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Office of the Comptroller of the Currency
250 E Street, S.W.
Mail Stop 2-3
Washington, D.C. 20219
Attention: Docket IDs OCC-2012-0008, OCC-2012-0009 and OCC-2012-0010
RIN 1557-AD46
Email: Regs.comments@occ.treas.gov

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551
Attention: Docket No. R-1442
RIN 7100-AD87
Email: Regs.comments@federalreserve.gov

Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
Attention: Comments/Legal ESS
RIN 3064-AD95, 3064-AD96 and 3064-AD97
Email: Comments@fdic.gov

Ladies and Gentlemen:

RE: REGULATORY CAPITAL RULES: REGULATORY CAPITAL, IMPLEMENTATION OF BASEL III, MINIMUM REGULATORY CAPITAL RATIOS, CAPITAL ADEQUACY, TRANSACTION PROVISIONS, AND PROMPT CORRECTIVE ACTION; STANDARDIZED APPROACH FOR RISK-WEIGHTED ASSETS, MARKET DISCIPLINE AND DISCLOSURE REQUIREMENTS; ADVANCED APPROACHES RISK-BASED CAPITAL RULE, MARKET RISK CAPITAL RULE

This comment letter is written on behalf of a number of financial institutions[1] that participate in the residential mortgage market. We have been working together with these financial institutions to address the revisions made by the Basel Committee on Banking Supervision ("BCBS") to the Basel capital framework, including those in Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems (December 2010, revised June 2011) ("Basel III") and the implementation of the regulatory capital requirements for residential mortgage transactions.[2] This letter is also responsive to the Federal Banking

[1]These financial institutions include many of the largest domestic and international financial institutions in the world. All of the financial institutions have $250 billion or more in total consolidated assets or have consolidated total on-balance sheet foreign exposure at the most recent year-end equal to $10 billion or more. These banking organizations are systemically important financial institutions ("SIFIs") under Title I of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd Frank"), and many of these SIFIs are global SIFIs.

[2]Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action, 77 Federal Register 169 at 52,792 (August 30, 2012) (the "Basel III NPR") available at http://www.stlouisfed.org/regreformrules/Pdfs/2012-8-30_FDIC_FRS_OCC_Joint_Basel_III_NPR.pdf; Regulatory Capital Rules, Standardized Approach (the "Standardized Approach") for Risk-Weighted Assets; Market Discipline and Disclosure Requirements, 77 Federal Register 169 at 52,888 (August 30, 2012) (the "Standardized Approach NPR") available at http://www.stlouisfed.org/regreformrules/Pdfs/2012-8-30_FDIC_FRS_OCC_Joint_standardized_approach_NPR.pdf; Regulatory Capital Rules: Advanced Approaches (the "Advanced Approaches") Risk-Based Capital Rules; Market Risk Capital Rule, 77 Federal Register 169 at 52,978 (August 30, 2012) (the "Advanced Approaches NPR") available at http://www.stlouisfed.org/regreformrules/Pdfs/2012-8-30_FDIC_FRS_OCC_Joint_advanced_approaches_market_risk_NPR.pdf. The general risk-based capital rules of the Office of the Comptroller of the Currency (the "OCC") are set forth at 12 C.F.R. 3, Appendix A and 12 C.F.R. 167. The general risk-based capital rules of the Board of Governors of the Federal Reserve System (the "Federal Reserve") are set forth at 12 C.F.R. 208 and 12 C.F.R. 225, Appendix A. The general risk-based capital rules of the Federal Deposit Insurance Corporation (the "FDIC") are set forth at 12 C.F.R. 325, Appendix A, and 12 C.F.R. 390, subpart Z. For banks and bank holding companies with significant trading activity, the general risk-based capital rules are supplemented by the market risk rules, which appear at 12 C.F.R. 3, Appendix B for the OCC, 12 C.F.R. 208, Appendix E for the Federal Reserve, and 12 C.F.R. 225, Appendix E for the Federal Reserve and 12 C.F.R. 325, Appendix C for the FDIC. The Advanced Approaches rules for the OCC are set forth at 12 C.F.R. 3, Appendix C and 12 C.F.R. 167, Appendix C, 12 C.F.R. 208, Appendix F for the Federal Reserve, and 12 C.F.R. 225, Appendix G for the Federal Reserve, and 12 C.F.R. 325, Appendix D for the FDIC, and 12 C.F.R. 390, subpart Z, Appendix A for the FDIC. The advanced approaches rules are generally mandatory for banking organizations and their subsidiaries that have $250 billion or more in total consolidated assets or that have consolidated total on-balance sheet foreign exposure at the most recent year-end equal to $10 billion or more. Other banking organizations may use the advanced approaches rules with the approval of their primary federal supervisor. *See* 12 C.F.R. 3, Appendix C, Section 1(b) for national banks; 12 C.F.R. 167, Appendix C for federal savings associations; 12 C.F.R. 208, Appendix F, Section 1(b) for state member banks; 12 C.F.R. 225, Appendix G, Section 1(b) for bank holding companies; 12 C.F.R. 325, Appendix D, Section 1(b) for state nonmember banks; and 12 C.F.R. 390, subpart Z, Appendix A, Section 1(b) for state savings associations. The market risk capital rules apply to a banking organization if its total trading assets and liabilities is 10% or more of total assets or exceeds $1 billion. *See* 12 C.F.R. 3, Appendix B, Section 1(b) for national banks; 12 C.F.R. 208 and 225, Appendix E, Section 1(b) for state member banks and bank holding companies, respectively, and 12 C.F.R. 325, Appendix C, Section 1(b) for state nonmember banks.

Agencies solicitation of comments on the proposed changes to the recognition of financial collateral[3] under the Advanced Approaches NPR.[4]

We support the efforts of the OCC, the Federal Reserve and the FDIC (collectively, the "Federal Banking Agencies") to recognize the credit risk mitigating impact of an expanded range of financial collateral, some of which we discuss further in this letter. In this letter, we will provide information to assist the Federal Banking Agencies with their understanding of the positive credit risk mitigation impact of conforming residential mortgage loans. Although the proposed regulatory capital rules permit banking organizations to recognize the credit risk mitigation[5] benefits of eligible financial collateral ("EFC"), the Federal Banking Agencies have proposed a significant change to the definition of EFC. Specifically, the Federal Banking

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[3]Financial collateral means collateral: (1) In the form of: (i) Cash on deposit with the [BANK] (including cash held for the [BANK] by a third-party custodian or trustee); (ii) Gold bullion; (iii) Long-term debt securities that are not resecuritization exposures and that are investment grade; (iv) Short-term debt instruments that are not resecuritization exposures and that are investment grade; (v) Equity securities that are publicly traded; (vi) Convertible bonds that are publicly-traded; or (vii) Money market fund shares and other mutual fund shares if a price for the shares is publicly quoted daily; and (2) In which the [BANK] has a perfected, first-priority security interest or, outside of the United States, the legal equivalent thereof (with the exception of cash on deposit and notwithstanding the prior security interest of any custodial agent). *See* Basel III NPR at 52851.

[4]The Federal Banking Agencies propose that conforming residential mortgages no longer qualify as financial collateral under the Advanced Approaches presumably because the Federal Banking Agencies believe residential mortgages are "less liquid collateral," and a banking organization should no longer be able to recognize the credit mitigation benefit of such collateral through an adjustment to exposure-at-default ("EAD"). *See* Advanced Approaches NPR at 52981 under Revisions to the Recognition of Financial Collateral, Eligible Financial Collateral.

[5]The Federal Banking Agencies have long recognized and encouraged financial institutions to use credit risk mitigation techniques, including collateralizing exposures with first priority claims, cash, securities, guaranties, credit derivatives, and netting techniques. *See* Standardized Approaches NPR at 52907.

Agencies would modify the existing Basel II[6] implementing regulatory capital rules by excluding "conforming residential mortgages" from EFC for banks that use the Advanced Approaches.[7]

Under Basel II and the current regulatory capital rules, financial collateral means collateral: (1) in the form of: (i) cash on deposit with the bank (including cash held for the bank by a third-party custodian or trustee); (ii) gold bullion; (iii) long-term debt securities that have an applicable external rating of one category below investment grade or higher; (iv) short-term debt instruments that have an applicable external rating of at least investment grade; (v) equity securities that are publicly traded; (vi) convertible bonds that are publicly traded; (vii) money market mutual fund shares and other mutual fund shares if a price for the shares is publicly quoted daily; or **(viii) conforming residential mortgages (emphasis added)**; and (2) in which the bank has a perfected, first priority security interest or, outside of the United States, the legal equivalent thereof (with the exception of cash on deposit and notwithstanding the prior security interest of any custodial agent).[8] We understand that the decision to exclude conforming residential mortgages from EFC was based upon a concern by the Federal Banking Agencies that there is insufficient liquidity in the market for residential mortgage loans to permit banks that use the Advanced Approaches to obtain the benefit of the credit risk mitigation[9] for collateral through an adjustment to the exposure at default ("EAD").

By this letter, and preferably a follow up meeting with the Federal Banking Agencies and many of the financial institutions who are concerned that the consequences of the proposed changes would unduly harm the public and borrowers in the residential housing market, we wish

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[6]The minimum risk based capital requirements for US banking organizations based upon the "International Convergence of Capital Measurement and Capital Standards" (July 1988) are referred to as ("Basel I"). The advanced approaches risk based capital rules for the largest internationally active banks on a new international capital adequacy framework set forth in the "International Convergence of Capital Measurement and Capital Standards: A Revised Framework" (June 2006) are referred to as ("Basel II"). Under the Basel II standardized approach, a standardized set of risk weights is applied to different asset categories. The standardized approach applies more risk buckets than Basel I and relies upon external rating agencies to help determine risk. In contrast, the internal ratings-based approach of Basel II allows banks themselves to estimate the amount of capital needed to support their unique set of risks. This approach, however, is limited to those banks, typically the largest banks, which demonstrate the ability to conduct a credit risk analysis that is acceptable to the prudential supervisor. There are two levels of the internal ratings approach (foundation or advanced). See "Basel and the Evolution of Capital Regulation: Moving Forward, Looking Back" at www.fdic.gov/bank/analytical/fyi/2003/011403fyi.html. The revisions to the market risk framework and the treatment of certain securitization exposures set forth in "Revisions to the Basel II Market Risk Framework, Guidelines for Computing Capital for Incremental Risk in the Trading Book, and Enhancements to the Basel II Framework" and "Changes to the Revisions to the Basel II market risk framework" at Changes to the Revisions to the Basel II market risk framework are referred to as (Basel II.5").
[7]*See* Advanced Approaches NPR at 52981.
[8]*See* 12 C.F.R. 3, Appendix C to Part 3 - Capital Adequacy Guidelines for Banks: Internal-Ratings-Based and Advanced Measurement Approaches at page 57.
[9]Each of the financial institutions with whom we are working have operational procedures and risk management processes that ensure that all documentation used in collateralizing a transaction is legal, valid, binding and enforceable under applicable law in the relevant jurisdictions.

to address this concern and provide important information to the Federal Banking Agencies that demonstrates that the approach taken by the Federal Banking Agencies in the implementation of Basel II for conforming residential mortgages is the better approach because these transactions provide sufficient liquidity, important funding to the housing market, especially in the form of lines of credit to non-depository mortgage companies,[10] and do not contain product features that are associated with higher credit risk.[11] The Basel II approach is also free of the unintended negative consequences of the proposed changes to conforming residential mortgages that would be caused by the Dodd Frank implementing regulations to Basel III, including the Advanced Approaches NPR.[12]

The financings provided to the housing market by these financial institutions provides vital liquidity and funding, promotes beneficial competition in the market and practical private sector solutions that help to improve and stabilize the housing market and the general economy. These transactions are typically structured with a 364-day term for accounting reasons and to take into account certain Bankruptcy Code protections. They are primarily documented by a master repurchase agreement and related documents. Under the master repurchase agreement, a financial institution would obtain a security interest in and/or ownership claims to the loans. The master repurchase agreement is also preferred because, without it, under the Bankruptcy Code, mortgage loans and certain other assets would be subject to the court-imposed automatic stay and such assets would not be legally transferred in full to the lenders in a timely manner, if at all. The master repurchase agreement structure, on the other hand, allows the lenders to seize and sell loans immediately from facilities, to be made whole and prevents any reduction in liquidity of assets due to potential delays caused by the automatic stay or a bankruptcy proceedings. Under the master repurchase agreement, the financial institutions are generally entitled a 100% full recourse facility against the borrowers. The master repurchase agreements are also used because they have advantages over a loan agreement. For example, under a typical loan agreement, the financial institution would have a security interest in the loans (but not a claim to legal ownership) and, upon an event of default that was bankruptcy related, the loan agreement

[10]*See* Mortgage Bankers Association Comment Letter dated October 17, 2012 to the Federal Banking Agencies on Proposed Basel III Rules at page 64.

[11]Unlike certain residential mortgage loans that experienced unprecedented levels of default, these residential mortgage loans were adequately underwritten and did not experienced any elevated default rates. Indeed, some of these transactions are structured to provide a "work out" solution to residential mortgages that qualify as debts previously contracted ("DPC") or other real estate owned ("OREO"). Moreover, these residential mortgage loans do not contain any of the high risk features that caused or exacerbated the housing market turmoil such as so-called pay-option adjustable rate mortgages, which provide for negative amortization and significant payment shock to the borrower; the practice of issuing mortgage loans to borrowers with unverified or undocumented income. *See* the Standardized Approach NPR at 52898.

[12]Title I of Dodd Frank sets forth many of the capital requirements, including Section 115 (b) (prudential standards), Section 115 (c) (contingent capital), Section 165 (b) (prudential standards for nonbank financial companies), Section 165 (c) (contingent capital for nonbank financial companies), Section 165 (i) (stress tests), Section 165 (k) (inclusion of off-balance sheet activities in computing capital requirements), and Section 171 (b) (minimum capital requirements).

would not be free of the automatic stay, and the financial institution would have to go to the bankruptcy court to lift the automatic stay. While the financial institution would be a secured creditor, the financial institution would be one among other secured creditors, and would still have to participate in legal proceedings to gain ownership of the collateral. This could be costly, and time consuming, and could lead to a significant reduction of liquidity of assets and value of the assets while the financial institution deals with the legal proceedings. In certain instances, a special purpose vehicle is used as the borrower to mitigate bankruptcy risk, and, in those cases, the loan agreement would also limit the recourse rights to 10% against the borrower in order to maintain the bankruptcy remote status (e.g., true sale, non-consolidation may be affected if the structure is done as full-recourse).

There are at least four types of transactions that are prevalent in the market that, if sufficient liquidity were the primary concern, would meet the definition of conforming residential mortgages. These transactions are designed by financial institutions to provide financing to help solve a recognized problem in the current housing market: the failure to help more homeowners, especially those who are attempting relief from foreclosures, and communities where depreciation in home values has been a major factor in further depressing the local economies. These financial institutions have increased the liquidity of the housing market by providing financing for a broad array of residential mortgage loans and assets. To be sure, if the Advanced Approaches NPR becomes final, in its current form, then many of the transactions that are provided by these financial institutions could be curtailed or significantly limited.

First, these financial institutions currently finance the acquisition of seasoned residential mortgage loans. Buyers of these seasoned loans typically purchase these loans to "work them out." Some of these "work-out" measures include modification into cash-flowing loans or to refinance/modify them into a new loan (e.g., Home Affordable Refinance Program/Home Affordability Mortgage Program, etc.) where possible. Typically, this is done where the purchaser of these assets is aligned with a special servicer on these "work-out" measures. Counterparties include hedge funds, private equity, special servicers, Real Estate Investment Trusts ("REITs") and general investors who purchase pools of these assets.

Second, these financial institutions finance real estate assets that have been worked through non-performing status through a foreclosure. This includes financing of vacant real estate along with the financing of real estate with tenants. These transactions have attracted a good amount of interest in the current market due to the large number of foreclosure actions and the resulting number of vacant homes in communities across the country. Counterparties include hedge funds, private equity, special servicers, REITs and general investors who purchase pools of these assets. Other parties for the OREO and DPC rentals[13] may include asset/property management companies.

Third, financial institutions provide the financing of new origination agency-eligible collateral. This collateral is underwritten to Government Sponsored Enterprises ("GSE") guidelines (e.g., Federal National Mortgage Association ("Fannie Mae"), Federal Home Loan Mortgage Corporation ("Freddie Mac"), Federal Housing Administration, US Department of Agriculture and Veterans Administration). These residential mortgage loans are sold into GSE securities or pursuant to the cash window shortly after origination. The financial institutions providing this financing provide short term liquidity while loans are aggregated for such subsequent agency transactions. Counterparties for this program include large, independent mortgage originators. Available data show that liquidity is not a problem with these transactions. Indeed, volumes are extremely high, and it could be argued that the housing recovery and the US economy depend on the success of these financings. The Advanced Approaches NPR, if it were to become final in its current form could have the effect of halting liquidity, adversely effecting interest rates and terms that would be offered to consumer borrowers, and reducing competition by passing costs to privately held originators.

Finally, these financial institutions finance new origination of mortgage loans that are not GSE eligible.[14] These loans have generally been sold in the secondary market through whole

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[13]OREO and OREO rentals (e.g., Fannie Mae, Freddie Mac and the Obama Administration) have strong strongly encourage private sector funding as evidenced by the Obama administration proposals and initiatives approved by the Federal Housing Finance Agency ("FHFA"). The private sector is a critical component to these efforts (e.g., Freddie Mac OREO rental programs are geared more towards institutional buyers like private equity and hedge funds. There is clearly sufficient liquidity to address the concerns of the Federal Banking Agencies. *See* http://www.bloomberg.com/news/2012-06-14/fannie-mae-freddie-mac-reo-costs-top-8-5-billion-auditor-says.html The FHFA recently announced the first pilot transaction under the OREO Initiative, targeted to hardest-hit metropolitan areas — Atlanta, Chicago, Las Vegas, Los Angeles, Phoenix and parts of Florida. With this next step, prequalified investors will be able to submit applications to demonstrate their financial capacity, experience and specific plans for purchasing pools of Fannie Mae foreclosed properties with the requirement to rent the purchased properties for a specified number of years. *See* http://www.reuters.com/article/2012/02/17/freddiemac-reo-idUSL2E8DH6VH20120217 and. http://www.freddiemac.com/news/blog/tracy_mooney/20120618_a_new_approach_to_reo_property_valuations.html Freddie Mac also has a plan, which has apparently gained traction over the past few weeks, and its proposed strategy of disposing of its enormous overhang of OREO properties is likely to differ from Fannie Mae's in important ways, particularly in how qualified investors may be able to procure financing to buy the pools of foreclosed single-family homes. For a comprehensive view of these program, please *see* http://www.freddiemac.com/news/blog/tracy_mooney/20111114_facts_about_fm_reo_and_community_stabilization.html and http://www.mortgagenewsdaily.com/05072012_gses_reo.asp

[14]Data shows that Fannie Mae and Freddie Mac owned about 180,000 foreclosed properties at the end of 2011, triple the amount they owned in 2007. This means that they own about a third of the entire US inventory of so-called OREO or DPC properties, according to RealtyTrac Inc., the Irvine, California-based provider of foreclosure data. Apparently, Fannie Mae and Freddie Mac sold 353,851 repossessed homes in 2011, up from 57,748 in 2007. *See* www.fhfa.gov/webfiles/23403/REOPR22712F.pdf

loan transactions or pursuant to securitization or other pass-through transactions. The financing programs of these financial institutions provide liquidity while loans are aggregated for such transactions. Particularly in the current market where liquidity is limited and the private housing market has been under intense pressure, such liquidity is significant to the ability of mortgage loan originators to originate new mortgage loans. Counterparties for these programs include large (and, in some cases, small or medium sized), independent mortgage originators. On October 21, 2011, the GSEs (e.g., Fannie Mae and Freddie Mac) reduced their conforming loan balances which have opened up the jumbo market considerably with high productions and a multitude of origination channels opening up for financial institutions and privately held originations, credit unions, etc. The Advanced Approaches NPR, if it were to become final in its current form, could have the effect of stopping liquidity in this space, which will halt mortgage loans in this space and may require the GSEs to increase their loan balance (putting taxpayers at greater risk) and creating problems for homeowner looking for jumbo products since financial institutions would have to alter their pricing upward to these originators.

These types of transactions are among the safest and most liquid financial assets and serves as valuable collateral in a variety of transactions that are essential to the mortgage finance market. Given the important benefits these assets provide to the housing market and the general economy, the Federal Banking Agencies should consider allowing financial institutions the option of looking through the structures to the financial collateral. The proposed regulatory capital rules apply a 100% Credit-Conversion Factor ("CCF") to off-balance sheet repurchase agreements, doubling the current rate of 50%. The CCF is applied to the market value of the amount lent or borrowed under the transaction. We believe this approach does not fully recognize the value of repurchase agreements, or any similar type funding structure that enables the financial institution to book the underlying mortgages as an asset acquired. The net effect of not recognizing the full value of repurchase agreements or similar type funding structures is that the proposed regulatory capital rules unnecessarily increases the cost of capital to mortgage lenders and ultimately consumers.

The proposed regulatory capital rules could cause the financial institutions to be required to increase their capital with respect to these transactions, and the likely impact of the increased capital requirement would be to increase interest rates on these transactions, reduce liquidity in the market, harm competition because of reducing funding, harm the housing market, and consequently, harm the general economy. The proposed changes could also require the financial institutions to restructure the transactions in a way that causes them to lose important protections, including protections from the automatic stay in bankruptcy, timely access to collateral and full recourse on loans, the loss of which, could cause safety and soundness concerns because of the additional risks related to realizing upon the collateral.

We appreciate the opportunity to comment on this important matter, and would be pleased to arrange a meeting among the Federal Banking Agencies and the financial institutions whom we are assisting to comply with the regulatory capital rules. If you have any questions or if you would like to further discuss these comments, please contact me at (212) 768-5371.

Very truly yours

Jerome Walker

cc: Robert McCarthy, Esquire
Matthew Dyckman, Esquire

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