Structured Finance Industry Group

July 12, 2018

Department of Treasury, Office of the Comptroller of the Currency (Docket ID OCC-2018-0009)

Federal Reserve System (Docket No. R-1605; RIN 7100-AF04)

Federal Deposit Insurance Corporation (RIN 3064-AE74)

Re: Regulatory Capital Rules: Implementation and Transition of the Current Expected Credit Losses Methodology for Allowances and Related Adjustments to the Regulatory Capital Rules and Conforming Amendments to Other Regulations

The Structured Finance Industry Group ("SFIG")[1] appreciates the opportunity to respond to the notice of proposed rulemaking by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation (together, the "Agencies"). Among other things, the proposal would revise the Agencies' regulatory capital rules to identify which credit loss allowances under the new accounting standard are eligible for inclusion in regulatory capital and to provide banking organizations the option to phase in the day-one adverse effects on regulatory capital that may result from the adoption of the new accounting standard.

SFIG is a member-based trade industry advocacy group focused on improving and strengthening the broader structured finance and securitization market. SFIG's core charge is to support a robust and liquid securitization market, recognizing that securitization is an essential source of funding for the real economy. We would like to take this opportunity to address the current redundancy of capital requirements within the financial system given the linkage between accounting and regulatory treatment.

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[1] SFIG is a member-based, trade industry advocacy group focused on improving and strengthening the broader structured finance and securitization market. SFIG provides an inclusive network for securitization professionals to collaborate and, as industry leaders, to drive necessary changes, be advocates for the securitization community, share best practices and innovative ideas, and educate industry members through conferences and other programs. Members of SFIG represent all sectors of the securitization market, including issuers, investors, financial intermediaries, law firms, accounting firms, technology firms, rating agencies, servicers, and trustees. Further information can be found at www.sfindustry.org.

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Current Landscape of Accounting and Regulatory Capital Treatment

Existing accounting rules which completely ignore the contractual transfer of risk create a situation where duplicative and redundant capital and loan loss reserves are held by banks. We would like to take this opportunity to share our concerns regarding the linking of such treatment to accounting consolidation. Prior to the financial crisis, accounting rules, which previously allowed for off-balance sheet treatment of sponsored transactions, were subsequently amended to require that such transactions be consolidated when issuers possessed control and held a potentially significant economic interest in the entities. These accounting rules, known as ASC 860 (FAS 166) and ASC 810 (FAS 167), although adopted post-crisis, were conceived of and proposed pre-crisis, and were designed in response to the Enron situation and the use of special purpose entities to hide certain activities. The Financial Accounting Standards Board ("FASB") implemented FAS 166 and FAS 167 to ensure open recognition of transactions on the face of the balance sheet, but did not address the concept of risk transfer in securitization structures.

Nevertheless, following the financial crisis, U.S regulatory agencies elected to link regulatory risk-based capital treatment (a risk transfer concept) to accounting-based consolidation (a recognition and disclosure concept) decisions. As a result, regardless of the particular history of an issuer, the economics of a funding transaction, or the level of risk transfer that had been achieved and contractually agreed upon by all parties, regulators would assume that any transaction where an issuer maintained control and held a retained interest would be subject to step-in risk and, therefore, receive no capital relief. We would highlight, however, that when the new regulatory capital regulations were implemented, transitional relief was given to those issuers who had not supported their securitization trusts despite their bonds getting downgraded and the associated threats to their funding programs. We believe it to be counterintuitive for regulators to then remove capital relief from such issuers.

In short, the regulatory assumption is that no risk has been transferred to investors in securitization transactions. We believe this assumption is incorrect considering the enormous losses that investors suffered during the crisis and the significant global regulatory response subsequent to the crisis to prevent recurrence of such losses. These erroneous assumptions create additional and duplicative capital requirements and reduce the amount of funding available to the real economy. While we acknowledge that during the financial crisis there were some instances of issuers/sponsors "stepping in" to support transactions, we would reiterate that this did not happen in the majority of cases and that risk was transferred and investors took losses. The risk-based capital rules, which link GAAP accounting and regulatory accounting, fail to recognize the levels of risk transfer or appropriately analyze the facts and circumstances of a transaction. This results in an overly punitive one-size-fits-all approach based on accounting recognition and disclosure considerations rather than appropriate risk-based capital criteria.

We would further highlight that any attempts to associate "implicit support" risk with past market actions is erroneous. Following the proposals of accounting standards FAS 166 and FAS 167, many industry participants, notably issuers and sponsors, asked the Agencies for guidance on how regulatory capital treatment would be treated following accounting consolidation. No such guidance was forthcoming. In the context of issuers and sponsors being forced by the Agencies to operate with zero knowledge of the future risk-based capital standards, it is not surprising – in the face of such a sizeable recession – that action to support trusts in support of liquidity considerations were taken. Had the Agencies been clear that any form of future risk-based capital relief might be forthcoming, then it is highly probable that trusts would not have been supported to the same degree. We do not believe any significance should be assigned to actions that were largely taken in an environment where accounting and regulatory frameworks conflict, especially when such conflict is perpetuated by a lack of clarity and decision-making by the prudential regulators.

The linkage of GAAP treatment and risk-based capital treatment is also demonstrated by 12 CFR 3.41, "Operational Requirements for Securitization Exposures," which is generally considered to make transactions such as Fannie Mae and Freddie Mac's credit-risk transfer ("CRT") transactions difficult, if not impossible, to be successfully employed by U.S. banks. We note that the Federal Housing Finance Agency recently proposed a rule on "Enterprise Capital" that would expressly take the CRT transactions into account in determining the required amount of required capital at Fannie Mae and Freddie Mac. The CRT program of Fannie Mae and Freddie Mac is universally considered as one of the great innovations in post-crisis financial technology and it is unfortunate that the banking regulations have not caught up to the reality.

SFIG recommends that there be an appropriate separation between GAAP consolidation treatment and determination of regulatory capital treatment. Using accounting treatment to determine required levels of capital is an example of applying the considerations of one discipline to completely different regimes. SFIG believes that regulatory capital levels should not be based on accounting treatment, but rather should be based solely on step-in risk, and that regulatory capital considerations should be divorced from GAAP treatment. Transactions should be separately evaluated for risk and related regulatory capital requirements –

accounting rules should not be at play in this determination. SFIG strongly encourages an appropriate recognition of risk transfer, and understands that many market participants are supportive of the European Banking Authority's significant risk transfer framework.

SFIG welcomes opportunities to work with the Agencies to make important modifications to the way in which regulatory capital is calculated. If you have any questions about this response, please contact Sairah Burki, Head of ABS Policy, at Sairah.Burki@sfindustry.org or (202) 524-6302.

Sincerely,

Sairah Burki

Sairah Burki
Head of ABS Policy
Structured Finance Industry Group