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Subject: **Risk-Based Capital Guidelines: Market Risk; Alternatives to Credit Ratings for Debt and Securitization Positions – Docket ID OCC-2010-0003; Docket No. R-[1401]; FDIC RIN 3064-AD70**

Ladies and Gentlemen,

The Mortgage Bankers Association[1] (MBA) welcomes the opportunity to comment on a proposed rule for market risk, risk-based capital ("market risk RBC") guidelines that provide alternatives to credit ratings for debt and securitization positions[2] ("Proposal"). The Proposal is a joint rule-making by the Office of the Comptroller of the Currency of the Department of the Treasury, Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation (collectively, the "Agencies"). The Proposal

[1] The Mortgage Bankers Association 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. For additional information, visit MBA's Web site: www.mortgagebankers.org.
[2] 76 Fed. Reg. 79380 (December 21, 2011).

was prompted by section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act[3] ("Dodd-Frank Act") that required all federal agencies to remove references to and requirements of reliance on credit ratings from their regulations and replace them with appropriate alternatives for evaluating creditworthiness.

While the Proposal is broad in its rule-making scope and addresses six market risk RBC exposure categories, MBA will focus its comments in this letter on the Securitization category because it represents an important source of real estate finance capital.[4]

MBA appreciates the Agencies for considering a range of options prior to presenting its proposed replacement for reliance on credit ratings. Under the Proposal, the Agencies' primary approach for market risk RBC is the simplified supervisory formula approach ("SSFA"). The Proposal also requests comments on two alternative approaches: (1) credit spread approach; and (2) the third-party vendor approach. In addition, Banks that are approved to use the Basel II internal ratings approach would be required to use the SSFA.

Our comments are intended to address the SSFA from a high-level policy perspective that does not delve into the SSFA formula construction. Our letter begins with a discussion of the public policy considerations that should guide the development of a risk-based capital regime governing the banking sector. This is followed by our general observations on the SSFA structure, as well as the relevant provisions of the Dodd-Frank Act that should determine the scope of this rulemaking. We then discuss, in light of the existing Basel III RBC treatment, the potential impact on banking institutions under the SSFA proposal.

Finally, given the importance and breadth of this rulemaking, we urge the Agencies to request further public comment and engage in ongoing dialogue with stakeholders in carefully crafting a new RBC regime pursuant to the Dodd-Frank Act.

Policy Considerations for Determining Market Risk RBC

Given the fragile state of the economy and current real estate market conditions, MBA strongly supports regulatory regimes that promote the return of private capital to the real estate market. The re-establishment of a fully-functioning, liquid and responsible capital market should be a primary policy objective. This is necessary for the nation's residential and commercial real estate sectors to flourish.

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[3] Public Law 111-203, 124 Stat. 1376-2223 (July 21, 2010).

[4] These exposure categories are the following: Multilateral Development Banks; Public Sector Entity; Bank; Corporate; and, Securitization.

Because this Proposal has the potential to impact bank capital allocation decisions, we urge the Agencies to carefully consider all the intended and potentially unintended consequences of the Proposal. In order to assist in this process, MBA developed a set of considerations that we would encourage the Agencies to employ in their evaluation of the Proposal:

- **Attracting Private Capital to the Real Estate Markets** - Private capital is essential to well-functioning residential and commercial real estate markets. The RBC regime should not negatively influence the return of private capital to these markets.

- **Promote the Efficient Allocation of Capital Within Banks** – Regulatory capital requirements should closely mirror economic capital. The allocation of capital to the various asset classes should take into account the relative economic risks and rewards of each of the investment opportunities. The RBC regime should not unduly influence the efficient allocation of bank capital purely for regulatory compliance purposes.

- **Reduce Regulatory Arbitrage** – MBA believes that market risk RBC regulations should be developed in a manner that prevents the opportunity for regulatory arbitrage. Bank entities, as determined by the scope of their operations, domestic or worldwide, should not fall under market risk RBC regulatory regimes that require banks to hold materially different market risk RBC. This would provide banks with a reduced market risk RBC requirement with a competitive advantage and potentially lead to regulatory arbitrage.

- **Efficient Implementation** - The RBC regime should be structured so it can be implemented by banks of all sizes in a cost efficient and timely manner that does not place a strain on their resources. In terms of the data required to comply with the RBC regime methodology, banks of all sizes and their compliance resources should be considered.

- **Intent of the Dodd-Frank Act** – The intent of the Dodd-Frank Act was to eliminate the overreliance on credit ratings by removing them from federal regulations, not precipitously increase market risk RBC for U.S. Banks. The RBC regime should not have a material impact on the market risk RBC for all banks.

Simplified Supervisory Formula Approach

The Agencies have proposed the SSFA as a simplified version of the Basel II advanced supervisory formula approach to assign specific risk-weighting factors to securitization positions, including resecuritization positions. The SSFA is designed to apply relatively higher capital requirements to the more risky junior tranches of a securitization that are the first to absorb losses and relatively lower requirements to the most senior positions.[5]

If a bank cannot, or chooses not to use the SSFA, a securitization position would be subject to a 100 percent of asset value risk-based capital charge, which roughly corresponds to a 1,250 percent risk weight (100% RBC/8% RBC category). MBA is concerned that banks that are not able to implement the SSFA would be put into a market risk RBC category that is currently associated with the highest risk securities (B, CCC). Consequently, for these banks, the SSFA would result in a dramatic market risk RBC increase. This penalty could be applied for inadvertent reasons and would not reflect the underlying risk of the securitization holdings. We encourage the Agencies to carefully review the required SSFA data inputs to ensure banks of all sizes have the ability to implement the SSFA without undue financial burden. Banks that are unable to implement the SSFA would likely find the 100 percent capital charge to be an impediment for acquiring and holding securitized assets.

The Agencies recognize the SSFA can result, under certain circumstances, in a higher market risk RBC weighting factor than would be required under the Basel-based approach primarily because the SSFA formula does not take into account securitization structure characteristics that are recognized by the rating agencies.[6] Consequently, the SSFA would cause banks to potentially face higher market risk RBC requirements for the current securitizations held in their portfolios, including mortgage-backed securities. This could provide an incentive for them to sell existing securitization positions and curtail future purchases of securitizations. MBA is concerned that this could potentially have a negative impact on the availability of capital to real estate and other sectors of the economy that utilize securitization as a capital source. Moreover, if the SSFA increases market risk RBC relative to non-securitized investment options, the SSFA could influence bank investment allocations for securitized assets.

Our members report that the SSFA could potentially have a stifling effect on bank purchases of securitizations from the secondary market. Ratings have and will continue

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[5] For additional information about the mechanics of the formula, see pages 79294-79295, 76 Fed. Reg. (December 21, 2011).
[6] 76 Fed. Reg. 79396 (December 21, 2011).

to be a major element in the pricing and trading of securitized assets for banks and non-bank financial institutions. However, for banks, the SSFA adds an additional component to this purchase decision because separate from the relative risks and rewards of the investment opportunity. Since the data required to calculate the SSFA may not be immediately available, banks may be reluctant to purchase securitizations with short deadline purchase offers. Non-bank financial institutions that are not subject to the SSFA rules would not factor the SSFA in their purchase decisions. We are concerned that the SSFA may provide a structural disadvantage for bank purchases of secondary market securitizations, which could distort the allocation of bank capital.

Statutory Foundations in the Dodd-Frank Act

As previously indicated, section 939A of the Dodd-Frank Act requires that references and reliance on credit rating agencies to be removed from federal regulations. Section 171(b) of the Dodd-Frank Act does not allow the Agencies to promulgate rules that quantitatively lower the RBC requirements of federally insured depository institutions as of July 10, 2010,[7] which the Agencies have reflected in the Proposal.[8]

Nonetheless, we are concerned that the SSFA has the potential to go beyond the intent of section 939A of the Dodd-Frank Act of not simply replacing credit ratings with an alternative market risk RBC formulation — but also substantially increasing the market risk RBC held by banks.

Regarding references to and reliance on credit ratings in federal regulations, Section 939A requires the following: [9]

> Each such agency shall modify any such regulations identified by the review conducted under subsection (a) to remove any reference to or requirement of reliance on credit ratings and to substitute in such regulations such standard of credit-worthiness as each respective agency shall determine as appropriate for such regulations. In making such determination, such agencies shall seek to establish, to the extent feasible, uniform standards of credit-worthiness for use by each such agency, taking into account the entities regulated by each such agency and the purposes for which such entities would rely on such standards of credit-worthiness.

The clear focus here is eliminating the reliance on a credit rating-based RBC regime — not a substantial increase in RBC for regulated entities. However, as indicated on the next page, the Proposal will increase RBC requirements:[10]

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[7] 76 Fed. Reg. 79398 (December 21, 2011).
[8] 76 Fed. Reg. 79399 (December 21, 2011).
[9] Public Law 111-203, 124 Stat. 1887 (July 21, 2010).

> In this regard, the agencies note that under this proposal, the specific risk capital requirements for debt and securitization positions should increase relative to the capital requirements for those positions under the existing market risk capital rules as of July 21, 2010.

We urge the Agencies to be mindful of the limited scope of the statutory directive as the Agencies continue in this rulemaking.

Basel III and the Agencies' Proposal

As noted in the Proposal, the removal of references to ratings for market risk RBC is a departure from Basel III, which maintains references to credit ratings for RBC. Basel III is an international regulatory framework for bank capital adequacy, stress testing, and market liquidity that builds upon Basel I and Basel II.[11] Basel III requires a nation's bank regulators to ensure that rating agencies are operating under the criteria set forth in Basel III.

We join the Agencies in their concern that the Proposal could create the opportunity for regulatory arbitrage. In requiring all domestic banks to comply with the SSFA, the Agencies provided the following statement:[12]

> Given concern about potential arbitrage opportunities that would be created if advanced approach banks were allowed the option to use either the SSFA or the SFA to calculate specific risk capital requirements for their securitization positions, the agencies propose to permit advanced approach banks to use only the SSFA for purposes of calculating the specific risk-weighting factors for their securitization positions.

Should the SSFA increase market risk RBC for U.S. banks relative to their non-U.S. peers that are regulated under the Basel III RBC guidelines, we see the strong potential for regulatory arbitrage by Basel III compliant non-U.S. banks. This could result in reduced capital allocations for U.S. operations of foreign banks or the movement of U.S. bank securitization assets for regulatory RBC purposes.

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[10] 76 Fed. Reg. 79399 (December 21, 2011).
[11] For a detailed description of Basel III, see *Basel III: A global regulatory framework for more resilient banks and banking systems*, Basel Committee on Banking Supervision, Bank for International Settlements, December 2010 (rev June 2011).
[12] 76 Fed. Reg. 79399 (December 21, 2011).

Other Potential Unintended Consequences

Should the net impact of the Proposal increase the risk weighting of existing assets held in the balance sheet of U.S. banks, the resulting decrease in RBC ratios could prompt many banks to decrease balance sheet size resulting in the net decrease in supply of credit to U.S. businesses and households. This could prolong the recovery from the current economic crisis.

Further, some of the hardest hit markets that are still recovering from the economic crisis are real estate and real estate finance. The Proposal could be especially harmful to these markets that would be greatly assisted by the return of private capital, including through securitization executions.

Conclusion

Given that the Agencies recognize that the SSFA should increase market risk RBC, we are concerned about the potential impacts, both intended and unintended, of the Proposal. Additionally, the opportunity for regulatory arbitrage between U.S. banks and non-U.S. banks could be created because of the different SSFA and Basel credit ratings-based market risk RBC methodologies. This could hinder the return of private capital to the securitization market. We strongly encourage the Agencies to modify the SSFA methodology to address these concerns.

Finally, given the importance and breadth of this rulemaking, we urge the Agencies to request further public comment and engage in ongoing dialogue with stakeholders in carefully crafting the RBC regime consistent with the Dodd-Frank Act.

MBA appreciates the opportunity to comment and request consideration of our concerns. Any questions about MBA's comments should be directed to George Green, Associate Vice President, Commercial Real Estate, at (202) 557-2840 or ggreen@mortgagebankers.org.

Sincerely,

David H. Stevens
President and Chief Executive Officer
Mortgage Bankers Association