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January 16, 2024

Board of Governors of the Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue, NW  
Washington, DC 20551  
Attention: Ann E. Misback, Secretary  
Docket No. R-1813  
RIN 7100-AG64

Office of the Comptroller of the Currency  
400 7<sup>th</sup> Street, SW  
Suite 3E-218  
Washington, DC 20219  
Attention: Chief Counsel's Office, Comment Processing  
Docket ID OCC-2023-0008  
RIN 1557-AE78

Federal Deposit Insurance Corporation  
550 17<sup>th</sup> Street, NW  
Washington, DC 20429  
Attention: Comments /Legal OES, James P. Sheesley, Asst. Executive Secretary  
RIN 3064-AF29

Re: Capital Rule Proposal – Basel III Endgame (the “Proposed Rule”)

Ladies and Gentlemen:

Pentalpha Surveillance, LLC (“Pentalpha Surveillance”) is in the corporate conflict supervision and remediation business. For the term of an institutional credit instrument, we are hired at the urging of investment fiduciaries to verify that lenders, collectors, deal parties, key vendors and underwriters have implemented their operational duties to the standards and bias described in their engagement contracts. If they haven't, our engagement contract specifies the breath of our authorities to remediate their operational failures. We provide additional services as well.

Pentalpha Surveillance and its affiliates have been engaged by individual securitization trusts, financial institutions, institutional investors and agencies of the U.S. Government. Pentalpha Surveillance's platform utilizes specialized compliance checking software and a team of industry operations specialists focused on loan origination and servicing oversight, with engagements in surveillance, valuation, collections optimization, representation and warranty failures, derivative contract errors, litigation resolution, expert testimony and other advisory assignments.

Pentalpha Surveillance fulfills the role of the operating advisor and asset representations reviewer in many securitization transactions, as required by the Dodd Frank legislation. Our deal volume, credit product expertise, operational insights and corporate ownership independence are notable and distinguishing features.

We are writing to express our concern about the Proposed Rule, particularly as it would reduce the consistent availability of low-cost consumer, corporate and mortgage loans to credit-worthy borrowers. The Proposed Rule will likely result in a material change in the macro-lending landscape and drive-up lending rates to borrowers. Additionally, it will likely damage loan and bond investors on existing and future holdings due to reduced trading liquidity. As “under the hood”

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operational supervisors millions of loans for decades, we have a unique perch. We have observed first-hand the negative effects of rapidly increasing borrowing costs has on corporations, consumers and property investors.

Many originators of corporate, mortgage and consumer loans finance their loan portfolios via securitization. Banks are foundational players in the securitization market, not only because they securitize their own loans, but because they invest in and act as market-makers for other party's asset-backed securities ("ABS"). They are frequently advancing the attributes of robust global financial markets. Regulatory changes that make it much more costly for banks to participate in that market will make securitizations a much more costly form of corporate, mortgage and consumer loan financing. Long term, those loans will likely become more and more expensive and less available. As the banks reduce their commitment to the securitized product market, it is likely that lower capitalized, conflicted and less regulated foreign and domestic parties will fill the void. Sadly, it is our experience that many (but not all) of those are short-term oriented and less committed to building a robust, structured bond market.

We have reviewed the comment letter on the Proposed Rule submitted by the Structured Finance Association ("SFA"), and generally agree with its findings and recommendations. Pentalpha Surveillance is a member of the SFA. We would like to emphasize two points that are particularly relevant.

First, many mortgage and consumer loans are financed by their originators under warehouse financing facilities. Each of these warehouse facilities is a securitization-like exposure for banks, which results from the transfer of the loans to a securitization special purpose entity that borrows the funds from a bank to purchase those loans. The bank's warehouse loan is a securitization exposure against which the bank must hold regulatory capital. Because of its higher p-factor, the proposed SEC-SA calculation method would require banks to hold significantly more capital against their warehouse securitization exposures than they do now. If the Proposed Rule is implemented, warehouse financing interest rates will likely increase substantially, resulting in higher borrowing costs for consumers, corporations and property owners.

Second, banks act as market makers and investors in ABS. The Proposed Rule, including SEC-SA, would apply regardless of whether a bank holds ABS in its trading book or in its banking book. The Proposed Rule's significantly higher capital charge for these positions could compel banks to demand a higher return on the ABS that they hold and/or reduce their market making participation in securitizations.<sup>1</sup> Higher interest rates, decreased liquidity, and a smaller investor base for ABS will likely result in more expensive and less available credit for consumers, corporations and property owners.

We are not aware of any public policy objective that supports the Proposed Rule's added costs and burdens. Rather, as the SFA letter points out, statements from the Banking Regulators consistently point to the success of current regulatory capital rules, stress tests, and enhanced supervisory programs in ensuring that U.S. banks are sufficiently capitalized.

As a sizable, daily participant in the securitization market in a supervisory role only, we see no economic evidence suggesting that the securitization product has become more risky or volatile since the current regulatory capital rules were implemented. In fact, many favorable securitization-related regulatory changes have gone into effect in recent years that have collectively made the securitized product significantly stronger. Notably, the CFPB was created to act as a first-in-

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<sup>1</sup> Banks also earn fee and commission income when they act as underwriters of ABS. The proposed operational risk capital requirement would impose a new capital requirement on such fee and commission income, which could lead banks to charge higher fees and commissions, thus increasing the cost of issuing ABS and, ultimately, the cost of mortgage and consumer loan credit. As the SFA's comment letter points out, the resulting costs are not outweighed by any benefit. The Federal Reserve's own study shows that such fee and commission income does not bear a statistically significant relationship to a bank's operational risks.

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line regulator for consumer lending/collecting, and their impact on the finance community's operational practices has been material and favorable. On top of that stronger operational foundation, there has been significant advancement in the alignment-of-interest principles found in credit facilities via risk retention, extensive rating agency reform, loan-level asset disclosures, and more stringent requirements for underlying asset reviews.

From our perspective, the NPR lacks robust data or sufficient explanation supporting the proposed significant increases in risk weights for securitization exposures. As a result, we are unable to fully understand and respond to the Banking Regulators' reasoning. However, the negative implications of the Proposed Rule are clear to us, and we hope that this letter will prompt the Banking Regulators to reconsider their approach.

We are grateful for your energy to continually analyze and socialize potential credit market enhancements, but we urge the Banking Regulators to reconsider the severity of the proposed changes and the long-term impact of moving our economy's lending apparatus to less stable ground.

Thank you for the opportunity to provide these comments on the Proposed Rule. Please feel free to contact us if you have any questions or if you would like to discuss our comments further.

Sincerely yours,



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Jim Callahan  
Executive Director  
Pentalpha Surveillance, LLC