differentiating between amortizing and revolving trusts and linked versus de-linked structures.

Q8: Servicers of securitized residential mortgages who participate in the Treasury's Making Home Affordable Program (MHAP) receive certain incentive payments in connection with loans modified under the program. If a structure must be consolidated solely due to loan modifications under MHAP, should these assets be included in the leverage and risk-based capital requirements?

We support a final regulatory capital framework that stands alone as a flexible set of rules for a variety of transaction structures without having to create exceptions. The potential impact to servicers executing loan modifications under the Making Home Affordable program demonstrates how the FASB's "all or nothing" approach may create unintended consequences across the financial services spectrum.

Making Home Affordable loan modifications can be considered a form of credit support to a loan. Modifications under Making Home Affordable may demonstrate additional control by the servicer and may also result in changes to its economic interests. Consequently, Making Home Affordable modifications may cause securitized assets to be consolidated.

We believe the potential impact to institutions participating in this program illustrates the need for a more nuanced approach to determining the real risk of a transaction. As such, we reiterate our recommendation that the agencies take into account a transaction's true risk profile when determining appropriate capital requirements.

Q9: Which features and characteristics of transactions that may not be subject to consolidation after the 2009 GAAP modifications become effective should be subject to risk-based capital requirements as if consolidated in order to more appropriately reflect risk?

Capital One does not have a position on this question. However, we feel that it is appropriate to highlight that the one area of major uncertainty in terms of which structures come back on-balance sheet concerns MBS transactions.

Considering that FAS 166 and 167 were largely initiated in the wake of the initial mortgage market meltdown in mid-2007, we believe the fact that these transactions may still escape accounting consolidation and regulatory capital rules belies the initial and true purpose of this accounting and regulatory rulemaking process. We believe this further validates our request that a full assessment of the true economic substance of securitization transactions needs to be made across all structure types.

Q10: Will securitized loans that remain on the balance sheet be subjected to the same ALLL provisioning process, including applicable loss rates, as similar loans that are not securitized? If the answer is no, please explain. If the answer is yes, how would banking organizations reflect the benefits of risk sharing if investors in securitized, on-balance sheet loans absorb realized credit losses? Additionally, are there policy alternatives to address any unique challenges the pending change in accounting standards present with regard to the ALLL provisioning process including, for example, the current constraint on the amount of provisions that are includible in tier 2 capital?

Banks will face two primary valuation options in how they elect to measure assets and securities that are consolidated back to their balance sheets post-FAS 166 and 167.

One of these choices would allow a bank to make a fair value election, where any expected future losses or non-recovery of a receivable balance are netted against other cash in-flows such as principal collections and finance charge and fee collections. For the purpose of this answer, we assume no fair value election is made and that the issuing bank chooses to consolidate returning balances at par or carry value.

Loan Loss Reserve Provisioning

Application of FAS 5[17]

The impact of balance sheet consolidation following implementation of FAS 166 and 167 is not limited to bringing assets back on-balance sheet and having to hold additional capital against those assets. Under FAS 5, financial institutions have to hold loan loss reserves to protect their balance sheets from potential future losses. This allowance is forward-looking and, consequently, once an economy begins to deteriorate any worsening loss assumptions have to be accelerated and recognized immediately in the loan loss reserve balance. This acceleration of losses exacerbates the pro-cyclicality referred to previously in this letter.

Application of GAAP, specifically FAS 5, will result in loan loss reserves having to be built for all securitized assets on exactly the same basis as if the assets were never securitized. **Under GAAP, no distinction will be made for the contractual terms of the securitization or how those terms seek to share risk with investors and issuing banks will be obliged to hold reserves against all losses associated with an asset, irrespective of who owns the risk of loss.**[18]

This disproportionate allowance build is created as a result of some specific accounting nuances pertaining to FAS 5. The purpose of FAS 5 is to ensure that future losses or gains in the value of an asset or liability are recognized on a prudent basis. The standard of probability for recognizing a contingent asset is much higher than the standard for reserving against a contingent liability. For non-securitized assets, this approach may be considered appropriately conservative because, although there may be an expectation that an asset's income stream will offset any potential losses, this offset is by no means guaranteed. It is therefore appropriate to recognize the risk of future loss immediately upon creation of the asset while delaying recognition of the income stream until it is actually realized.

[17] Where relevant, references to Statements of Financial Accounting Standards No. 5, *Accounting for Contingencies* ("FAS 5") include application of FAS No. 114, *Accounting by Creditors for Impairment of a Loan* ("FAS 114").

[18] Appendix 3 shows an illustrative example of how a credit card issuing bank, which has a contractual limitation on the amount of losses that it may have to absorb, might, under the new GAAP, be obligated to hold allowance for loan losses equal to several times the maximum amount of losses that it would ever have to absorb.

However, FAS 5 was written without consideration of the securitization market and therefore without regard to the specific linkages between securitized assets and the related asset-backed securities.

In the case of a securitized asset, there is similarly no guarantee that an asset's income stream will be available to offset any potential loss of that asset. However, should a securitized asset's income stream be insufficient to cover losses, investors in the related asset-backed security are contractually obligated to absorb the loss and the issuing bank has the right to enforce that contractual obligation.

In summary, we would present the following risk matrix for securitized versus non-securitized assets:

	Non-Securitized Asset	Securitized Asset
Asset income stream offsets expected losses	No loss of asset value	No loss of asset value
Losses exceed asset income stream	Loss in value of the asset is borne by the issuing bank	**Issuing bank losses are limited to contractual exposures pertaining to retained/residual interests** **Any additional loss in value of the asset is borne by the investor**

Following FAS 5 for on-balance sheet securitized assets therefore requires a loan loss reserve to be created by the issuing bank against a risk of loss that the bank is not contractually obligated to assume.

Impact to Regulatory Capital

We view loan loss reserves and capital as closely aligned since both are intended to absorb future losses, with reserves covering anticipated losses and capital covering unanticipated losses. In this way, loan loss reserves essentially function as a form of capital and should therefore be assigned greater regulatory capital relief. Loan loss allowances are by their very nature pro-cyclical and – whenever we approach the turn of the credit cycle – create the highest risk-bearing capacity just when capital is most expensive. Giving additional capital credit for allowance building would provide banks with an incentive to take a more conservative approach toward allowance during strong economies and may help reduce some of the pro-cyclical issues that we have seen demonstrated over the recent economic downturn.

Currently, allowance for loan losses is included in Tier 2 capital for regulatory capital purposes, however:

i. The amount is capped at 1.25% of risk-weighted assets; and
ii. Any excess allowance over the 1.25% cap is deducted from risk-weighted assets.

This limitation in the inclusion of loan loss reserves in Tier 2 capital further exacerbates the regulatory capital consequences of the new accounting standards. For an already "capped" institution, the additional reserve build will not be allowed for regulatory capital purposes. In fact, this cap could dissuade an institution from taking a conservative approach to building reserves, since the negative impact to earnings without any accompanying capital relief ultimately reduces an entity's capital levels.

We encourage the agencies to look through GAAP treatment of the loan loss provision and recognize that a provision that protects a bank from a risk of loss that the bank is not obligated to bear should be treated as capital.

We recommend that the Tier 2 cap of 1.25% be increased by the amount of any provision created pertaining to securitized assets that get consolidated as a consequence of FAS 166 and 167.

Furthermore, as such allowances are deducted against retained earnings, thereby reducing Tier 1 capital, **we recommend that the agencies give consideration not only to increasing the Tier 2 allowable allowance cap, but also to adding back the full amount of any redundant loss reserves to Tier 1 capital;** i.e., add back total allowance built as a result of consolidation under FAS 166 and 167 less a probability-weighted adjustment for potential losses due to contractual obligations under the related securitization documents. On the basis that these losses are not contractually realizable, we would envision such a rule working similarly to the existing adjustments to OCI for FAS 115 securities.

Impact from current deferred tax asset capital rules

The detrimental impact on capital from the implementation of FAS 166 and 167 is further exacerbated by its impact on DTAs, which are created as a consequence of the timing differences between taxable income/expenses and book income/expenses recognized under GAAP.[19] The DTAs of many banks will grow as a result of the additional loan loss allowance booked upon implementation of FAS 166 and 167. However, under the current regulatory capital regime, these assets will not be considered capital for many financial institutions, exacerbating the current downturn in the economy.

According to current regulatory capital rules for banking institutions, the amount of DTAs that can be included in Tier 1 capital is limited. Capital ratios can include all DTAs if they can recover the DTAs through loss carry-backs. DTAs that are dependent upon future taxable income are limited to the lesser of:

- The amount of DTAs that the bank expects to realize within one year of the calendar quarter-end date, based on its projected future taxable income for that year, or
- 10% of the amount of the bank's Tier 1 capital

Given the distressed economic environment since 2007, many financial institutions will likely lack sufficient DTA carry-back or look-forward capacity. These institutions will therefore be disallowed from absorbing significant portions of existing DTAs into Tier 1 capital beginning in 2009. The negative DTA impact is a further example of the pro-cyclical nature of current capital rules.

Furthermore, these DTAs are being created in relation to a redundant loan loss allowance (see "Loan Loss Reserve Provisioning" above) relating to losses that an issuing bank does not have a contractual obligation to bear.

Consequently, not only are these DTAs being built at the worst point in the economic cycle, but they are also being built as a consequence of a redundant reserve. We therefore propose a blanket exception to the regulatory capital treatment of DTA balances created as a consequence of the additional loan loss reserves upon implementation of FAS 166 and 167.

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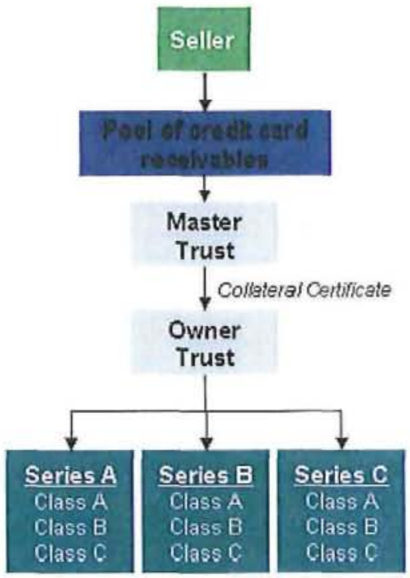
[19] For example, banks that book loan loss allowances under GAAP will recognize an expense for the full amount of any allowance that gets booked. However, most banks cannot deduct the allowance for tax purposes and instead only receive an income tax deduction for losses at the time they are actually written off. Consequently, there is now a timing difference between the date that the expense is charged through earnings and the date that it becomes allowable for tax purposes, essentially deferring the tax relief a company may expense until the date that the loan loss is actually realized. This deferral of tax relief, which will ultimately be realized in the future, is shown on a bank's balance sheet as a DTA.

Appendix 2 – Linked vs. Delinked Revolving Card Trusts

Card structures have evolved continuously since the 1980s. The most significant innovation was the development of the **master trust technology** in the early 1990s by which pro-rata shares in a revolving pool of assets were sold to investors (rather than receivables being segregated to support particular series). The **master *owner* trust technology** built upon the traditional master trust structure by changing the form of issued securities from certificates to notes, thus meeting ERISA eligibility and expanding the investor base. **Most structures now take the form of a master owner trust and are either linked or delinked.**

Linked Structure

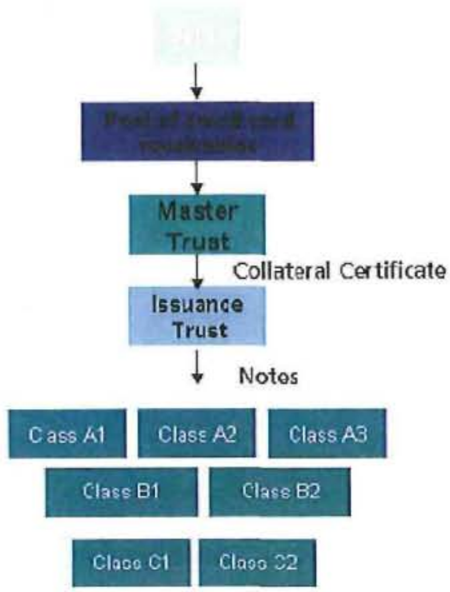
In a linked structure, subordinate classes of securities are issued to support senior classes, maturing concurrently with or after the senior classes. A typical series issuance might, for example, include class A and B certificates that are sold to third-party investors and a class C certificate retained by the issuing bank. The class B and C certificates are subordinate to the class A certificates, and the class C certificate is subordinate to both the class A and B certificates. Each subordinate class provides enhancement to the more senior classes of the same series. However, no subordinate class provides enhancement to the certificates of any other series and no series provides enhancement to any other series.



Each series is entitled to a pro rata share of collections on receivables. A new series can be issued with different enhancement requirements without changing the available enhancement for the prior series.

De-linked Structure

De-linked issuance platforms typically have only one outstanding series. The de-linked series is made up of different classes, each composed of multiple tranches with different issuance and maturity dates. The diagram below depicts issuances of multiple tranches of notes within a de-linked structure.



In this structure, subordinate classes of the single series provide enhancement to the more senior classes. The tranches within a subordinate class, however, are not linked to any particular tranche or group of tranches within the senior classes. Instead, all tranches within a subordinate class provide enhancement to all of the more senior classes.

Appendix 3

This appendix shows an illustrative example of how the total reserve requirement (capital and allowance) for securitized assets increases significantly under the proposed FAS 166 and 167 framework relative to today's FAS 140 methodology, and a comparison of those increases to the changes in contractual risk resulting from the additional credit enhancement provided by financial institutions that decided to support their trust.

Consider a credit card issuing bank with a $1,000 portfolio of credit card receivables with a yield (including finance charges, fees and other income) of 13%.

If the portfolio of receivables is securitized and the related asset-backed securities are sold to investors (other than a $50 retained interest/residual interest[20]), most of the contractual risk of loss would be shifted to those investors. This contractual risk is mirrored by the way that the current FAS 140 methodology would account for the transaction i.e. the risk borne to the issuing bank is limited to the retained/residual interest:

FAS 140 Framework

							Bank Capital Under FAS 140			
Loss Rate	Excess Spread	Securitized Loan Balance	Securities Held by Investors	Issuer-Retained/ Residual	Losses Borne by Investors	Losses Borne by Issuer	Capital Held	P&L Writedown	ALLL	Impact to Reserves
10%	3%	$1000	$950	$50	$0	$0	$50	$0	$0	$50
11%	2%	$1000	$950	$50	$0	$0	$50	$0	$0	$50
12%	1%	$1000	$950	$50	$0	$0	$50	$0	$0	$50
13%	0%	$1000	$950	$50	$0	$0	$50	$0	$0	$50
14%	-1%	$1000	$950	$40	$0	($10)	$40	$10	$0	$50
15%	-2%	$1000	$950	$30	$0	($20)	$30	$20	$0	$50
16%	-3%	$1000	$950	$20	$0	($30)	$20	$30	$0	$50
17%	-4%	$1000	$950	$10	$0	($40)	$10	$40	$0	$50
18%	-5%	$1000	$950	$0	$0	($50)	$0	$50	$0	$50
19%	-6%	$1000	$940	$0	($10)	($50)	$0	$50	$0	$50
20%	-7%	$1000	$930	$0	($20)	($50)	$0	$50	$0	$50

Under FAS 166 and 167 the issuing bank would have to bring these securitizations back on-balance sheet and, despite the lack of contractual risk, would be deemed responsible for absorbing losses on the portfolio. Accordingly, the bank would have to hold both regulatory capital and allowance for loan losses against the portfolio of loans. Assuming the bank continues to maintain the 10% "well-capitalized" level and given the 100% risk-weighting for credit card receivables, the bank would have to hold reserves as follows:

[20] The hypothetical issuing bank in this example is assumed to retain only a 5% non-rated retained/residual interest in the trust. While credit card securitization issuing banks often hold other retained interests in their trusts (A-rated, BBB-rated, BB-rated etc), those retained interests that receive an investment-grade or BB rating are risk-weighted for regulatory capital purposes. For simplicity's sake this example assumes such risk-weightings as applied against all retained/residual interests of the issuing bank equate to the equivalent of one non-rated retained piece against which dollar-for-dollar capital is maintained.

FAS 166 and 167 Framework

Bank Economics Assuming No Securitization				Bank Capital Under FAS 166/167		
Expected Yield	Expected Loss Rate	Loan Balance	Expected Loss*	Capital Held	Loan Loss Allowance	Total Reserves
13%	10%	$1000	$0	$100	$100	$200
13%	11%	$1000	$0	$100	$110	$210
13%	12%	$1000	$0	$100	$120	$220
13%	13%	$1000	$0	$100	$130	$230
13%	14%	$1000	($10)	$100	$140	$240
13%	15%	$1000	($20)	$100	$150	$250
13%	16%	$1000	($30)	$100	$160	$260
13%	17%	$1000	($40)	$100	$170	$270
13%	18%	$1000	($50)	$100	$180	$280
13%	19%	$1000	($60)	$100	$190	$290
13%	20%	$1000	($70)	$100	$200	$300

* 12-month forward-looking loss forecast.

Comparing reserve requirements for issuing banks under FAS 140 and FAS 166 and 167 (as shown below), the total capital and allowance reserves the bank is required to hold under FAS 166 and 167 greatly exceeds the amount of contractual risk of loss borne by the issuing bank (the FAS 140 method).

Depending on the loss rate, the implementation of FAS 166 and 167 will cause the issuing bank to hold reserves of four to six times the contractual risk of loss:

Loss Rate	Contractual Risk/ FAS 140 Total Reserve	FAS 166/167 Total Reserves	Excess Reserves	Multiple of Contractual Risk Total Reserve
10%	$50	$200	$150	4.0x
11%	$50	$210	$160	4.2x
12%	$50	$220	$170	4.4x
13%	$50	$230	$180	4.6x
14%	$50	$240	$190	4.8x
15%	$50	$250	$200	5.0x
16%	$50	$260	$210	5.2x
17%	$50	$270	$220	5.4x
18%	$50	$280	$230	5.6x
19%	$50	$290	$240	5.8x
20%	$50	$300	$250	6.0x

Recent optional support provided by certain credit card banks to their securitization trusts increased credit enhancement levels for the related asset-backed securities, resulting in a loss of off-balance sheet treatment for regulatory capital purposes for these assets. However, the impact of these actions in relation to contractual risk of loss is substantially smaller than the corresponding impact to capital and allowance reserves of FAS 166 and 167.

Issuer	AAA Credit Enhancement Before Support (under FAS 140)	Optional Support	AAA Credit Enhancement After Support (under FAS 140)	Multiple of Credit Enhancement Before Support
American Express	12.0%	5.5%	17.5%	1.5x
Bank of America	14.0%	8.0%	22.0%	1.6x
Capital One†	17.0%	0.0%	17.0%	1.0x
Chase	11.5%	2.5%	14.0%	1.2x
Citi	12.3%	3.8%	16.0%	1.3x
Discover	12.5%	6.5%	19.0%	1.5x
GE Capital	18.8%	8.5%	27.3%	1.5x
			Weighted Average*	1.4x

Source: Standard and Poor's Ratings Direct, "U.S. Credit Card ABS Issuer Report: Additional Credit Support from Originators Results in 154 Upgrades of Ratings Previously on Watch Negative," September 2, 2009.
* Average of the above-listed banks weighted by master trust asset size.
† Capital One opted not to support its securitization trusts.

Viewing credit enhancement as the maximum potential bank contractual risk of loss[21], the multiple above represents a proxy for the increased risk that issuing banks are now exposed to due to their implicit support actions.

As noted above, FAS 166 and 167 will require banks to hold capital and allowance reserves in an amount several times greater than the increase in contractual loss exposure. Even considering the additional loss exposures created by optional trust support, the effect of FAS 166 and 167 on capital and allowance requirements will require banks to hold substantial reserves above and beyond contractual risk of losses.

If the FAS 166 and 167 capital "scale up" factors were applied to trusts' initial credit enhancement levels, the new credit enhancement would be indicative of consumer loss levels beyond that ever seen in the U.S. economy. **Recognizing there has historically been a relationship of less than one-to-one between credit card portfolio losses and unemployment, the capital increase required under the new FAS 166 and 167 standards are the equivalent to holding capital against contractual risk associated with unemployment levels in excess of those during the Great Depression.**

[21] This conservatively assumes all credit enhancement is retained by the issuing bank.

Appendix 4

The regulatory capital impact of FAS 166 and 167 implementation will decrease the availability and increase the cost of consumer credit. From Meredith Whitney's recent opinion article[22]:

> *Since the onset of the credit crisis over two years ago, available credit to small businesses and consumers has contracted by trillions of dollars, and that phenomenon is reflected in dismal consumer spending trends.*
>
> *...I believe that we are only in the early stages of the second half of this credit cycle. I expect another $1.5 trillion of credit-card lines to be removed from the system by the end of 2010. This includes not only the large lenders reducing exposure but also the shuttering of several major subprime credit-card lenders....The next phase will likely be credit-line cuts as lenders race to pre-emptively protect themselves from regulatory changes associated with the Credit Card Accountability, Responsibility and Disclosure Act, passed in May of this year, and the 2008 Unfair and Deceptive Acts and Practices Act.*
>
> *...Regulators should be mindful that regulatory change during the midst of a credit crisis often ends with unintended consequences. Those same consumers that regulators are trying to help are actually being hurt by a vast reduction in available credit.*

To demonstrate the magnitude of the potential squeeze in consumer credit, we have prepared two hypothetical examples based loosely on the credit card industry. The first shows the potential reduction in credit availability and the second illustrates the related increased costs passed on to consumers and small businesses. If off-balance sheet securitization trusts are consolidated for regulatory capital purposes, it is likely that some combination of these two effects will occur, with the overall impact to credit availability and cost falling somewhere between these examples. While the below example specifically references the credit card industry, the embedded concepts could equally be applied against other consumer asset types.

Example 1: Reduction in Credit Availability

(numbers in billions)	RAP	GAAP	Total
Total Card ABS Outstanding[23]	$307.50	$307.50	
Total Off-B/S Card ABS[24]	$50.00	$307.50	
Additional Regulatory Capital (at 10% "well-capitalized" level)	$5.00		$5.00
Additional Loan Loss Allowance (assuming 12-month losses of 10%)		$30.75	$30.75
Total Additional Capital Requirement			$35.75
Reduction in Credit Availability[25]			$357.50

[22] Meredith Whitney, "The Credit Crunch Continues", Wall Street Journal, October 2, 2009.

[23] The source of this data is SIFMA as of Q209.

[24] Issuing banks that structured their securitization trusts as off-balance sheet vehicles but provided optional support currently consolidate their trusts for RAP purposes, but not under GAAP. Following recent support actions we have assumed the majority of credit card ABS is already back on-balance sheet for RAP purposes but has remained off-balance sheet under GAAP.

[25] Represents the shrinkage of credit card portfolios necessary to account for the additional capital requirement, assuming the 10% "well-capitalized" level.

In this example, we assume that all outstanding credit card ABS is held off-balance sheet for GAAP purposes, and only ABS which has been supported with recourse is consolidated for RAP purposes. After implementation of FAS 166 and 167, issuing banks will have to hold additional capital against loans that were previously off-balance sheet for RAP purposes and hold allowance for loan losses for all consolidated loans. We assume for this example that issuing banks will be forced to reduce loan balances by $10 for each dollar of additional capital required, in order to continue meeting the 10% "well-capitalized" standard.

Example 2: Increase in Cost to Consumers

(numbers in billions)	
Approximate Cost of Raising Tier 1 Capital[26]	12.00%
ABS Cost of Funds[27]	- 2.55%
Incremental Cost of Raising Capital	9.45%
Total Additional Capital Requirement	$35.75
Annual Cost of Raising Additional Capital[28]	$3.38
Total Credit Card Receivables Outstanding[29]	$972.73
Potential Increase in APR (all cardholders)	0.35%
Potential Increase in APR (new cardholders only)[30]	3.47%

In this example, we assume that banks will meet the additional capital requirements resulting from implementation of FAS 166 and 167 by raising private capital in the form of common equity. Because the cost of issuing common equity is significantly greater than the cost of accessing the ABS market, banks will experience substantially greater economic costs, which will ultimately fall on consumers. Above, we show a potential increase in cost as applied uniformly across all existing cardholders as well as applied only to new accounts. As shown, the increase in funding costs could have a significant impact on the pricing of new accounts[31], further contributing to a trend toward higher pricing for consumer accounts already created by the economic downturn and other factors such as new restrictions on certain credit card practices forcing consumers to pay additional fees during the beginning of the economic recovery.

[26] Assumed Tier 1 common capital raised at a required annual return of 12%.
[27] Assumes swap rate of 1.8% and spread of 75bp.
[28] Represents the difference between cost of issuing common equity and interest paid on ABS issuance.
[29] Source: "Credit Card Outstandings – Market Share", The Nilson Report, April 2009.
[30] Assumes annual new origination volume equal to 10% of outstanding issuance.
[31] Assumes prohibition of broad-based portfolio repricing abilities as a consequence of the Credit Card Accountability, Responsibility and Disclosure Act, passed in May 2009, and the 2008 Unfair and Deceptive Acts and Practices Act.