UnionBank

October 22, 2012

Via Electronic Mail

Office of the Comptroller of the Currency
U.S. Department of the Treasury
250 E Street, SW
Mail Stop 2-3
Washington, D.C. 20219
Regs.comments@occ.treas.gov
Basel III OCC Docket ID OCC-2012-0008, 0009, and 0010

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave., NW
Washington, DC 20551
Regs.comments@federalreserve.gov
Basel III Docket No. R-1442, RIN 7100-AD87

Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429-0002
Comments@FDIC.gov
Basel III FDIC RIN 3064-AD95, RIN 3064-AD96, and RIN 3064-D97

Re: Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements NPR; Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Prompt Corrective Action, and Transition Provisions NPR; and Advanced Approaches Risk-based Capital Rules; Market Risk Capital Rules NPR

Dear Sirs and Madams:

Union Bank, N.A. ("Union Bank" or "the Bank") submits this comment letter ("Comment Letter") in response to the above-referenced notices of proposed rulemaking (the "NPRs") entitled (i) Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements (the "Standardized Approach NPR"); (ii) Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Prompt Corrective Action, and Transition Provisions (the "Basel III NPR"); and (iii) Regulatory Capital Rules: Advanced Approaches Risk-based Capital Rules; Market Risk Capital Rules (the "Advanced Approaches NPR"), each

jointly issued by the Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System (the "Board"), and the Federal Deposit Insurance Corporation (the "FDIC") (collectively, the "Agencies"). Union Bank appreciates the opportunity to comment directly on these NPRs. Most of our comments are directed at the Standardized Approach NPR, but some of our comments also have bearing on the Basel III NPR and the Advanced Approaches NPR.

By way of background, Union Bank is a national bank, an insured depository institution, with its headquarters in San Francisco, California. It is a full-service commercial bank providing an array of financial services to individuals, small businesses, middle-market companies, and major corporations. Union Bank's annual level of residential mortgage originations is sixth in market share of all California originations (jumbo, conforming and other originations); the Bank is one of the top four jumbo lenders in the U.S. The Bank operates 402 branches in California, Washington, Oregon, New York, Illinois, and Texas, as well as two international offices. Union Bank is a wholly-owned subsidiary of UnionBanCal Corporation ("UnionBanCal"). UnionBanCal is a wholly-owned subsidiary of The Bank of Tokyo-Mitsubishi UFJ, Ltd., which is a wholly-owned subsidiary of Mitsubishi UFJ Financial Group, Inc. ("MUFG"). As of June 30, 2012, UnionBanCal had $87.9 billion in assets. MUFG is a publicly traded company in Japan and its shares also trade on the New York Stock Exchange in the form of American Depository Receipts. UnionBanCal files quarterly and annual financial statements (Forms 8-K, 10-Q, 10-K) with the Securities and Exchange Commission.

Executive Summary

Union Bank supports efforts to ensure the safety and soundness of the financial services industry by further aligning capital requirements with the risk of different asset classes, and by making capital calculations more reflective of the loss-absorbing content of capital elements. However, Union Bank has a number of concerns about the specific proposals in the NPRs, which differ materially from any prior final rules under Basel I and Basel II, as well as the internationally proposed Basel III rules. The Bank has been involved with industry trade organizations and agrees with many of the recommendations put forward in The Clearing House Association, L.L.C. ("TCH") and the American Securitization Forum ("ASF") (collectively, "TCH/ASF") comment letter and the American Bankers Association, the Securities Industry and Financial Markets Association, and Financial Services Roundtable ("Associations") comment letter. Those comment letters cover a broad array of topics with which we are also concerned. However, we have a unique perspective we wish to share on select issues. Specifically, we wish to comment on how the NPRs, if adopted in their current form, would adversely impact residential mortgage and home equity line of credit ("HELOC") products, pension plans and the securitization market in the U.S. We also address Union Bank's support of the Agencies' proposal to calculate conservation buffer requirements for banks subject to the Advanced Approaches Rule, inclusive of both mandatory and opt-in banks, on the basis of total advanced approaches risk-weighted assets. These particular topics are of the highest concern to Union Bank.

We support the Agencies' efforts to further differentiate risk-weightings for all credit lending products, not just residential mortgage assets. However, the Bank is concerned that if the NPRs are adopted in their current form, their implementation will result in unintended consequences that will have an unnecessarily adverse impact on consumers and the U.S. economy. It appears that the Standardized NPR has assigned mortgage-related risk-weightings applicable to all institutions in a manner commensurate with inadequate underwriting by unsafe and unsound financial institutions. In addition, under the Standardized Approach NPR, the mortgage-related risk-weightings address product and property value, but ignore the credit profile of the borrower, which in our view is one of the top two factors we evaluate in considering mortgage credit risk. Further, the proposed capital impacts related to banks' pension plans do not reflect true pension economic liability. Finally, there are excessively punitive impacts associated with the securitization framework and its expansive definition of securitization, which has the potential of leading institutions to forego obtaining partial guarantees, which may lead to systemic risk and the potential for curtailed lending. We wish to specifically advocate the following:

(i) Risk-weighting assignments for mortgage loans should be based upon prudent underwriting and a measure of the borrower's credit profile, in addition to loan to value and product type. We also propose that refinements be made to the NPR's Category 1 and 2 structure by adding a new Category 1.5 to acknowledge interest only ("IO") mortgages as clearly less risky than negatively amortizing products;

(ii) We do not believe that all junior lien HELOCs should be placed into Category 2. Also, we believe a Category 2 junior lien loan should not impact the treatment of a Category 1 first lien loan in cases where both loans are held by the same institution;

(iii) To attain a better perspective on what impact the Standardized Approach NPR will have on consumer credit and available loan products, we recommend that a Quantitative Impact Study ("QIS") be conducted, along with other empirical analysis;

(iv) Pension-related accumulated other comprehensive income ("AOCI") unrealized gains and losses should be excluded from the calculation of regulatory capital; should the Agencies reject this recommendation, at the least, AOCI should be calculated on an Accumulated Benefit Obligation ("ABO") basis which reflects the current obligation if settled at the time of calculation, instead of on a Projected Benefit Obligation ("PBO") basis which considers future increases in compensation;

(v) The Simplified Supervisory Formula Approach ("SSFA") should be revised to address inequities impacting small to mid-size institutions and the seemingly unintended requirement to hold capital significantly greater than the amount of the underlying exposure;

(vi) A collateralized loan obligation ("CLO") which includes a de minimis re-securitization underlying asset exposure (which we propose to define as less than 5% of overall underlying assets) should be exempted from inclusion in the definition and from the risk-based capital treatment associated with re-securitizations;

(vii) The definition of a securitization should be narrowed to exclude commercial real estate ("CRE") and commercial and industrial ("C&I") loans with limited guarantees;

(viii) The Agencies should allow for the application of the SSFA and optional implementation of the Supervisory Formula Approach ("SFA") for non-mandatory, voluntary opt-in, Advanced Approaches banks; and

(ix) We support the adoption of the Agencies' proposal that banking organizations subject to the Advanced Approaches Rule, inclusive of voluntary (non-mandatory) opt-in banks, calculate their capital conservation buffer, and by extension any future additionally enacted buffers, using the Advanced Approaches' total risk-weighted assets.

Discussion

I. Residential Mortgages and HELOC products

We support the Standardized Approach NPR's general attempt to address lessons learned from the recent financial crisis by increasing the required capital for certain assets, including for certain higher-risk residential mortgages. Currently, most residential mortgages are assigned a 50% risk-weight, despite the broad range of risk profiles associated with mortgage exposures. Under the proposed rule, residential mortgages would be assigned to a range of risk-weight categories (between 35 to 200%) based upon the loan-to-value ("LTV") ratio of the mortgage, certain mortgage product features, and underwriting practices and standards. Union Bank is concerned that the proposed risk-weighting assignments for residential mortgage and HELOC products under the Standardized Approach NPR generalize and group certain products, lenders and borrowers into very broad, generally overly punitive, categories without adequate differentiation, and in doing so, inaccurately reflect the inherent risk with respect to these products, lenders and borrowers. We list below specific concerns, and later in this Comment Letter outline changes that we would propose to mitigate these concerns.

There are risks to the industry and consumers arising from applying excessively conservative risk-weightings. The NPR proposes very conservative risk-weightings. However, there are risks that applying such excessively conservative risk-weightings could result in unintended consequences that:

- Result in higher rates to consumers, including higher rates for Community Reinvestment Act ("CRA") loans, and potentially reduce available funds especially for CRA loans
- Reduce the choice of products available to consumers
- Lead banks to allocate less capital to support residential assets at a time when housing markets are still fragile in this post- recovery period
- Extend mortgage market reliance on government-sponsored entities ("GSEs") and the Federal Housing Administration ("FHA")

- Restrict the economic and housing recovery by reducing credit availability[1]
- Result in fewer mortgage lenders, as history has indicated that more lenders exit the market with increased regulation
- Increase mortgage lending through non-bank entities and incent lenders to move mortgage assets to offshore entities

The NPR, if adopted as proposed, will have the unintended consequence of imposing higher rates to borrowers and limiting credit availability; in order to meet their cost of capital, lenders must necessarily increase the interest rates charged to borrowers in Category 2 mortgages or exit products entirely. For example, a lender who prudently holds common equity tier 1 ("CET1") of 8.5%, recognizes a cost of capital of 10%, and has a 35% effective tax rate would have to increase the loan coupon by approximately 0.65% for a loan product that changes from a 50% risk-weight to a 100% risk-weight. The higher loan coupon will directly limit the loan size available to the consumer. Using a 25% debt to income ("DTI") ratio, the maximum loan size for a 100% risk-weighted mortgage loan will be 5% - 8% lower than a 50% risk-weighted mortgage to the same borrower. Thus, the higher risk-weights will necessarily increase consumer credit costs, reduce credit availability and place downward pressure on home prices.

It is very important to differentiate product from credit quality; the proposed risk-weight capital scheme should focus on the borrower, the property, and the product, in that order of importance. We acknowledge that certain mortgage products are riskier than others, such as negatively amortizing or option adjustable rate mortgages and teaser rate products. However, since the financial crisis, the riskiest products have essentially ceased to be offered in the marketplace. The assignment of these kinds of products to Category 2 makes it even less likely that they will return. The borrower's capacity to pay and willingness to pay are important drivers of credit performance. Acceptable credit scoring schemes include the use of Fair Isaac Corporation credit score ("FICO"), which we will focus on as an example, although other credit scoring schemes are possible. As found in numerous studies,[2] and in the expected credit loss results from the CoreLogic Risk Model discussed in more detail later in our letter, **credit scores are the number one predictor of loan performance, ranked higher than LTV.** The property focus is centered on Loan to Value ("LTV"), which we believe is rightly considered in the Standardized Approach NPR. Finally, there is clear historical

---

[1] A recent Federal Reserve Bank of San Francisco study indicated that in the aftermath of the financial crisis, tighter credit conditions are restricting the flow of credit to consumers and slowing the recovery in the housing market. http://www.frbsf.org/publications/economics/letter/2012/el2012-25.html. Further, in a recent speech at Jackson Hole, Wyoming, Mr. Bernanke commented on how restrictive mortgage underwriting standards have reduced the otherwise beneficial effects of lower mortgage rates. http://www.federalreserve.gov/newsevents/speech/bernanke20120831a.htm

[2] For example, a FHFA study found that credit scores were a main loan risk differentiator, in addition to other macroeconomic variables, such as LTV ratio and mortgage insurance coverage; loan purpose; borrower documentation; occupancy status; product type; mortgage interest rate; property type; origination channel; and borrower debt-to-income ratio. "Fannie Mae and Freddie Mac Single-Family Guarantee Fees in 2010 and 2011," Federal Housing Finance Agency, August 2012.

evidence that certain product features, including IO and negative amortization products, are indicative of higher credit losses, although not to an equal extent. For example, negatively amortizing loans are correlated with much higher risk than a simple amortizing loan. As discussed further below in this Comment Letter, Union Bank's experience with IO that is not negatively amortizing has shown these loans to have a much better performance history; these IO loans should not be placed in the same risk category as negatively amortizing loans. The Standardized Approach NPR paints IO products with a broadly punitive brush -- IO loans were successfully offered before and after the more egregious products were available and should not be treated in a like manner.

A borrower who is properly qualified for an IO adjustable rate loan, as discussed in this Comment Letter, or even on an amortizing ARM, may be able to curtail principal and lower their monthly payments at their discretion. This feature is favorable even when compared with traditional 30-year fixed products. Treating these loans within the Category 2 risk-weighting will make it more difficult and expensive for consumers to meet their personal financial needs and will unnecessarily reduce consumer choice.

We refer you to the Basel II credit formulas and the rigorous history behind their development. There is significant statistical research as a basis supporting the Basel II Advanced Approaches credit formulas which stands in clear contrast to the four row by two column grid of risk-weights proposed in the Standardized Approach NPR. Although it is not practical, or recommended, to have all institutions implement the Advanced Approaches credit risk methodologies, it does highlight that the Standardized Approach NPR's proposed calibration is overly broad, omits key risk elements, and results in adverse impacts which should be investigated through a QIS. For example, under Basel I, the Bank's residential portfolio was mostly treated under a 50% risk-weighting. Based on the Bank's preliminary internal estimates, the Standardized Approach NPR more than doubles the risk-weighting on the Bank's portfolio, while the Bank's underwriting criteria and practices have not significantly changed. This marked increase follows the recent housing downturn during which the Bank's quarter end total delinquency rate for 1st lien single family residence mortgages never exceeded 2.05%, indicating no need for higher capital holdings against this portfolio. Union Bank is currently in parallel run for the Basel II Advanced Approaches and our internally built models suggest risk-weight percentages significantly lower than the rates that would be applied under the proposed Standardized Approach, and even lower than the current 50% risk-weighting**.** The Bank's Advanced Approaches models are built upon our better than average credit performance, which is more highly correlated with a focus on better credit criteria and less on product features.

Further, the proposed risk-weightings should be addressed at protecting against financial risks and not at preventing abusive lending practices. The proposed risk-weightings assign many loan products to Category 2 which, in practice, equates these loans with the treatment extended to abusive lending practices. The higher capital requirements associated for the array of products proposed to all be classified as Category 2 loans will have the impact of making it cost prohibitive for many institutions to continue offering these products. The capital treatment under the Standardized Approach NPR implies that 30-year fixed rate loans placed in Category 1 are fair loans to make to consumers, while loans in

Category 2, which includes IO and 40-year loans, represent abusive lending practices that need to be discouraged. The Board, the OCC and the FDIC play important roles in setting the standards for safety and soundness, including those reflected in the capital regulations. However, if the Agencies truly believe that the offering of IO and 40-year loans constitutes abusive lending, these loan practices should be addressed directly through the examination process and/or through the rulemaking process. The Consumer Financial Protection Bureau ("CFPB"), for example, was specifically charged by Congress to serve as the primary federal consumer protection regulator of consumer financial products and services and, in that role, has authority to address abusive lending practices in the residential mortgage industry.

The risk-weighting treatment for the proposed Category 1 versus Category 2 assets is significantly different, and places a severe, and in some cases unwarranted, penalty on those assets assigned to Category 2. We very much support risk differentiation as an improvement on existing rules, but the Standardized Approach NPR proposes broad categories of risk-weighted assets which are over-inclusive with respect to Category 2. Category 2 seems to be the default category, unintentionally capturing products whose risks are significantly different from each other. For example, the risks associated with IO loans are significantly less than those of negative amortization adjustable rate mortgages ("ARMs") or option ARMs, which are appropriately classified as high risk loans, but both are assigned the same risk-weightings under Category 2. We support a risk classification system with a broader spectrum in which there is meaningful differentiation of risk. In our view, Category 2 should include the highest risk products, such as negative amortization loans, while less risky products should be treated in Category 1 or under a new classification such as Category 1.5. Under a construct including a new category 1.5, amortizing loans would fall to Category 1, negatively amortizing loans to Category 2, and IO loans to Category 1.5.

For product segmentation, we believe Hybrid IO ARMs should be differentiated from other high risk loans such as option ARMs, and subprime products such as a 2/28 ARM. By "Hybrid IO ARM," we are referring to interest-only ARMs, where interest only payments are calculated on a fixed interest rate for some initial period (typically 5/7/10 years), followed by annual rate resets and payments based on principal and interest ("P&I") amortizing over the remaining term. We do not believe loans with IO features should be treated the same as other "high risk loans" (e.g., option ARMs) simply because they have IO features. IO product features can be used as part of a conservative, responsible lending program, as both Union Bank's experience and industry experience demonstrate.

Prudent lenders underwrite IOs in a markedly different way than high risk loans (e.g., negatively amortizing loans) which were made through the height of the housing market build up. Prudent underwriting of an IO loan includes proof of good credit history, full income documentation, confirmation of income and employment, liquidity requirements, and demonstration that the borrower will be able to make fully amortizing payments, including their ability to demonstrably absorb some interest rate shock. Only when these criteria are met does the borrower qualify for a prudently underwritten IO. These loans are typically subject to a 3/2/5 cap structure, which means the initial reset cannot change the interest rate by more than 3%, subsequent periodic resets cannot change more than 2%, and the lifetime maximum change is 5%. These are the criteria by which Union Bank underwrites an IO borrower today.

In addition, borrowers can benefit from IO features due to greater flexibility in the timing of curtailment payments than found in a typical amortization schedule.

In summary, it is our view then that interest only features should not automatically push a loan into Category 2.

Industry data supports a difference in performance between Hybrid IO ARMs and higher risk loans. Available data does indicate that IO losses are lower than option ARMs and other higher risk ARMs, such as 2/28 and 3/27 ARMs. CoreLogic, a mortgage and real estate industry data provider, was commissioned by Union Bank to independently produce data based on their vast industry performance database, including most of the top 20 mortgage servicers. It should be noted that Union Bank information is not included in CoreLogic's data and, therefore, Union Bank's better than average industry performance is not reflected within the noted CoreLogic industry information. The Bank's performance, depicted further below in this Comment Letter, has been and remains better than industry performance. The CoreLogic historical data below shows delinquency (any time a loan has been 60+ days delinquent ("ever 60+")) by vintage and LTV and over time by different years in the following groups:

1) Fixed Rate <=30 Yr Loans: fully amortizing fixed rate loans.

2) Hybrid ARMs (5/1, 7/1, 10/1): ARMs with amortizing fixed rate period to start (5, 7, or 10 years) then 1 year adjustable amortizing ARM afterwards.

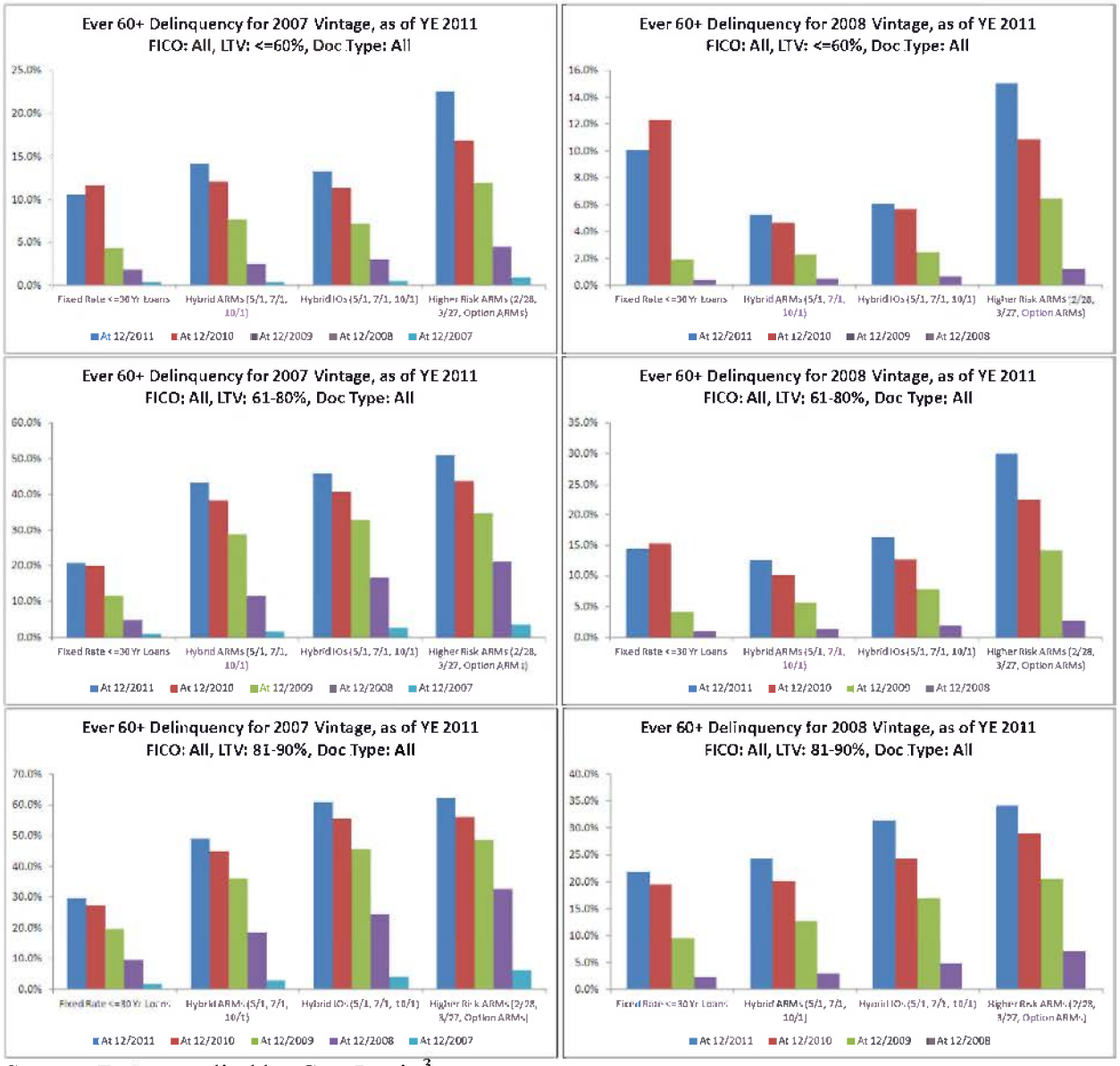
3) Hybrid IOs (5/1, 7/1, 10/1): ARMs with interest only fixed rate period to start (5, 7, or 10 years) then 1 year adjustable amortizing ARM afterwards.

4) Higher Risk ARMs (2/28, 3/27, Option ARMs): Option ARMS that offer multiple payments to the borrower, sometimes 4 different ones, 2/28 and 3/27 ARMs offer shorter interest only fixed rate period (2-3 years) which are typically followed with 6 month adjustable ARMs.

The graphs show specifically all FICO and income documentation types with LTVs grouped into <=60%, 61-80%, and 81-90%, for vintages 2007-2008. Performance is from December 2007 to December 2011.

UnionBank

FIGURE 1



Source: Data supplied by CoreLogic[3]

The graphs above in Figure 1 show that in the industry, at lower LTVs, there is not much performance difference between fixed rate loans and IO ARMs or Hybrid amortizing ARMs. In our view, this does not substantiate the proposed risk-weight differences at lower LTVs. As the LTVs move up to 61-80%, the performance is different for certain vintages (the 2007 and 2008 were originated in the middle of the financial crisis) and not for others, suggesting that risk-weight percentages could increase with LTV. This exercise, however, does

[3] Data was supplied by CoreLogic, based on industry data with deep history; CoreLogic's industry database encompasses most of the top 20 U.S. mortgage servicers and contains loan data back to 1999.

not normalize for credit quality, such as FICO score, which would further explain performance differences.

Union Bank's experience with originating IO loans has been highly successful. Union Bank fully underwrites each applicant, including reviewing borrower's liquid reserves, capacity, credit, and collateral. Our portfolio included roughly 70% of IO loans through the housing downturn; our delinquency rates for IO loans were lower than those of our peers and other institutions lending in California. We believe that our strong underwriting discipline has helped keep the delinquency and loss performance of this portfolio low. Union Bank's underwriting targets higher FICO and lower LTV mortgage loans, and demonstrates how credit factors outweigh product features in determining credit performance.

FIGURE 2

Union Bank Owned Mortgage Portfolio (Serviced in House)
As of July 31, 2012

	30+%	90+%	YTD Annualized NCL%	12 month Annualized NCL%	Average FICO
Fixed Rate Portfolio	2.27%	1.43%	0.24%	0.23%	747
ARM – Fully Amort Portfolio	2.82%	1.31%	0.22%	0.27%	747
ARM – Interest Only Portfolio	1.26%	0.78%	0.20%	0.19%	755

FIGURE 3

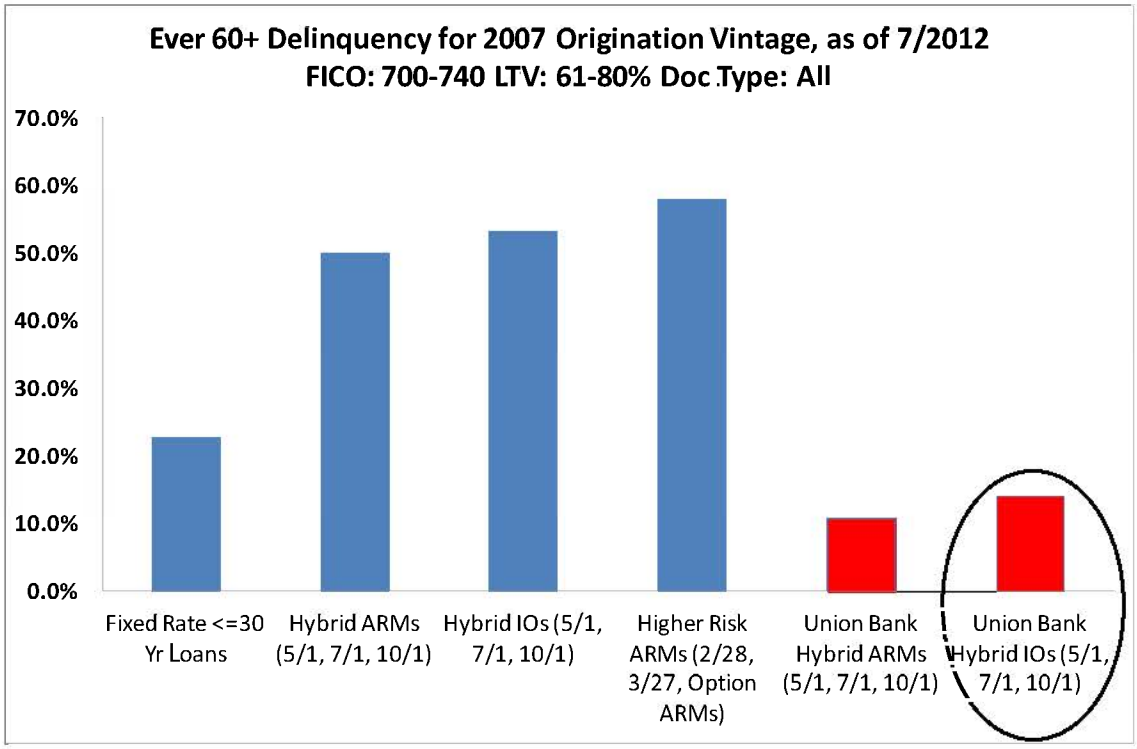
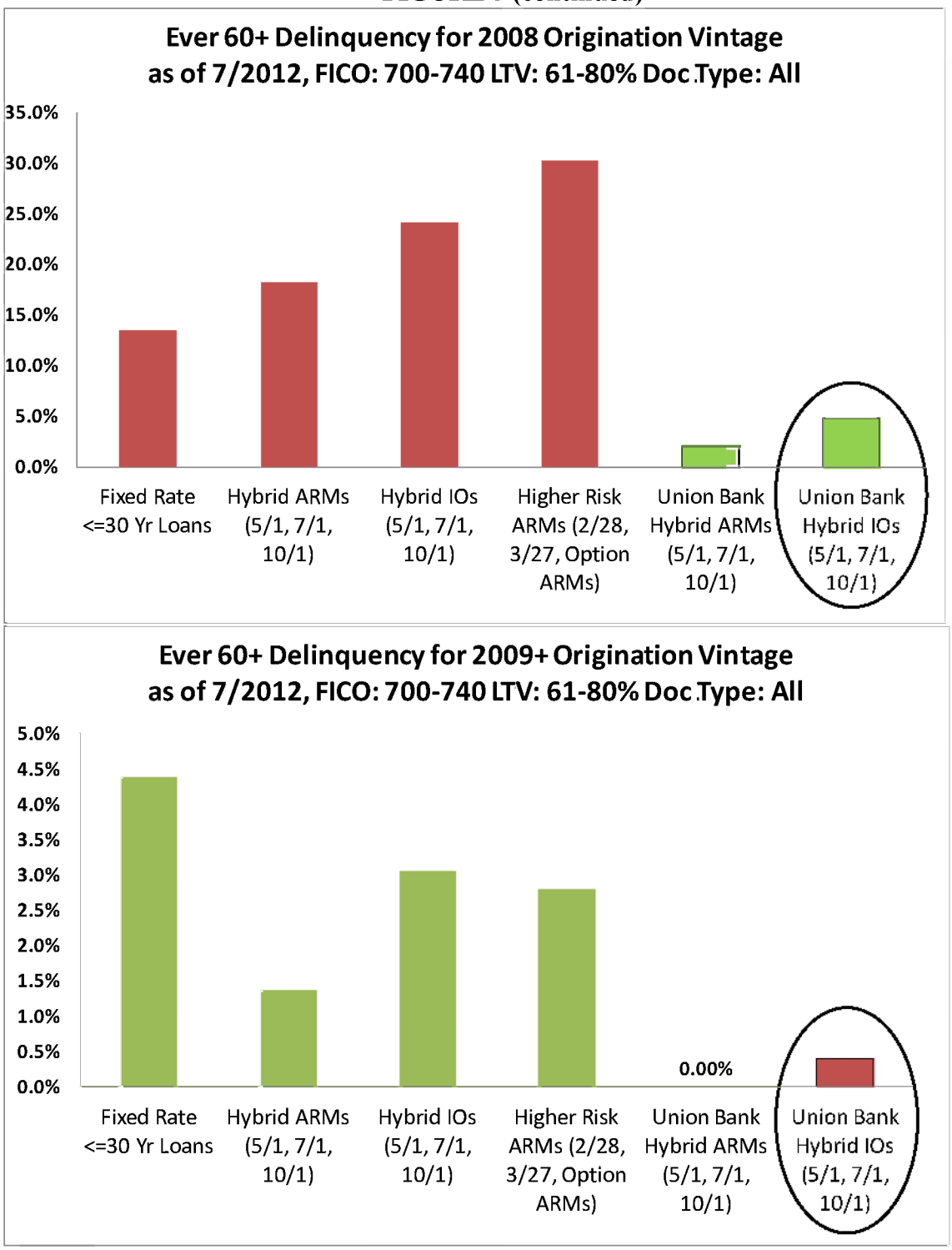


FIGURE 3 (continued)



Source: Data on left side of each chart is industry data provided to Union Bank by CoreLogic. Data on the right side of each chart is from Union Bank's own portfolio.

Other interest rate reset cap structures should be allowed under Category 1. The Standardized Approach NPR sets forth cap structures that are too prescriptive and are not consistent with industry practices or with Fannie and Freddie guidelines. Flexibility in determining interest rate cap structures is important because these features reduce risk to financial institutions from an interest rate risk perspective. Conforming Hybrid ARM loans, written to Fannie and Freddie's standards, typically are subject to a 5/2/5 cap structure. A 5/2/5 structure means that the initial interest rate reset cannot exceed 5%, any subsequent periodic reset cannot exceed 2%, and the maximum lifetime interest rate change is 5%. The 5/2/5 structure is standard in the industry today, but these would be treated under Category 2 in the Standardized Approach NPR as currently proposed. Similarly, jumbo ARMs with 3/2/5 cap structures should be allowed under Category 1. In a typical Hybrid ARM with an initial fixed period of 5-10 years, the borrower has many years to plan ahead for a possible rate increase and the associated payment increase. Restricting the maximum interest rate change on the initial reset to only 2% on a 10/1 Hybrid ARM may have some de minimis credit risk value but should not result in a doubling of risk-weighted assets if for example the initial reset is permitted to be 3%.

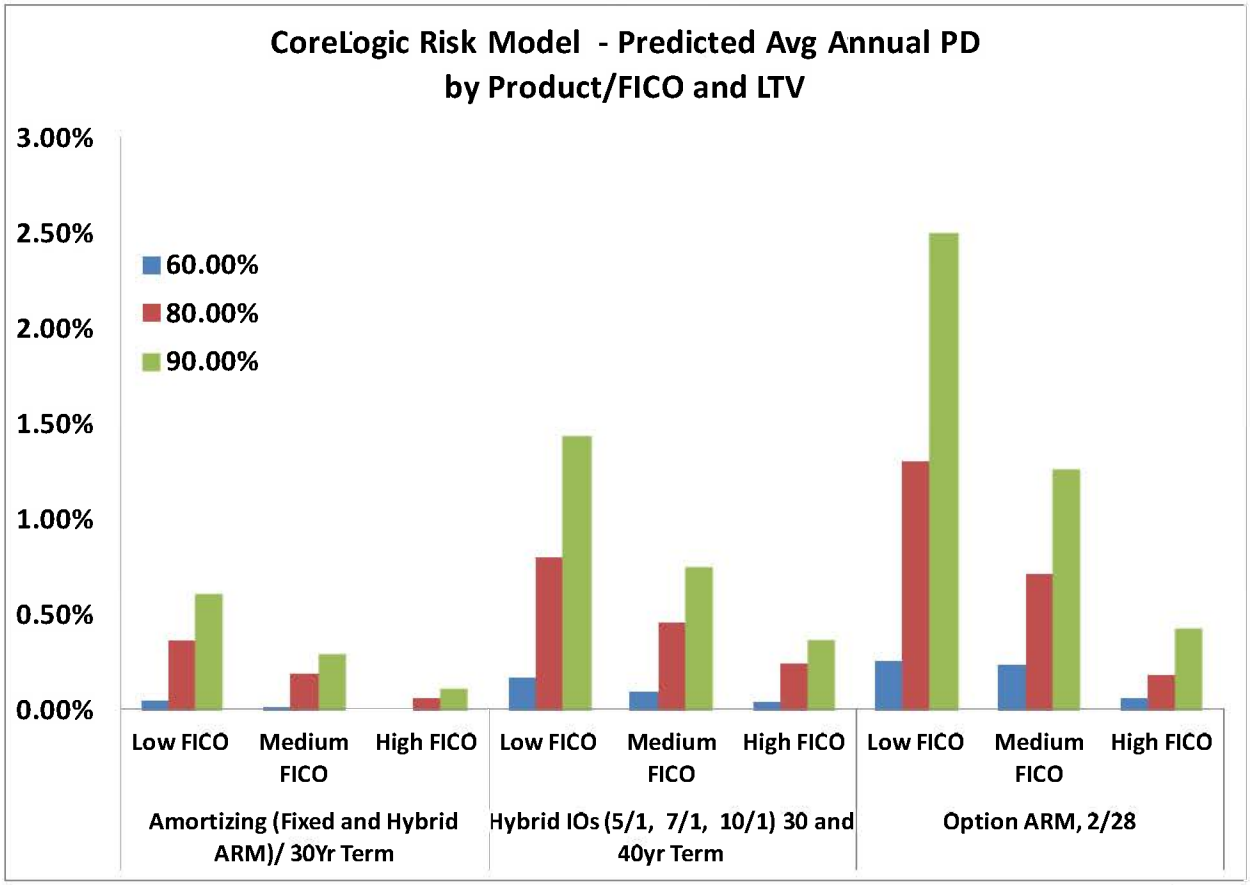
We disagree that 40-year loan products are significantly more risky than other loan offerings. For borrowers who qualify for several loan products, including for 30-year fully amortizing loans, obtaining a 40-year loan may be for them a better choice. The 40-year loan can provide lower payment benefits relative to other products with shorter terms. There is a relatively small difference in the amount of principal reduction over the first 5 or 7 years after origination when comparing a 40-year term loan to a 30-year term loan. This is the period during the life of a loan when default risk is the highest, indicating limited difference in the credit risk profile of these different terms, all other factors being equal. We agree that this does increase the expected average life of the loan, thus somewhat increasing the related risk. However, we do not feel that that this risk increase justifies 100% risk-weight in every case and would propose Category 1 or Category 1.5 classification as being more appropriate.

Given the concerns outlined above, including the many unintended consequences that may be associated with the implementation of the Standardized Approach NPR in its present form, we urge that the Agencies consider alternative risk-weighting proposals. Our first suggestion is that risk-weighting should expand the focus on credit to incorporate a borrower credit score, such as FICO. Union Bank's own experience points to the superiority of credit criteria over product features in determining credit performance. We suggest that risk-weighting should use a multi-factor approach. This approach would be closer to the intent of the Basel II and Basel III Advanced Approaches rules and guidance. We believe that the focus on LTV continues to be appropriate, because it is directly correlated to Loss Given Default ("LGD"), with some connection to Probability of Default ("PD"). However, LTV alone is not the only acceptable criterion. PD is driven more by borrower credit history, debt ratios, reserves, and other factors. Consumer credit scoring (such as with FICO) is a strong determinant of PD. Credit scores could be incorporated into the risk-weightings and would provide a more accurate assessment of the risk in a loan portfolio. This can be augmented with underwriting criteria, such as debt to income and the requirement to analyze the borrower's payment under a fully amortizing schedule in order to qualify for lower risk-weights.

We further recommend that the Agencies explore a Category 1.5 which includes Hybrid IO ARMs and fully amortizing 40-year term loans. This would leave fixed rate, non-balloon loans and hybrid fully amortizing 30-year ARMs in Category 1 and option ARM, 2/28, 3/27, balloon loans and other higher risk products in Category 2. This approach would more appropriately differentiate the risk of Hybrid IO ARMs from negatively amortizing loans and other high risk products.

An industry standard mortgage credit loss model, the CoreLogic Risk model, can be utilized to show how this might be implemented. This model is built on historic industry data that CoreLogic has collected back to 1999, and can predict default, loss, and prepayment under various interest rate and house price scenarios. Union Bank commissioned CoreLogic to independently run hypothetical loans through their model to estimate the difference in lifetime default between different loans, running through 14 different types of product/loan structures, along with different credit and loan size combinations. The results show clear risk differentiation across FICO, in addition to LTV and product features. The table in Figure 4 below shows the expected performance in the form of annualized probability of default ("PD").

FIGURE 4



Source: Model output produced independently by CoreLogic and results provided to Union Bank.[4]

[4] Probability of Default ("PD") estimates are created based on synthetic loans run through the CoreLogic Risk Model. Annual numbers are developed using the model's life of loan estimates

As demonstrated above, the data shows in general that for loans with LTVs at 60% or less, there is little default risk in the loan regardless of the structure being fixed rate, Hybrid ARM, or Hybrid IO ARM -- certainly not justifying the 100% risk-weight that a Hybrid IO ARM would face under the proposed Category 2. For LTVs 61-80%, risk of default does increase, but at a level we believe to be significantly lower than the proposed 100% risk-weight rate would suggest.

After reviewing this information, we suggest that a potential Category 1.5 could be created to contain risk-weights in between Category 1 and Category 2, increasing with LTV as the currently proposed categories do. Combined with our recommendation for the use of credit scoring (in this case low, medium, and high, based on defined ranges), we suggest a more refined borrower credit score, LTV, and product categorization.

An example of this new categorization is set forth below, with hypothetical risk-weights that we believe illustrate the relative relationships that risk-weights shuld have based on industry data and our own experience. In general, the absolute risk-weight percentages should be finally determined using a QIS, but we believe that for the lowest LTV's, and highest credit scores, that there should be only minimal difference in the risk-weights. Conversely, for high LTV's and low credit scores, there should be significant variation in the risk-weights.

FIGURE 5

Product	Category 1			Category 1.5			Category 2		
Property: LTV	Credit Score (e.g. FICO)								
	High	Medium	Low	High	Medium	Low	High	Medium	Low
<=60	25%	25%	50%	25%	35%	75%	75%	75%	100%
61-80	35%	50%	75%	50%	75%	85%	75%	100%	150%
81-90	50%	75%	100%	75%	85%	125%	100%	150%	200%
91+	75%	100%	100%	85%	125%	150%	150%	200%	200%
Products	Fixed rate and Amortizing loans			Interest Only ARMs, 40-year term loans			Option ARMs, 2/28, 3/27, balloon loans		

Although LTV and FICO are powerful determinants of credit performance, other underwriting guidelines are equally important. We recommend that the proposed rules include minimum standards regarding how borrowers are underwritten to adjustable and fixed rate loans for qualifying in a given FICO band category. These standards should account for debt ratio thresholds and stressed payments for ARMs to include amortizing principal and interest

---

(Lifetime PD/Average Life). Loans have fully documented income, FICO scores of 660, 720 and 800 and loan sizes from $120K, $350K, and $650K, and PD is averaged over all loans from each category. Model assumes a rising rate environment and slowly recovering housing market.

payments which also include taxes and insurance. Loans for non-owner occupied properties may require additional criteria. Mortgages that do not meet these criteria would shift into the next lower FICO category in recognition of the incremental risk or perhaps be classified within the next higher risk Category.

We provide the above-noted examples for enhancing risk-weight assignments only to make the point that there may be many ways to approach the risk-weightings which would be significant improvements from the currently proposed approach.

Turning from risk classification alternatives, we wish to make the following other points about the Standardized Approach NPR.

A Category 2 junior lien loan should not impact the treatment of a Category 1 first lien loan. The Standardized Approach NPR proposes treating all junior liens as Category 2 exposures, unless the same institution holds both the first and the junior lien loans and the combined first and junior lien total exposure meets all other Category 1 criteria. However, a Category 2 junior lien loan should not impact the treatment of a Category 1 first lien at the same institution. The proposed treatment would create a number of unintended consequences, discussed below, and would be detrimental to borrowers who prefer to maintain fewer banking relationships.

The capital required on a junior lien loan that "pulls" a Category 1 first lien at the same institution to Category 2 will in many cases be out of line with the incremental risk of the loan itself, which will encourage the origination of junior lien loans by an institution that does not hold the first lien. This is detrimental to both the bank and the borrower, and increases the overall risk in the financial system. By an institution underwriting both the first and junior lien loans, the institution has better insight into the risk profile of the borrower, and in the case of a delinquent or defaulted loan, eliminates any conflicts that may arise between lenders in different lien positions. This indicates that first and junior liens held by the same institution present less risk than when held by different institutions; unfortunately, the NPR discourages this behavior with potentially punitive capital treatment.

Further, we do not agree that all HELOCs should be classified as Category 2 assets. A recent study by the Federal Reserve Bank of New York presents data suggesting that wholesale classification of varied types of junior lien mortgages as Category 2 exposures is inappropriate.[5] This study showed that HELOCs were given primarily to the best quality borrowers, were underwritten to the credit quality of the borrower and not just the value of the home, and generally performed consistent with prime exposures. The study further found that HELOCs performed much closer to prime first liens, and that the timing of origination and the credit quality of borrowers appear to explain most of these differences.

[5] Donghoon, Lee, Mayer, Christopher & Tracy, Joseph, "A New Look at Second Liens," Federal Reserve Bank of New York Staff Report No. 569, 2012, available at http://www.newyorkfed.org/research/staff_reports/sr569.pdf.

There is a lack of clarity in the Standardized Approach NPR on how an asset classified under Category 2 can migrate to Category 1. Our understanding is that the Agencies intended that a loan could migrate from Category 2 to Category 1, but how such migration would occur is not clear from reading the NPR and we would request that this point be clarified. For example, if an IO loan reached the end of its IO period and all of its other characteristics qualified for Category 1, the loan should be classified then as Category 1. In addition, 40-year amortized loan was ten years seasoned and reached the point where it had less than 30 years until maturity, then it should be able to be treated as a Category 1 loan.

Similarly, the Agencies should allow greater ability to change categorization over the life of a loan. The NPR does not account for the ways that credit risk changes over the life of a loan. We propose that any loan that has been paying according to its contractual terms for a period of time, such as three years, can be treated as less risky and move to a lower risk-weighting category because it is past the peak height of the credit loss curve and the borrower has demonstrated the willingness and ability to pay.

There is a need for greater clarity related to documentation on income verification. The Standardized Approach NPR introduces a new method of assigning risk-weights to residential mortgage loans for classification into one of two categories. One of these factors relates to the measurement of documentation and income verification used for making a Category 1 determination, but these factors need to be clarified. We believe that how borrower income is documented is an important determinant of credit performance.

There should be exceptions from the more severe risk-weightings for loans qualifying for credit under the CRA. We recommend that loans that qualify for CRA credit should receive some exemption from the standard risk-weighted asset treatment as the CRA program exists to meet important public policy goals and institutions are significantly encouraged to make CRA loans, which are viewed by the Agencies as meeting standards of safety and soundness. Such treatment would be similar to the Home Affordable Modification Program ("HAMP") exemption to meet public policy goals already specified in the NPR. Higher risk-weightings necessarily will lead to higher consumer borrowing costs and reduced loan sizes, which particularly impacts CRA borrowers in high-cost geographies. We specifically recommend that there be a specific 50% risk-weighting for CRA loans to remain consistent with how they are treated under current regulation.

If CRA loans are not provided an exemption, the CRA loan market will be reduced because this business would be pushed to government/FHA loans, a consequence which is inconsistent with the Federal Housing Finance Agency's ("FHFA's") and the Administration's stated goals of reducing reliance on government subsidies. Without an exemption, implementation of the Standardized Approach NPR will result in the decline of the number of CRA loans being made, which would be injurious to those borrowers who are the country's hardest hit by the economic downturn. Borrowers residing in low to moderate income communities have the least amount of financial resources to qualify for low LTV Category 1 mortgages. Placing a capital premium on institutions offering CRA loans is counterproductive and could lead to either fewer loans being made available or institutions offering them at a higher cost.

If no changes to the NPR are provided, we urge that the Agencies permit grandfathering of existing loans under the previous capital treatments. Many loans that are on the books today will still be outstanding as of the anticipated time of implementation of the NPR, January 2015. The Standardized Approach NPR includes many new criteria that may push low risk loans into Category 2. Lenders need a "grandfathering" period to allow institutions to align their internal policies and product offerings with the finalized rules and avoid overly conservative treatment of loans failing to meet minor Category 1 criteria that were not known at the time of origination. Such low risk products include: ARM reset caps, 40-year loans, IO loans, full documentation loans; and certain HELOC products.

If the Agencies do not agree that grandfathering would be appropriate, there are other alternatives to the proposed implementation timeframe. The agencies, for example, could permit a longer "phase-in" period, which could reference other phase-in timeframes from Basel III NPR. We urge that the agencies consider a longer schedule for when the NPR becomes effective, much longer than the period contemplated in this NPR (proposal in June 2012, with a fully effective date in January 2015), perhaps to 2019.

II. Pension Plans

We turn to comments on the Basel III NPR. While we support the general components of the Basel III NPR, one of the particular elements in the proposal does not reflect a bank's economic liabilities, and will produce unintended adverse consequences. **Specifically, the proposal to include pension-related Accumulated Other Comprehensive Income ("AOCI") unrealized gains and losses in the qualifying capital for common equity tier 1 capital is not reflective of the true inherent risk associated with pension obligations; it increases capital volatility; and it significantly increases the cost for institutions to maintain pension plans for their employees.** We understand that this is not an issue for all institutions because many companies have stopped the practice of providing employee pension plans. It is, however, a significant issue for institutions that do have defined benefit pension plans, especially for institutions that have active pension plans and still offer employer-paid defined benefit retirement plans, such as Union Bank. The combined impact of (i) a new requirement to include unrealized gains and losses on defined benefit pension obligations within common equity tier 1; (ii) the subsequent need to manage volatility caused by related increases to capital; and (iii) existing funding requirements governing defined benefit pension plans, is likely to result in more institutions terminating their employer-sponsored defined benefit plans.

The pension plan component of the proposal impacts an institution's capital position by taking a point in time measurement of purported volatility on stated obligations, but the institution's ultimate liability for the pension plan can be more reliably estimated and is not volatile. The capital treatment of the pension plans should take a longer term view because an institution's commitment to its pensioners is for pay-outs over the long term. Union Bank's defined benefit pension plan obligation, for example, has an approximate duration of 16 years.

By way of background, the funding of pension plans is already governed and required under the Pension Protection Act and subsequent laws. There are specific rules requiring plan sponsors to fund pension plans or freeze benefits if funding drops below a certain level. Institutions with active pension plans must continue to fund the benefits for which they have made a commitment. A portion of the pension AOCI is amortized into net income each year based on the remaining service life of employees in the plan. Therefore, there is already an amount that is being recognized each year directly into Retained Earnings and included in the regulatory capital calculations. The balance in pension AOCI represents temporary differences that will be adjusted at the end of each year as rates move up and down, even though there is no substantial change in the ultimate potential obligation of the Bank to its retirees.

Pension AOCI is created when the assumed rates for the year are different than the actual rates at the end of each year. If rates go down from one year to the next, AOCI will decrease and the present value of the benefit obligation will increase, while the actual benefit to be paid to the participant will not change. The opposite happens in an increasing rate environment. This accounting treatment can result in significant changes to AOCI and capital requirements under the proposed rules on the last day of the fiscal year, even though there is no real change in what is required to settle the benefit obligation. The balance in AOCI is really just a temporary measurement of loss/gain as a result of primarily short term changes in interest rates for what is otherwise a long term obligation.

We urge exclusion of pension-related AOCI unrealized gains and losses from regulatory capital. We support the TCH/ASF comment letter and Associations letter, which both recommend selective exclusion from regulatory capital for unrealized gains and losses on available for sale ("AFS") securities whose changes in fair value are predominantly attributable to fluctuations in interest rates.[6] Consistent with that recommendation, pension-related actuarial gains and losses should be similarly excluded from regulatory capital as AOCI calculations are predominantly influenced by the applied discount rate assumptions which, in turn, are also driven by fluctuations in market interest rates. We note that other pension-related factors, such as mortality tables, change very little (e.g., 1% per year) compared to changes in discount rate assumptions. The TCH/ASF letter notes that based on a survey of Union Bank and eight other member banks, that the amount recorded in AOCI with respect to defined benefit pension plans is approximately six times more sensitive to changes in the discount rate than any other factor.[7] Thus, the pension AOCI is more sensitive to volatile market interest rates and less sensitive to other pension factors.

Further, U.S. GAAP accounting for pension-related actuarial unrealized gains and losses applies assumptions that are inconsistent since long-term plan liabilities are assessed utilizing a derived point in time discount rate tied to current prevailing interest rates. The applied discount rate is only established and updated once a year on the last day of the fiscal year, which generally coincides with the lightly traded period in December. The prevailing point in time rate environments can lead to material fluctuations in AOCI on the last day of the fiscal year under U.S. GAAP accounting treatment. Under the proposed rules, this would then

[6] TCH/ASF letter, Section II.A.1; Associations letter, Section II.A.2.
[7] TCH/ASF letter, Section II.A.1.

result in significant capital fluctuations which could change by the end of the subsequent year, with no changes in the funding requirements of the plan. Under the rules as proposed, we estimate that for Union Bank a 1% change in the discount rate would produce a $200 million, or an approximate 2%, change in tier 1 common capital.

In the event that the agencies are not inclined to eliminate pension related unrealized gains and losses from regulatory capital, we alternatively urge that amendments to the calculation of pension-related AOCI be considered.

We recommend that Projected Benefit Obligation ("PBO") be replaced by the Accumulated Benefit Obligation ("ABO") calculation. PBO includes future compensation increases, whereas ABO excludes them. Consistent with the Basel III NPR's proposed eligible inclusion of overfunded pension assets held at FDIC- insured institutions, where there is unfettered access to these funds in the event of receivership[8], Union Bank believes that the appropriate view for evaluating pension-related unrealized gains and losses should be an organization's ABO. The effects of future compensation increases should be excluded from inclusion in regulatory capital because they not only would not be paid in the cases of entering into receivership, they also are not knowable or determinable in receivership as those future salary increases will likely not be realized.

In summary, the pension components of the current Basel III NPR do not reflect the economic exposure of defined benefit pension plans and introduce unnecessary capital volatility, which is more due to interest rate fluctuations and less due to the true underlying economic risk exposure. This capital volatility will only be expressed once per year, when accounting rules require a discount rate update based on point in time market rates. Further, the reduction in capital called for by the Basel III NPR, if adopted in its current form, will very likely lead to more pension plan terminations by employers.

III. Securitizations

Union Bank strongly supports the key proposed amendments to the NPRs specific to the securitization framework outlined in the TCH/ASF letter and the Associations letter.[9] Union Bank, however, would like to emphasize certain issues and offer commentary complementary to the positions stated in these letters.

We recommend a cap on risk-based capital for securitizations and re-securitizations exposures at the amount of the exposure(s).[10] Given the increased capital to risk-weighted asset ratio requirements and more stringent qualifying capital requirements proposed in the Basel III NPR, it is prudent and appropriate, in our opinion, to assess a maximum equivalent dollar-for-dollar cap on the amount of required risk-based capital. The proposed 1250% required maximum risk-weight is not well-calibrated to the increased capital requirements associated with the NPRs. Calibration to 1250% risk-weight reflects calibration

[8] Basel III NPR, 77 FR 52818.
[9] TCH/ASF letter, Section III.A, and Associations letter, Section XI.
[10] TCH/ASF letter, Section III.A.1.

to an 8% capital requirement and failure to amend this requirement would result in institutions with greater than 8% total capital to total risk-weighted assets ratio to hold more than dollar for dollar capital against a particular securitization exposure.

De minimis re-securitization exposures held within CLO structures, defined to be less than 5% of the aggregate underlying exposure, should be excluded from the definition of a re-securitization under the Standardized Approach and Advanced Approaches final rules. Union Bank views the NPRs to be overly punitive in classifying collateralized loan obligations ("CLOs") with minimal amounts of structured product collateral as re-securitizations. A typical CLO structure allows asset managers to purchase a minimal amount of structured products in addition to bank loans as underlying collateral. CLO structures cap the amount of structured products that may be used as collateral to generally less than 5% of the aggregate underlying exposure. This uniquely distinguishes CLO re-securitizations as defined under the NPRs from re-securitizations in other asset classes whose underlying collateral is typically comprised of 100% structured products, which are often acknowledged to be of higher risk. In light of these considerations unique to CLOs, Union Bank strongly recommends de minimis re-securitization exposures held within CLO structures be exempted from the definition and from the due diligence requirements of a re-securitization.

Failure to meet strict due diligence requirements associated with securitization exposures should not disqualify CLO de minimis re-securitization exposures from the above-noted re-securitization classification exception. Two of the four operational due diligence analysis requirements specifically identified in the Standardized Approach NPR and Advanced Approaches NPR require assessments of "(2) relevant information regarding the performance of the underlying credit exposure(s)" and "(4) for re-securitization exposures, performance information on the underlying securitization exposures" [11] at acquisition and periodically thereafter. CLOs are not Securities and Exchange Commission ("SEC") registrants; they are issued as private placements. If a CLO invests in a de minimis amount of a second CLO backed exposure, granular data regarding the underlying assets in the second indirectly held CLO tranche is not available.

Specifically, CLO asset managers provide collateral performance data, including delinquencies and bankruptcies, and cash collections of principal and interest from the collateral, to a CLO deal trustee. The trustee prepares the distribution report for the bondholders. The distribution report includes the amount of principal and interest due to the bondholders and all of the collateral performance data. If the bonds are SEC registered, then the trustee will post the distribution report publicly, as well as submit it to the SEC, as required. However, if the bonds are private placements, and not SEC registered, then the trustee will only provide the distribution reports to bondholders of record. In the cases where banks invest in CLOs that contain de minimis CLO re-securitization collateral, they would not be recognized as bondholders of record and disclosure of non-SEC registrant information would represent a breach of a trustee's fiduciary responsibility.

[11] Standardized Approach NPR, 77 FR 52916; and noted as consistent in the Advanced Approaches NPR, 77 FR 52989.

As proposed, the Simplified Supervisory Formula Approach ("SSFA") and Supervisory Formula Approach ("SFA") require modifications, including the following modifications:

The proposed 1250% maximum risk-weight should be replaced with the risk-weight corresponding with fully phased-in proposed total capital requirement of 10.5%, or 952% allowing for transition arrangements consistent with the Basel III Numerator NPR.[12] We recommend replacement of the proposed maximum risk-weight of 1250% associated with an 8% total capital requirement under the 1988 Basel Capital Accord, with the proposed minimum total capital requirement plus conservation buffer requirement of 10.5% applying transition arrangements consistent with the transition arrangements provided for in the Basel III NPR. This would be the inverse of 10.5%, or 952%. Union Bank also recommends that the calibration of the maximum risk-weight percent be revisited in conjunction with expected future rule making involving capital surcharges specifically associated with domestic and global systemically important financial institutions ("D-SIFIs" and "G-SIFIs," respectively).

The constant "p" parameter of 0.5 associated with securitizations should be applied throughout the calculation of the SSFA involving CLO exposures which include de minimis CLO re-securitization exposure, consistent with the definition and argument set forth above. Applying the constant 1.5 "p" parameter associated with re-securitization exposures as compared to that of 0.5 associated with securitizations is overly punitive given the comparatively lower risk nature of CLOs to other re-securitization asset classes as demonstrated through historical performance.[13]

The inability for some banks to access information required to calculate the SSFA, as noted above, due to confidentiality and other legal restrictions creates inequities across U.S. institutions. Under the proposed rules, banks lacking access to information required to support portions of their calculation of their securitization exposures subject to the SSFA approach are required by default to apply the maximum risk-weight of 1250%. Non-market making banks lack access to some of the required information for CLOs which contain re-securitization collateral. This lack of access may be attributed to the trustee acting to protect the exemption under the Securities Act of 1933[14] for private placements and thereby disclosing information only to pre-qualified participants and parties with whom there is a pre-existing relationship, or complying with contractual confidentiality restrictions prohibiting disclosure of investment strategies and other sensitive information. These banks without access to the required information would face higher capital requirement assessments as compared to larger market making firms which do have access to the required information necessary to perform the SSFA calculation.

---

[12] Union Bank endorses the transitional arrangements as put forth in the Associations letter, noted in Table B-1, page B-10.

[13] See, Associations letter, references in Section XI.B.1, loss performance through the 2008 financial crisis, citing Moody's Investor Services, CLO Interest 4 (Jul. 2012).

[14] 15 USC Section 77a.

The securitization framework fails to recognize "soft credit support," as noted in the Associations letter.[15] We strongly urge that amendments to the SSFA calculation be adopted to address the following areas of concern:

- **There is a failure within the securitization framework to provide recognition for the credit support provided by excess interest**. Excess spread, which is the positive difference between interest received on the securitization's underlying assets and interest paid to the securitization's investors (plus fees and funding costs), is not only a key component of credit support in securitization structures, it is the first source of credit enhancement used. This is extensively used within auto and credit card ABS deals, as well as with CLO transactions. Excess spread can be redirected to other parts of the capital structure to support interest shortfalls; captured to fund reserve accounts to absorb credit losses; and, in some cases (e.g., CLOs, credit card ABS), used to pay down note principal directly.

- **There is a lack of recognition for the carrying value of a securitization position in determining its attachment point.** Calculations of attachment points within the SSFA framework assume that the securitization investments are carried at par or face value. If the securitization investments are purchased at a discount, the losses on the bonds would be realized at a point higher than the original structural attachment point. In other words, the bonds can absorb additional realized losses up to the amount of the purchase discount before the bank itself realizes any losses.

We further recommend that the Agencies allow for the application of the SSFA approach and optional implementation of the SFA for non-mandatory Advanced Approaches banks. The Agencies state in the preamble to the Advanced Approaches NPR that they expect banking organizations to use the SFA, rather than the SSFA, "in all instances where data to calculate the SFA is available."[16] The Advanced Approaches NPR further requires that a banking organization be able to "explain and justify (*e.g.*, based on data availability) to its primary federal regulator any instances in which the banking organization uses the SSFA rather than the SFA for its securitization exposures." For a non-mandatory Advanced Approaches bank that is already constrained by the Standardized Approach after considering the requirements under the Collins Amendment of the Dodd-Frank Act, a requirement to implement additional technology-based solutions and business processes to support the SFA approach would be burdensome, come at additional cost, and presumably the SSFA calculation would produce a more conservative (i.e., higher) regulatory capital requirement.

Union Bank strongly endorses the recommendations put forth in the TCH/ASF letter and the Associations letter for limiting and clarifying the definition of securitization

[15] Associations letter, Section XI.E.3.

[16] Advanced Approaches NPR, 77 FR 52991.

exposures. We specifically wish to comment, however, on the exclusion of limited or partial guarantees (as opposed to pro-rata guarantees) associated with commercial and industrial ("C&I") loans and commercial real estate ("CRE") loans and on the proposed exclusion of loan exposures to private equity funds for bridge or capital subscription lending purposes from the definition of securitizations.

Union Bank respectfully argues for the explicit exclusion of limited guarantees of C&I loans and CRE loans from the definition of traditional or synthetic securitizations. We support the comments made by the American Bankers Association in its letter on the supervisory view of commercial loans with limited guarantees as synthetic securitizations and the comments put forth in the Associations letter.[17] The proposed definition of a securitization leaves open to question whether C&I and CRE loans with limited guarantees are viewed to be synthetic securitizations under the following circumstances: (i) all or a portion of the credit risk of one or more underlying exposures is transferred to one or more third parties through the use of one or more credit derivatives or guarantees (other than a guarantee that transfers only the credit risk of an individual retail exposure); (ii) the credit risk associated with the underlying exposures has been separated into at least two tranches reflecting different levels of seniority; (iii) the performance of the securitization exposures depends upon the performance of the underlying exposures; and (iv) all or substantially all of the underlying exposures are financial exposures (such as loans, commitments, credit derivatives, guarantees, receivables, asset-backed securities, mortgage-backed securities, other debt securities, or equity securities).

The NPRs, consistent with prior Basel II final rules, note that the "securitization framework is designed to address the tranching of the credit risk of one or more underlying exposures and is not designed, for example, to apply to tranched credit exposures to commercial or industrial companies or nonfinancial assets."[18] Despite these explicit references, Union Bank has received informal guidance from regulators that limited (partial) guarantees are considered to be credit risk tranching under the Basel II final rules, and therefore, presumably also would be treated as credit risk tranching under the proposed rules, indicating that such exposures might be covered under the securitization treatment. We acknowledge that the regulators have indicated they will be providing additional guidance on this matter, but in its absence, we believe that it is important to discuss a number of factors in support of our position that limited (partially) guaranteed loans are not securitizations, specifically:

- There is an explicit carve-out for C&I and CRE loans in the NPRs, stating that "the securitization framework is designed to address the tranching of the credit risk of

[17] Letter dated August 22, 2012 from the American Bankers Association to the OCC, Federal Reserve Board and the FDIC re: "Supervisory View of Commercial Loans with Limited Guarantees on Synthetic Securitizations;" see, also, the Associations letter, Section XI.A.

[18] Standardized Approach NPR, 77 FR 52914, and Basel II final rules, 72 FR 69327.

financial exposures and is not designed, for example, to apply to tranched credit exposures to commercial or industrial companies or nonfinancial assets."[19]

- Portions of the synthetic securitization definition do not apply to the situation represented by a limited guarantee of a C&I and CRE loan in that:

    - The guarantors of such loans are generally closely related to the borrower (e.g., the owner of the company, the sponsor of the real estate project, etc.). Although these parties are not the same legal entity as the borrower, it seems unreasonable to consider these related parties to be "third parties" as noted in the description of a synthetic securitization[20] because the guarantor's creditworthiness is highly correlated to that of the obligor's.

    - The underlying exposures of a limited (partially) guaranteed C&I or CRE loan are NOT financial assets, but are real assets usually consisting or real estate, plant, property and equipment, inventory and cash.

- Requiring CRE and C&I loans with limited guarantees to be handled under the securitization treatment produces illogical results especially under the Advanced Approaches NPR. If these exposures were to be treated as synthetic securitizations and the guarantee is deemed ineligible, which would be the case in many CRE and C&I loans, then the synthetic securitization rules would give no credit for the risk mitigation provided by such guarantees and the result is punitive. It is unreasonable for the Agencies to give no benefit at all for the credit risk mitigation provided by the limited guarantee, while at the same time affording credit to a pro-rata partial guarantee through the wholesale treatment[21] since pro rata guarantees provide a lesser economic benefit than that of a limited guarantee covering the same portion of an exposure.

- Lastly, we note that a potential unintended consequence of including partial guarantees on C&I and CRE loans in the classification of securitizations could incent institutions to forgo obtaining partial guarantees, or to obtain structurally weaker pro rata guarantees, in order to avoid more punitive securitization treatment. The result of this is the encouragement of more weakly structured loans.

IV. **Calculation of Capital Conservation and Additional Buffers**

Union Bank strongly supports the proposal that banking organizations subject to, either as a mandatory bank or voluntary opt-in bank, the Advanced Approaches Rule must calculate

[19] Standardized Approach NPR, 77 FR 52914, and noted as consistent in the Advanced Approaches NPR, 77 FR 52989.

[20] Standardized Approach NPR, 77 FR 52915, and noted as consistent in the Advanced Approaches NPR, 77 FR 52989.

[21] Advanced Approaches NPR, 77 FR 53022, proposed §___.134 Guarantees and Credit Derivatives: PD Substitution and LGD adjustment approaches.

their capital conservation buffer using advanced approaches total risk-weighted assets.[22] Union Bank recognizes and supports the Agencies' premise to enact an approach which promotes establishment of capital conservation buffers in a manner comparable across foreign jurisdictions. Union Bank also recommends that this approach be extended to the D-SIFI, G-SIFI, and countercyclical capital buffers, if enacted in the future.

V. Summary

For the foregoing reasons, we respectfully request that the Agencies consider our proposals, as summarized in the Executive Summary at pages 2-3 of this Comment Letter. Union Bank appreciates having the opportunity to comment on these important NPRs and thanks the Agencies for their consideration of these comments. If it would be helpful to discuss these issues with us or if there is any additional information that you would like us to provide, please contact Kerry Massey, SVP Capital Manager, at (213) 236-6098.

Respectfully submitted,

UNION BANK, N.A.

John F. Woods, my

John F. Woods
Chief Financial Officer

Cc:
Masashi Oka
President and CEO

[22] Basel III NPR, 77 FR 52804.