June 18, 2026

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Attention:
Benjamin W. McDonough
Secretary
Docket Nos. 1887, R-1888, 1889
RINs 7100-AH20, 7100-AH21, 7100-AH22

Federal Deposit Insurance Corporation
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Washington, DC 20429
Attention:
Robert Meiers
Regulatory Counsel
RINs 3064-AF29, 3064-AG23

Office of the Comptroller of the Currency
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Suite 3E-218
Washington, DC 20219
Attention: 1557-0318 and 1557-0247
Chief Counsel's Office
Docket IDs OCC-2026-0265, OCC-2026-0034
RINs 1557-AF52, 1557-AF49

Re: Regulatory Capital Rule: Category I and II Banking Organizations, Banking Organizations With Significant Trading Activity, and Optional Adoption for Other Banking Organizations, 91 Fed. Reg. 14952 (March 27, 2026) ("NPR 1")

Regulatory Capital Rules: Regulatory Capital and Standardized Approach for Risk-Weighted Assets, 91 Fed. Reg. 15332 (March 27, 2026) ("NPR 2", and collectively with NPR 1, the "NPRs")

Ladies and Gentlemen:

The Structured Finance Association (the "SFA") appreciates the opportunity to respond to the request of the Agencies[1] for comments on the proposed amendments to the regulatory capital rules (the "Proposed Rules") set forth in the above-referenced NPRs.

SFA's mission is: *"To help its members and public policy makers grow credit availability and the real economy in a responsible manner."*

SFA is a consensus-driven trade association with over 370 institutional members representing the entire value chain of the securitization market. By facilitating the responsible issuance and investing of loans and securities, the market provides trillions of dollars of capital to

[1] We refer to the Board of Governors of the Federal Reserve System (the "Federal Reserve"), the Office of the Comptroller of the Currency (the "OCC"), and the Federal Deposit Insurance Corporation (the "FDIC"), collectively, as the "Agencies."

consumers and businesses in communities across the country. SFA members include issuers and investors, broker-dealers, rating agencies, data analytic firms, law firms, servicers, trustees, and accounting firms. As such, unlike many other trade associations, before we take any advocacy position our governance requires us to achieve consensus by agreement rather than majority vote, ensuring the perspectives of all our diverse membership are included. This diversity is our strength, as it builds healthy tension in arriving at our consensus position. Because of this, we are methodical and thoughtful as we analyze the pros and cons of regulatory proposals before we reach a mutually acceptable position.

SFA previously submitted comments on January 16, 2024 in response to the prior notice of proposed rulemaking titled "Regulatory Capital Rule: Amendments Applicable to Large Banking Organizations and to Banking Organizations with Significant Trading Activity, 88 Fed. Reg. 64028 (Sept. 18, 2023) (the "Prior NPR"). SFA appreciates the efforts of the Agencies to address certain concerns raised by industry participants during the comment period related to the Prior NPR. The Proposed Rules reflect meaningful responsiveness to several issues identified by SFA and other commenters. The modifications reflected in the Proposed Rules demonstrate a constructive dialogue between the regulatory community and market participants, and SFA commends the Agencies for their willingness to reconsider aspects of the original proposal contained in the Prior NPR.

However, significant issues remain that require further modification before the Proposed Rules should be adopted in final form. In particular, the Proposed Rules continue to contain provisions that, with respect to certain securitization exposures, would increase capital requirements beyond what is warranted by the underlying risk, increase borrowing costs for consumers and businesses in those circumstances, and place U.S. banking organizations at a competitive disadvantage relative to their international peers operating under the Basel framework as implemented in other jurisdictions.

SFA urges the Agencies to give careful consideration to the specific recommendations set forth in this letter. Without further recalibration, the Proposed Rules risk undermining the very markets that provide critical financing to the real economy, reducing liquidity in a manner that is inconsistent with the regulatory objectives of safety, soundness, and efficient capital allocation. SFA stands ready to engage further with the Agencies to achieve a final rule that appropriately balances prudential objectives with the continued functioning of securitization markets.

Table of Contents

This letter begins with an Executive Summary and Introduction and is thereafter organized as follows:

TABLE OF CONTENTS

Page

Executive Summary 5

Introduction 8

Our Recommendation 10

I. Sponsor-Provided Guarantees Should Not Automatically Disqualify Treatment as a "Securitization" 10

II. The Agencies Should Clarify That Banks May Rely on the BCC 13-2 Interpretive Framework for Paragraph (8) of the Traditional Securitization Definition 12

III. Senior Resecuritizations Should Not Be Subject to a Punitive 100% Risk Weight Floor; At a Minimum, (A) Senior Re-securitization Exposures Where Underlying Securitization Exposures are also Senior and (B) Financing of Servicer Cash Advance Receivables Should Be Exempt 13

IV. Originating Banks of Synthetic Resecuritizations Should be Able to Disregard the Purchased Protection and Risk-Weight the Underlying Exposures as if the Resecuritization Did Not Occur 15

V. Routine Changes in the Fair Value of Underlying Credit Exposures Should Not Cause the Characterization of a Transaction to Toggle Between the Securitization and General Credit Risk Frameworks 15

VI. New Definition of "eligible prepaid credit protection arrangement" 17

VII. Certain Parameters in the Proposal Should be Modified 19

- **A. The Final Rule, like the 2023 Proposal, should clarify that "current dollar" means "outstanding principal balance" in determining the attachment point (A) and detachment point (D) of securitization exposures of underlying exposures with contractual principal amounts.** 19
- **B. SEC-SA Treatment of Defaulted Exposures as Excess Collateral (Incorporating A, D, K_G, and K_A Adjustments)** 19
- **C. FHA/VA/FFELP/USDA and similar guaranteed exposures should be expressly excluded from the numerator of the W parameter.** 20
- **D. The positive current exposure of interest rate and exchange rate derivatives should not be included in the calculation of K_G.** 21
- **E. K_G and W should not double count delinquent exposures in the calculation of K_A** 21

VIII. The Agencies Should Clarify That Definitions of "regulatory residential real estate exposure" and "regulatory commercial real estate exposure" Permit Banks to Evaluate Underlying Assets as if the Bank Had Originated the Loan 21

TABLE OF CONTENTS
(continued)

Page

IX. Commitments, Unconditionally Cancelable Commitments and Credit Conversion Factors (“CCFs”) for Commitments 22

X. The final rule **should permit consideration of exposure-level factors in the assessment and determination of investment grade for certain securitization - like exposures.** 22

XI. Other Provisions of the Proposed Rules Should Be Removed or Adjusted 234

- **A. For the purposes of determining risk weights applicable to securitization exposures backed by regulatory retail exposures, the aggregate limit and granularity limit criteria should be measured at the pool level.** 24
- **B. Where there is no pari passu exposure, the Proposed Rules should permit the use of a derivative contract’s exposure at default as an alternative method for determining tranche size.** 24
- **C. Where the delinquency status of a portion of underlying exposures is unknown, a subpool approach is reasonable.** 25
- **D. Question 68 of NPR 1 and Question 42 of NPR 2 regarding minimum payment thresholds under credit default swaps and whether there should be changes.** 26
- **E. The definition of an eligible clean up call should be further expanded to include clean up calls that may be exercised with contemporaneous regulatory consent or upon adverse regulatory guidance..** 26
- **F. The Agencies should retain a cap on the maximum capital requirement for securitization exposures similar to § 217.141(d) of the capital rule.** 27

Conclusion 28

Executive Summary

The Proposed Rules are a significant improvement from the Prior NPR, but should be further revised in several respects.

- SFA commends the Agencies for their willingness to reconsider aspects of the original proposal contained in the Prior NPR and appreciate that the modifications reflected in the Proposed Rules demonstrate a constructive dialogue between the Agencies and market participants.

- After carefully reviewing the Proposed Rules, SFA believes the Proposed Rules should be modified further in several respects.

Sponsor-Provided Guarantees Should Not Automatically Disqualify Treatment As A "Securitization"

- SFA respectfully requests that the Agencies delete the newly-added word "solely" from paragraph (3) of the definitions of traditional securitization and synthetic securitization.

- Finalizing these definitions in their current form would violate the Administrative Procedure Act's (APA) change-in-position doctrine because the Agencies have not displayed awareness of the regulatory changes resulting from the new definitions or demonstrated a reasoned basis for those changes.

- The proposed shift does not fully reflect long-standing practice where securitization treatment is based on economic substance (not form), recognizes that limited recourse features (e.g., reps, servicing, guarantees) do not meaningfully alter reliance on underlying assets, and is in-consistent with established policy (e.g., risk retention) that appropriately uses sponsor "skin in the game" to align incentives without warranting punitive capital treatment.

- The proposed addition of "solely" fails to account for significant industry reliance on the current definitions, introduces ambiguity regarding scope without articulating a clear policy concern, and, despite being framed as a clarification, creates confusion that suggests a potentially unintended narrowing of transactions historically treated as securitizations.

- The APA requires that an Agency provide the public with a meaningful opportunity to comment on the basis for its proposed rule. That dialogue cannot occur here because the proposed rules provide no explanation for the Agencies' change in policy on what counts as securitization.

- Retaining "solely" creates inconsistency between the rule text and preamble (which acknowledges expected limited recourse) and may undermine safety and soundness by discouraging prudent credit protection.

- SFA is prepared to work constructively with the Agencies to refine the definition to better capture transactions where performance is driven by underlying exposures while accommodating structures with limited credit enhancement features.

The Agencies should clarify that banking organizations may rely on the BCC 13-2[2] interpretive framework for purposes of paragraph (8) of the traditional securitization definition.

Resecuritizations

- Senior resecuritizations should not be subject to a punitive 100% risk weight floor. The new 100% risk weight floor is unnecessarily punitive for many senior resecuritizations, especially in light of the 1.5 p-factor that already accounts for the heightened complexity and correlation risk inherent in resecuritization exposures. The stated rationale is that resecuritizations exhibit "heightened correlation risks inherent in the underlying securitization exposures." This is not true for many resecuritizations, particularly senior tranches, and does not account for the protective effect of subordination and other credit enhancement in well-structured resecuritizations.

- Originating banks of synthetic resecuritizations should be able to disregard the purchased protection and risk-weight the underlying exposures as if the resecuritization did not occur.

Routine changes in the fair value of the underlying credit exposures should not cause the characterization of a transaction to toggle between the securitization and general credit risk frameworks.

- The treatment suggested under footnotes 165 of NPR 1[3] and 77 of NPR 2[4] would create significant practical and policy concerns for securitization structures. In determining the amount of the underlying credit exposures, credit tranching and information reflected on servicer reports, most securitization transactions look at the principal amount of the exposures. It is unusual in most transactions to have a periodic valuation of the underlying exposures to determine the current fair value of the collateral. As a general matter, underlying credit assets in a securitization are not fair valued, and requiring such valuations would be extremely difficult, if not impossible, to implement.

- SFA urges the Agencies to enable a banking organization to determine at the inception of a securitization transaction that the application of the securitization framework is appropriate and routine changes in the fair value of the underlying credit exposures would not warrant classification changes. This approach avoids unnecessary operational burdens while preserving the prudential objectives of the securitization framework.

[2] BCC Bull. 13-2 (Mar. 21, 2013), https://www.federalreserve.gov/bankinforeg/basel/files/bcc1302.pdf
[3] NPR 1, 91 Fed. Reg. at 14994.
[4] NPR 2, 91 Fed. Reg. at 15353.

SFA supports the proposed reduction of the risk-weight floor from 20% to 15% for securitization exposures that are not resecuritization exposures.

- SFA affirmatively supports this recalibration, which more appropriately reflects the risk profile of senior securitization exposures and is consistent with the Basel standards. SFA urges the Agencies to retain this proposed reduction in the Final Rule.

We support the new definition of "eligible prepaid credit protection arrangement," subject to certain clarifications regarding the loss-recognition trigger under Criterion 7 and the treatment of CLN fair values for GAAP purposes.

Other recommended changes:

- The Final Rule, like the 2023 Proposal, should clarify that "current dollar" means "outstanding principal balance" in determining the attachment point (A) and detachment point (D) of securitization exposures.

- SEC-SA parameters should not include defaulted underlying exposures that serve as excess collateral.

- FHA/VA/FFELP/USDA and similar guaranteed exposures should be expressly excluded from the numerator of the W parameter under the proposed SEC-SA.

- The positive current exposure of interest rate and exchange rate derivatives should not be included in the calculation of K_G in light of the operational complexity and burden detailed in this letter

- K_G and W should not double count delinquent exposures in the calculation of K_A.

- Definitions of "regulatory residential real estate exposure" and "regulatory commercial real estate exposure" should be clarified to confirm that banks may evaluate underlying assets as if the bank had originated the loan.

- The final rule should permit consideration of exposure-level factors in the assessment and determination of investment grade for certain securitization-like exposures.

- The definition of an eligible clean up call should be further expanded to include clean up calls that may be exercised with contemporaneous regulatory consent or upon adverse regulatory guidance.

- The Agencies should retain a cap on the maximum capital requirement for securitization exposures similar to § 217.141(d) of the capital rule.

Introduction

While SFA acknowledges that the modifications reflected in the Proposed Rules demonstrate a constructive dialogue between the regulatory community and market participants, and SFA commends the Agencies for their willingness to reconsider aspects of the original proposal contained in the Prior NPR, SFA believes the Proposed Rules should be modified further in several respects. If adopted without revisions, the Proposed Rules could have negative impacts on securitization and, by extension, on the availability of affordable credit to consumers and businesses in the United States. They would also risk harming the international competitiveness of U.S. banks and hinder their ability to manage their credit risks.

The proper determination of bank regulatory capital requirements is one of the most important and challenging aspects of economic policy. Capital requirements help to ensure the stability and solvency of our banking system, and they have a direct impact on the terms under which credit is extended and to whom credit is extended.

Securitization is essential for our economy for many reasons, including the following:

- **Supports credit availability and growth:** Securitization provides cost-efficient funding that underpins consumer and business lending and broader economic activity.
- **Reflects structural risk mitigants:** Credit enhancement and bankruptcy remoteness improve credit quality and should be recognized to avoid overstating risk.
- **Enables efficient risk distribution:** Pooling and tranching facilitate diversified risk transfer and more effective capital allocation across investors.
- **Promotes liquidity and pricing efficiency:** Converting loans into tradable securities broadens the investor base and supports competitive funding costs.
- **Supports bank funding and risk management:** Capital requirements directly affect banks' ability to fund, intermediate, and manage credit risk through securitization.
- **Avoids unintended credit constraints:** Excessive or misaligned capital can raise costs, reduce market participation, and limit credit availability, undermining safety, soundness, and efficient capital allocation.

The securitization market has undergone significant regulatory reforms since the adoption of Basel III. We note that the Agencies incorporated SSFA into the capital rule in 2013. Since that time, the regulatory environment in which securitization operates in the United States has changed considerably. Most notably, the requirements of Regulation RR[5] (credit risk retention) became effective beginning December 24, 2015, for all asset-backed securities backed by residential mortgages, and beginning December 24, 2016, for all other classes of asset-backed securities. As the Agencies and the other regulators observed when they adopted Regulation RR,

[5] Credit Risk Retention, 12 C.F.R. § 244 (2014).

that rule was a significant, but not the only, part of a much larger legislative and regulatory effort to improve securitization and lessen its risks:

> the credit risk retention requirements of section 15G are an important part of the legislative and regulatory efforts to address weaknesses and failures in the securitization process and the securitization markets. Section 15G also complements other parts of the Dodd-Frank Act intended to improve the securitization markets. Such other parts include provisions that strengthen the regulation and supervision of nationally recognized statistical rating organizations (NRSROs) and improve the transparency of credit ratings; provide for issuers of registered asset backed securities offerings to perform a review of the securitized assets underlying the asset-backed securities and disclose the nature of the review; require issuers of asset-backed securities to disclose the history of the requests they received and repurchases they made related to their outstanding asset backed securities; prevent sponsors and certain other securitization participants from engaging in material conflicts of interest with respect to their securitizations; and require issuers of asset-backed securities to disclose, for each tranche or class of security, information regarding the assets collateralizing that security, including asset-level or loan-level data, if such data is necessary for investors to independently perform due diligence.[6]

In addition to the changes in the capital rule and the market reforms described above, starting in 2013, the largest banks have been subject to annual stress testing under the Comprehensive Capital Analysis and Review ("CCAR") and the stress capital buffer ("SCB"). Among other things, the stress tests evaluate whether banks have sufficient capital to continue operations through times of economic and financial market stress. This quantitative evaluation was supplemented by qualitative supervisory assessments. As the Federal Reserve noted:

> In part due to the revised regulatory capital rules, the Federal Reserve's stress testing program, and enhanced supervisory program, the largest banking organizations supervised by the Federal Reserve have more than doubled their common equity capital in aggregate since 2009.[7]

Other trade groups have submitted comments regarding broader concerns with the NPRs. SFA shares many of these groups' concerns, particularly those expressed in the letter submitted by the Bank Policy Institute, the American Bankers Association, the Financial Services Forum, and the U.S. Chamber of Commerce.

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[6] *See* Credit Risk Retention, 79 Fed. Reg. 77602, 77605 (Dec. 24, 2014). Indeed, regulatory reforms continue to this day. *See, e.g.,* Prohibition Against Conflicts of Interest in Certain Securitizations, SEC Release No. 33-11254 (Nov. 27, 2023).

[7] *See Stress Tests*, BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/supervisionreg/stress-tests-capital-planning.htm (last updated June 22, 2022).

The primary focus of this letter is on the proposed changes to the securitization framework. Accordingly, this letter contains comments and suggestions regarding aspects of the Proposed Rules that apply to securitization.

Our Recommendation

We recommend that the Agencies modify the Proposed Rules as set forth in this letter.

I. Sponsor-Provided Guarantees Should Not Automatically Disqualify Treatment as a "Securitization"

The NPRs add the word "solely" to the definitions of both "traditional securitization" and "synthetic securitization" to require, in paragraph (3) of each definition, that "[p]erformance of the securitization exposures depends solely upon the performance of the underlying exposures."[8] SFA respectfully requests that the Agencies not adopt these new definitions of traditional securitization and synthetic securitization for several reasons.

First, the Agencies have provided no justification for this change to regulatory definitions of securitization. It is hornbook APA law that modifying a regulation requires that an agency "'display awareness that it is changing position' and 'show that there are good reasons for the new policy.'"[9] That reasoned explanation must, at minimum, account for "facts and circumstances that underlay or were engendered by the prior policy" as well as any "serious reliance interests" at stake.[10] Failure to explain a change in position is grounds to set aside a regulation as arbitrary and capricious.[11]

Here, the proposed rules would change existing policy. The addition of "solely" in the text of the rules narrows the definitions of "securitization" to encompass transactions in which, among other requirements, performance of the exposures depends only on performance of the underlying exposures. That is a departure from the current performance requirement under which the designation of an exposure as a securitization exposure has long been guided by the economic substance of the transaction, rather than its form, where it is not unusual to have some recourse in securitization transactions.

Yet the preambles to the NPRs do not "display awareness" of this significant proposed change that would scope out a large number of transactions that qualify as securitizations today—much less "show that there are good reasons" for the change.[12] Indeed, language in the preambles suggests that the Agencies recognize that some recourse is expected in securitization transactions. For example, virtually all securitization transactions have servicer and trustee obligations, and often have some limited recourse or credit support from the sponsor of the transaction. The

[8] *See* NPR 1, 91 Fed. Reg. at 15275; NPR 2, 91 Fed. Reg. at 15404.
[9] *Encino Motorcars, LLC v. Navarro*, 579 U.S. 211, 221 (2016) (quoting *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009)); *see also Food & Drug Admin. v. Wages & White Lion Invs., L.L.C.*, 604 U.S. 542, 570 (2025).
[10] *Encino Motorcars*, 579 U.S. at 222.
[11] *Id.*
[12] *Id.*

unexplained departure from that policy in the regulatory text would, if adopted, be arbitrary and capricious.

Further, the designation of an exposure as a securitization exposure has long been guided by the economic substance of the transaction, rather than its form. It's not unusual to have some recourse in securitization transactions. Examples include representations and indemnities, servicing obligations and limited credit recourse.

Some securitization transactions (e.g., mortgage warehouse facilities) may include a sponsor or originator guarantee; however, repayment is driven by the performance of the underlying receivables. The bank underwrites the securitization on the basis that, if the receivables are originated as represented and serviced in accordance with required standards, collections will retire the securitization debt without recourse to the guaranty. While the presence of a guarantee introduces nominal recourse, it does not represent a meaningful source of repayment or credit support. Rather, such provisions primarily serve to align the incentives of the sponsor or originator with those of the lender or investor.

Indeed, the Agencies are among the group of joint regulators that have adopted the risk-retention rules pursuant to Section 941 of the Dodd-Frank Act. In adopting the risk retention rules, the Agencies recognized that it is appropriate to require a securitization originator/sponsor to have "skin in the game" to align the incentives of the originator/sponsor with those of the bank lender/investor. The capital rules should not prohibit, undermine or reduce the efficacy of this alignment of incentives.

In addition to the circumstances that support the current definitions of securitization, the Agencies have not considered the considerable industrywide reliance interests at stake. The addition of "solely" would create confusion for banks on the scope of the "securitization" definitions. We note that the GSIBs recently completed an ERBA QIS and calculated that the impact of the change in the definition of securitization increases RWA for the eight GSIBs by $83 billion. This is further evidence that the addition of the word "solely" is not merely a "clarification." The Agencies haven't articulated what concerns they have that merit this proposed change.

The "solely depends" standard creates a definitional rigidity that disqualifies transactions whose economics are driven by the underlying pooled financial exposures. This definitional rigidity discourages lenders from accepting economically sound credit support (such as limited guaranties or originator performance obligations) that reduce, rather than increase, the risk to the bank. It creates cliff effects in which functionally identical structures receive materially different capital treatment depending on whether minimal corporate credit support is present.

The APA requires that an agency provide the public with a "meaningful opportunity to comment" not only on the text of a proposed rule but also on "the basis for its proposed rule."[13]

[13] *FBME Bank Ltd. v. Lew*, 209 F. Supp. 3d 299, 312 (D.D.C. 2016).

"An agency commits serious procedural error when it fails to reveal portions of the technical basis for a proposed rule in time to allow for meaningful commentary."[14]

Where, as here, the proposed rules contemplate significant changes to regulatory definitions, the meaningful-opportunity standard requires that the public have the ability to respond to the agency's analysis of the "facts and circumstances that underlay or were engendered by the prior policy" as well as any "serious reliance interests" at stake.[15] But without a reasoned explanation for the Agencies' proposed departure from longstanding policy, SFA and the public have no meaningful opportunity to assess the proposal, test its premises, and offer informed alternatives.

Safety and soundness considerations also merit the deletion of the word "solely." Keeping "solely" would create a disconnect between risk and capital requirements, discourage banks from accepting recourse, and incentivize banks to remove sponsor accountability from a securitization even where the sponsor guarantee is not a meaningful source of repayment. Banks would be encouraged not to take additional credit support when available, leading to banks taking more risk.

We're assuming that the Agencies may be seeking to ensure the definition of securitization captures structures where performance is driven primarily by the underlying exposures, rather than the creditworthiness of a counterparty. To the extent there are concerns regarding how the current definition may be applied in practice, SFA would welcome the opportunity to engage constructively with the agencies to help refine the definition to address those concerns. In that context, replacing "solely" with "primarily" may better align with this objective while continuing to accommodate structures that include credit enhancement features beyond the underlying assets, where the performance of those assets remains the principal driver of the transaction's overall credit risk.

II. The Agencies Should Clarify That Banks May Rely on the BCC 13-2 Interpretive Framework for Paragraph (8) of the Traditional Securitization Definition

The traditional securitization framework generally applies to exposures to entities with material liabilities that are not operating companies and whose underlying exposures are all, or substantially all, financial exposures, unless the primary Federal supervisor determines that the exposure is not a traditional securitization based on the transaction's leverage, risk profile, or economic substance. This supervisory discretion is grounded in paragraph (8) of the definition of "traditional securitization," which provides that the applicable Agency may determine that a transaction in which the underlying exposures are owned by an investment firm that exercises substantially unfettered control over the size and composition of its assets, liabilities, and off-balance sheet exposures is not a traditional securitization based on the transaction's leverage, risk profile, or economic substance.[16]

SFA respectfully requests that the Agencies confirm that, for purposes of paragraph (8), banking organizations may rely on the existing interpretive framework reflected in FRB staff

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[14] N. *Am.'s Bldg. Trades Unions v. Occupational Safety & Health Admin.*, 878 F.3d 271, 301 (D.C. Cir. 2017).
[15] *Encino Motorcars*, 579 U.S. at 222.
[16] *See* NPR 1, §___.2 (definition of "traditional securitization," paragraph (8)); NPR 2, §___.2 (same).

guidance BCC 13-2, which states that FRB staff would recommend that an exposure to an investment firm not be considered a traditional securitization under paragraph (8) if the investment firm satisfies the five criteria set forth in BCC 13-2. Specifically, SFA requests confirmation that: (i) where an investment firm exercises "substantially unfettered control" under the BCC 13-2 criteria, a banking organization may treat its exposure as an equity exposure or corporate exposure, as applicable, based on a rebuttable presumption arising from satisfaction of the BCC 13-2 criteria, without requiring the Agency to affirmatively exercise paragraph (8) authority on a transaction-by-transaction basis; and (ii) where an investment firm does not exercise "substantially unfettered control" under the BCC 13-2 criteria, a banking organization may treat the exposure as a traditional securitization exposure, provided the remaining definitional elements are satisfied. This clarification would further paragraph (8)'s intent to distinguish actively managed investment firms from static or constrained securitization pools by relying on the established BCC 13-2 criteria, rather than case-by-case supervisory determinations that are difficult to operationalize, could delay routine financing activity, and may lead to inconsistent classifications. The Agencies would retain full authority to review a banking organization's application of the criteria and to rebut the presumption where facts and circumstances indicate the criteria are not met in practice or the classification would be inconsistent with the transaction's economic substance.

III. Senior Resecuritizations Should Not Be Subject to a Punitive 100% Risk Weight Floor; At a Minimum, (A) Senior Re-securitization Exposures Where Underlying Securitization Exposures are also Senior and (B) Financing of Servicer Cash Advance Receivables Should Be Exempt

The Proposed Rules would introduce a new 100% risk weight floor for resecuritization exposures.[17]

The NPRs state that the 100% risk weight floor for resecuritizations "is intended to capture the greater complexity of such exposures and heightened correlation risks inherent in the underlying securitization exposures."[18] The NPRs explain that:

> The proposed 100 percent supervisory risk-weight floor for resecuritization exposures is intended to capture the greater complexity of such exposures and heightened correlation risks inherent in the underlying securitization exposures.

This is not true for many senior resecuritizations. In fact, many senior resecuritization exposures have no greater correlation risk than the underlying securitization because the subordination provided by junior tranches absorbs the correlation-driven losses. The stated rationale also does not account for the protective effect of subordination and other credit enhancement in well-structured resecuritizations.

As a result, the new 100% risk weight floor would be unnecessarily punitive for senior resecuritizations, especially in light of the 1.5 p-factor for resecuritizations. The greater 1.5 p-factor already effectively imposes a penalty capital charge on resecuritizations to take into account any potentially greater complexity and correlation risk. Applying a 100% floor on top of the

[17] *See* NPR 1, §___.133(a)(4); NPR 2, §___.44(a)(4).
[18] *See* NPR 1, 91 Fed. Reg. at 15000.

elevated p-factor results in a cumulative capital charge that is disproportionate to the actual risk of many resecuritization positions.

We note that risk retention rules now apply to the original securitization, the resecuritization or both. Origination standards and disclosure standards have been improved since the global financial crisis. Lenders who provide backleverage to securitization investments generally have access to all of the pertinent transaction information. Finally, the SEC-SA formula already adequately requires additional capital for mezzanine and junior tranches.

For example, if a bank were to provide a loan with a 75% advance rate backed by a high quality senior securitization exposure, it is illogical that the risk weight should go from 15% on the underlying securitization to 100% when there is effectively less risk in the bank's resecuritization position. A 100% risk weight floor for resecuritizations can be disproportionate to the actual risk. For example, senior re-securitization exposures where underlying securitization exposures are also senior should be exempt from the 100% risk weight floor.

In addition, to finance their servicer advances, RMBS servicers often pool their servicer advance receivables in an SPE which then issues senior variable funding notes ("Senior VFNs") to third-party lenders. This transaction is structured to be bankruptcy remote, with the SPE's obligations secured solely by and payable solely from the cash flows from the reimbursements of servicer advances in the RMBS transactions. Because the servicer advance receivables are securitization exposures and are re-tranched in a separate traditional securitization (the VFN transaction), the resulting Senior VFNs are resecuritization exposures for the Senior VFN-holding bank under both the current capital rule and the Proposed Rules. The Proposed Rules would impose a 100% floor on the risk weight that a bank lender would be required to assign to the Senior VFN. Given the seniority of the bank lender's claims in the Senior VFN transaction and the seniority of the underlying Servicer Advance receivables in the related RMBS transaction, this 100% floor requirement is disproportionate to the actual risk. This would be similarly true for many high quality resecuritization transactions.

Servicer advance resecuritization transactions are typically short tenor, senior in the cash flow waterfall and supported by predictable reimbursable collections. With a 100% risk weight floor, it will be more difficult and expensive for servicers to obtain financing for their advances, thus making it more difficult for them to make such advances to investors. This would not only limit the ability of mortgage servicers to provide future forbearance in times of need (as they did during the COVID pandemic), but it would also increase servicing costs and ultimately mortgage borrowing costs.

This adverse impact on the cost and availability of Servicer Advances would have serious real-world impacts. During the COVID-19 pandemic, the demand for P&I Servicer Advances surged as banking regulators encouraged forbearance for affected borrowers. While banks stepped in to provide Senior VFN funding for Servicer Advances to help with the strain, the Proposed Rules' 100% resecuritization risk weight floor would reduce the amount and increase the cost of Servicer Advances. This would not only limit the ability of servicers to provide future forbearance relief in times of need, but it would also increase mortgage servicing costs and, as a result, mortgage borrowers' costs.

IV. Originating Banks of Synthetic Resecuritizations Should be Able to Disregard the Purchased Protection and Risk-Weight the Underlying Exposures as if the Resecuritization Did Not Occur

Section 41(b) of the existing capital rules (Operational Criteria for Synthetic Securitizations) provides that if the applicable conditions are satisfied, a bank that transfers the risk of underlying exposures in a synthetic securitization via a credit risk mitigant "may" recognize the use of the credit risk mitigant for risk-based capital . In other words, the bank has the option, not a requirement, to treat the transaction as a synthetic securitization exposure.

Unlike the treatment of securitizations, resecuritizations would not have this option under the Proposed Rules. NPR 1 and NPR 2 provide that unlike in the case of a securitization exposure that is not a resecuritization exposure, the proposal would not provide the option for a banking organization to elect to treat a resecuritization exposure as if the underlying exposures had not been re-securitized because a resecuritization "may not offer similar risk reduction or diversification benefits". This premise is flawed, particularly in the case of synthetic securitizations, where obtaining a credit risk mitigant to hedge a portfolio of securitizations can only provide a benefit to the banking organization, and does not directly change the risk profile of the underlying securitization exposures. The Proposed Rules would discourage hedging and depart from the well-established principle that obtaining a credit risk mitigant should not increase the risk-based capital associated with the hedged exposures.

Denying sponsoring banks the ability to elect to treat resecuritization exposures based on the underlying assets represents an inconsistent and overly conservative departure from the treatment afforded to synthetic securitizations under Section 41(b). Mandatory recognition of the resecuritization unnecessarily penalizes the banking organization by resulting in a higher risk-weighted asset amount than would apply to the underlying securitization exposures themselves.

V. Routine Changes in the Fair Value of Underlying Credit Exposures Should Not Cause the Characterization of a Transaction to Toggle Between the Securitization and General Credit Risk Frameworks

Under the capital rules, a transaction qualifies as a securitization exposure in part because the credit risk of the underlying exposures has been "separated into at least two tranches reflecting different levels of seniority."

Footnotes 165 of NPR 1[19] and 77 of NPR 2[20] read as follows:

> For example, assume a covered banking organization extends a loan to a bankruptcy remote special purpose entity which holds financial exposures (including equity securities) and the fair value of the underlying financial assets exceeds that of the loan. Under this transaction, the underlying financial exposures are pledged as collateral to the lender. As the excess collateral would initially absorb any losses arising from non-payment on the loan (after which the covered banking organization would be exposed to

[19] *Id.* at 14994.
[20] NPR 2, 91 Fed. Reg. at 15353.

> any subsequent losses), the loan would generally be viewed as tranched and could qualify as a securitization exposure under the proposal, if the transaction satisfies all of the other applicable requirements. Consistent with the current capital rule, to the extent the fair value of the collateral declines such that it no longer exceeds the outstanding principal balance of the covered banking organization's exposure to the borrower, the transaction would no longer involve tranching of credit or equity risk and thus would not qualify as a securitization exposure under the proposal. Rather, the covered banking organization would be required to calculate risk-based capital requirements for the exposure using the general risk-weight framework as described in section III.A. of this SUPPLEMENTARY INFORMATION.

Securitization transactions are typically structured so that there is overcollateralization (i.e., the amount of the underlying exposures exceeds the amount of the loan or security). In determining the amount of the underlying exposures, credit tranching and information reflected on servicer reports, most securitization transactions look at the principal amount of the exposures. It is unusual in most transactions to have a periodic valuation of the underlying exposures to determine the current fair value of the collateral. Indeed, as a general matter, the underlying assets in a securitization are not fair valued, and imposing such a requirement would be extremely difficult, if not impossible, to implement given the volume and nature of the assets typically held in securitization pools.

This treatment implied under footnotes 165 and 77 would create significant practical and policy concerns for securitization structures. Securitization transactions are generally not based on the fair value of the underlying exposures.[21] They are based on the expected cash flows from the underlying exposures and the likelihood that those cash flows will be sufficient to make the required payments on the asset-backed loan or security. A requirement to determine the fair value of the underlying exposures on a periodic basis would be operationally infeasible for the vast majority of securitization transactions and would impose costs that are disproportionate to any prudential benefit. For loan-backed securitization structures, requiring periodic fair value determinations of underlying assets would be impracticable and inconsistent with how these transactions operate.

Moreover, the fair value of the overcollateralization in some transactions may fluctuate due to temporary mark-to-market movements like interest rate changes —which do not reflect actual credit impairment. Therefore, a transaction could toggle between securitization treatment and wholesale treatment on a reporting-period-by-reporting-period basis, creating operational burden, capital volatility, and cliff effects that are disproportionate to the underlying risk.

SFA urges the Agencies to clarify that, once a transaction is determined at inception to meet the definition of a securitization exposure, including that the credit risk of the underlying exposures has been separated into tranches reflecting different levels of seniority, subsequent changes in the fair value of the underlying exposures should not be viewed as eliminating that tranching or otherwise causing the exposure to move to the general risk-weight framework. This

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[21] One notable exception, which the Agencies have recognized in the Proposed Rules, are securitizations of equity exposures which are generally based on fair value.

approach preserves the prudential objectives of the securitization framework and avoids unnecessary operational burden.

VI. New Definition of "eligible prepaid credit protection arrangement"

SFA commends the Agencies for introducing the concept of an “eligible prepaid credit protection arrangement” as a new category of recognized credit risk mitigant under §___.130(b)(1)(iv) of NPR 1 and §___.41(b)(1)(iv) of NPR 2. This structure greatly facilitates the future issuance by banks of credit-linked notes directly issued by banks and their subsidiaries (“Directly Issued CLNs”).

As a technical matter, we would like the Agencies to confirm that eligible cleanup calls would be permitted under eligible prepaid credit protection arrangements and would not create a maturity mismatch. An eligible cleanup call applies only when the outstanding principal amount of the underlying exposures is less than 10% of the original amount, and does not create the type of risk that the maturity mismatch requirements are designed to address. It is also often difficult for banks to foresee the precise date when a cleanup call will become exercisable.

In addition, in the NPRs, the Agencies asked certain questions relating to eligible prepaid credit protection arrangements. Question 58 of NPR 1 and Question 31 of NPR 2 ask about whether the reduction of the balance of the eligible prepaid credit protection arrangement should correspond to recognition of a loss for accounting purposes. We'd encourage the Agencies to allow these to be independent. For example, some Directly Issued CLNs have been rated by nationally recognized statistical rating organizations (“NRSROs” or “Rating Agencies”). A rating agency might insist on recognition of losses on the rated security when, for example, a receivable becomes 90 days past due while the bank’s accounting policies might have a longer period before a full chargeoff. We see no reason to tie the timing of loss recognition on eligible prepaid credit protection arrangements to loss recognition for accounting purposes, particularly when loss recognition in the eligible prepaid credit protection arrangement would be earlier than loss recognition for accounting purposes.

Question 59 of NPR 1 and Question 32 of NPR 2 asks the following:

> *The proposal would define the protection amount of an eligible prepaid credit protection arrangement to mean the effective notional amount of the prepaid credit protection. Certain credit-linked notes that may qualify as eligible prepaid credit protection under the proposal, are sometimes accounted for on a fair value basis. The fair value of such credit-linked notes may be affected by factors other than losses or credit events (for example, a change in interest rates) in respect of the reference exposure. As a result, at the time that credit losses in respect of the reference exposure are realized, the fair value of the credit-linked note, and the amount by which the banking organization may set off its losses in respect of the reference exposure, may be less than the notional amount of the note. What, if any, modifications to the proposal should the agencies consider to address the risk that a banking organization may not be able to set off losses on a reference exposure against the full notional amount of a prepaid credit protection instrument? What would be the advantages and disadvantages of defining the protection amount of an eligible prepaid*

credit protection instrument to be the instrument's carrying value (For example, the fair value if the banking organizations elects this accounting treatment)?

We note that CLNs are often measured at fair value due to GAAP accounting requirements; however, the amount of credit protection is determined by the contractual notional amount, not the fluctuating fair value. This is no different from how purchased CDS protection functions—the notional amount of protection is fixed regardless of fluctuations in the mark-to-market value of the contract. If a bank issues a $100 CLN, it gets exactly $100 of credit protection regardless of whether the mark-to-market value is $98 or $102. The Agencies should not define the amount of protection with any reference to a carrying value that is based on mark-to-market accounting.

Question 60 of NPR 1 and Question 33 of NPR 2 asks whether prepaid credit protection arrangements should allow for a reduction in the initial principal amount of the arrangement upon the recognition of losses on one or more reference exposures due to credit quality deterioration of the exposures, even in the absence of any nonpayment. SFA's members recognize that the market for eligible prepaid credit protection arrangements is at a relatively early stage, and there may be reasons for loss recognition in some transactions to occur upon not only a payment default in the underlying exposures but there may also be important non-payment defaults that are appropriate circumstances for loss recognition. We'd encourage the Agencies not to unnecessarily preclude development of the market.

With respect to criterion (7) of the definition of eligible prepaid credit protection arrangement, SFA recommends that the Agencies clarify that criterion (7) is intended to be triggered by a contractually defined default (or other specified credit event) that results in a credit loss, rather than by any mere failure to make a required payment. For many consumer and other retail exposures, contractual grace periods and standard servicing practices mean that a short-term delinquency may be cured and does not, by itself, establish a credit loss. Absent clarification, a literal interpretation of "failure … to make a contractually required payment" and "promptly" could be read to require an immediate reduction of the prepaid balance upon any missed payment, even where no loss amount is yet determinable. This could drive inconsistent implementation across firms and products and reduce the practical availability of prepaid credit protection arrangements for retail portfolios.

Accordingly, SFA proposes that the final rule align criterion (7) with the default-based construct applicable to eligible guarantees in the capital rules today, specifically the principle reflected in the eligible guarantee requirement that the protection provider make payment to the beneficiary on the occurrence of a default (as defined in the guarantee) of the obligated party on the reference exposure in a timely manner without the beneficiary first having to take legal actions to pursue the obligor for payment. Consistent with this construct, criterion (7) for eligible prepaid credit protection arrangements should clarify that the purchaser has the ability, without protection provider consent, to promptly reduce the outstanding prepaid balance by the amount of the covered credit loss after (i) the occurrence of a contractually defined default (or other specified credit event) on the reference exposure and (ii) determination of the resulting covered loss amount, without first having to take legal action to pursue the obligor for payment. The protection purchaser should also be able to recognize losses in a manner that is consistent with its servicing practices, for example, in the case of auto loans, after repossession and sale of the financed vehicle.

VII. Certain Parameters in the Proposal Should be Modified

A. The Final Rule, like the 2023 Proposal, should clarify that "current dollar" means "outstanding principal balance" in determining the attachment point (A) and detachment point (D) of securitization exposures of underlying exposures with contractual principal amounts.

The 2023 Proposal stated as follows:

The proposal would modify the definition of attachment point so that it refers to the outstanding balance of the underlying assets in the pool rather than the current dollar value of the underlying exposures.[22]

We recommend that the final rule adopt the approach proposed in the 2023 Proposal for both the attachment and detachment point of securitization exposures. "Current dollar value" is not currently defined. For securitizations of underlying exposures with contractual principal amounts (e.g. loans and debt securities), using outstanding principal balance would more accurately reflect the structural subordination and loss-allocation mechanics of a securitization's credit risk and align the regulatory capital calculations with longstanding market practice, transaction documentation and investor analysis. This approach also enhances risk sensitivity and comparability across institutions.[23]

B. SEC-SA Treatment of Defaulted Exposures as Excess Collateral (Incorporating A, D, K_G, and K_A Adjustments)

Under the SEC-SA, the calculation of key input parameters—including A (underlying exposure amount), D (delinquency/default measure), K_G, and K_A —should exclude defaulted underlying exposures that are no longer eligible for inclusion in the borrowing base but remain in the SPE as excess collateral.

In many securitization facilities where a bank lends to an SPE, defaulted exposures are ineligible to support borrowings (i.e., advances cannot be made or maintained against them). However, these exposures typically remain within the SPE and continue to provide residual economic value as excess collateral benefiting the lending or investing bank. As such, they serve a protective function for investors despite not being creditable in borrowing base calculations.

Including these defaulted exposures in A, D, K_G, K_A, and related inputs (e.g., W) can overstate the effective risk of the securitization exposure, resulting in a materially higher capital requirement that is not aligned with the exposure's economic profile. This treatment may also create unintended incentives for banks to permit or require the removal of defaulted exposures from the SPE.

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[22] 88 Fed. Reg. 64028 at 64069.

[23] The agencies clarify in the Proposed Rules that "a transaction transferring equity risk could be subject to the securitization framework". SFA agrees with this clarification and notes that for securitizations of equity exposures the attachment point and detachment point should generally be based on fair value given equity exposures typically do not have a contractual principal amount.

To address this misalignment, the Agencies should permit institutions to exclude defaulted underlying exposures from SEC-SA input parameters (including A, D, K_G, and K_A) where such exposures:

- are not included in the borrowing base or attachment point, and
- remain in the SPE solely as excess collateral.

This approach effectively treats such exposures as if written off for parameterization purposes, without requiring their removal from the securitization structure.

Aligning treatment across these parameters ensures that SEC-SA outputs more accurately reflect the true risk and economics of the exposure, while preserving incentives to retain collateral that may generate future recoveries.

C. FHA/VA/FFELP/USDA and similar guaranteed exposures should be expressly excluded from the numerator of the W parameter.

The Agencies should clarify that underlying exposures insured or guaranteed by the Federal Housing Administration ("FHA"), the Department of Veterans Affairs ("VA"), the U.S. Department of Education ("DOE") and the U.S. Department of Agriculture ("USDA"), and similar exposures that are fully or partially insured or guaranteed by U.S. government agencies, are eligible for exclusion from the numerator of W under the proposed SEC-SA. As drafted, the proposal permits excluding from W those underlying exposures "directly and unconditionally guaranteed by the U.S. government, its central bank, or a U.S. government agency."[24] At the same time, the preamble to NPR 1 states that "consistent with the current capital rule, banking organizations generally would apply a 20 percent risk weight to real estate exposures guaranteed by the U.S. government through the FHA or VA under the proposal."[25] The proposal retains the 20 percent risk weight under § 217.32(a)(1)(ii) for exposures "conditionally guaranteed" by the U.S. government, implying that the Agencies may consider FHA and VA guarantees to be conditional rather than unconditional.

Read together, these provisions create an ambiguity that could be interpreted to require inclusion in W of delinquent FHA- and VA-insured loans, loans under the Federal Family Education Loan Program and other loans whose credit risk is, in substance, borne by the United States. To resolve this ambiguity, the Agencies should revise the W definition to state expressly that the numerator of W excludes FHA/VA/FFELP/USDA and similar insured or guaranteed exposures to the extent of the guaranteed portion. This clarification would more appropriately align the capital requirement with the economic reality that these exposures benefit from government credit support that substantially mitigates the risk of loss to securitization investors.

[24] *See* NPR 1, §___.133(b)(1)(vii); NPR 2, §___.44(b)(1)(vii).
[25] *See* NPR 1, 91 Fed. Reg. at 14972.

D. The positive current exposure of interest rate and exchange rate derivatives should not be included in the calculation of K_G.

Unlike the calculation of K_G under SSFA, the NPRs propose to include in the numerator, but not the denominator of K_G the positive current exposure of interest rate and exchange rate derivative contracts *times* the risk weight of the related counterparty *times* 0.08.[26]

We request that interest rate and currency derivative contracts not be included in the calculation of K_G. Requiring banks to calculate the positive current exposure of an interest rate or exchange rate derivative contract presents a significant operational burden. The information necessary to calculate the positive current exposure is not readily available from the other sources of information used to calculate risk weights generally, such as monthly servicing reports, trustee reports, or data from providers such as Intex and Bloomberg. Moreover, the Agencies acknowledge that interest rate and currency derivatives don't provide any credit enhancement to the securitization transaction[27] and therefore little benefit is gained from the inclusion of those contracts. We note that the Agencies have performed no cost-benefit or other economic analysis to justify this change.

If the interest rate and exchange rate contracts must be included in the calculation of K_G, that exposure amount should be included in the denominator as well as the numerator. We disagree that interest rate and exchange rate derivatives do not provide any credit enhancement to a securitization. Payments under such derivatives are a component of excess spread, which is a significant source of (first loss) credit enhancement in securitization transactions. Indeed, without such derivatives, the credit enhancement provided by excess spread could be eliminated by unfavorable changes in interest rates or exchange rates.

E. K_G and W should not double count delinquent exposures in the calculation of K_A

Question 73 of NPR 1 and Question 47 of NPR 2 ask about the appropriateness of requiring banking organizations to reflect underlying past due exposures in both the K_G and the W parameter components when calculating K_A, and to what extent could including past due exposures in both components result in overly punitive capital requirements for such exposures under SEC-SA.

We believe the double counting of the defaulted underlying exposures is excessive. The Agencies should revise the definition of K_G to apply solely to performing assets because delinquent exposures are already included in the calculation of K_A through the W parameter.

VIII. The Agencies Should Clarify That Definitions of "regulatory residential real estate exposure" and "regulatory commercial real estate exposure" Permit Banks to Evaluate Underlying Assets as if the Bank Had Originated the Loan

Under the NPRs, the definitions of "regulatory residential real estate exposure" and "regulatory commercial real estate exposure" contain underwriting criteria that presuppose the

[26] *See* NPR 1, §___.133(b)(2)(i); NPR 2, §___.44(b)(2)(i).
[27] NPR 2 at 15358.

bank assigning the risk weight is the same bank that originated the loan. For example, the proposed definition of regulatory residential real estate exposure requires that the exposure "[i]nvolves a loan, for which the [BANKING ORGANIZATION] applied underwriting policies that took into account the ability of the borrower to repay in a timely manner based on clear and measurable underwriting standards."[28] The proposed definition of regulatory commercial real estate exposure contains parallel language requiring that "[d]uring underwriting of the loan, the [BANKING ORGANIZATION] must have applied underwriting policies" meeting specified standards, and that the exposure be "directly secured" by the real estate with the bank holding a first-priority interest.

These definitions disadvantage banks that acquire whole loans or participations in the secondary market, banks that provide warehouse financing secured by pools of residential or commercial mortgage loans, and banks that invest in mortgage-backed securities. Such banks did not originate the underlying loans and therefore did not "apply" the underwriting policies during origination—even though the loans may have been underwritten to identical or superior standards by the originator. Under the NPRs' literal language, such exposures would not qualify as regulatory residential or commercial real estate exposures for purposes of K_G calculations, resulting in higher risk weights for the securitized pool and therefore higher SEC-SA capital requirements for the securitization exposure held by the bank.

SFA requests that the Agencies clarify that the definitions permit a bank to qualify a real estate exposure as a regulatory residential or commercial real estate exposure if the originator of the loan applied underwriting policies meeting the specified standards, regardless of whether the bank currently holding or financing the exposure is the same entity that originated it. SFA does not understand the Proposed Rules to require otherwise and believes the Agencies intended for the existing practice—under which banks evaluate underlying assets for purposes of K_G as if the bank had originated the loan—to continue. SFA respectfully requests that the Agencies confirm this understanding in the final rule. In addition, the definition of regulatory commercial real estate exposure should be clarified to permit qualification where the exposure is directly or indirectly secured by real estate and the lender (which need not be the bank assigning the risk weight) holds a first-priority security interest in the property. These clarifications would avoid penalizing secondary-market investment by banks, warehouse lending, and securitization of high-quality mortgage loans by banks that did not originate those loans.

IX. Commitments, Unconditionally Cancelable Commitments and Credit Conversion Factors ("CCFs") for Commitments

The proposed changes would significantly increase capital requirements with respect to commitments. Further, the proposed changes would materially impact a sizable, mature market. The proposal contains no analysis of this potential impact. If the agencies decide these definitional changes are appropriate, they should support that determination with a reasoned analysis, including consideration of the impact on capital requirements. Until they do so, the agencies should withdraw these changes. We also encourage the agencies to refer to the recommendations regarding these definitions in the separate comment letter on the Proposal submitted by the Bank Policy Institute,

[28] *See* NPR 1, §___.101(b); NPR 2, §___.2.

the American Bankers Association, the Financial Services Forum, and the U.S. Chamber of Commerce, which we agree with and fully support.

X. The final rule should permit consideration of exposure-level factors in the assessment and determination of investment grade for certain securitization -like exposures.

The proposal would provide a 65% risk weight for corporate exposures that are investment grade exposures. To determine whether an exposure is investment grade, a firm would have to determine that the obligor "has adequate capacity to meet financial commitments for the projected life of the asset or exposure." With respect to this determination, the preamble to the proposal notes that "[b]ecause the rating assessment and the corresponding determination of investment grade would occur at the obligor level, such determinations would not include exposure level loss given default factors, such as credit enhancements, transaction structure, and collateral."

For whole business securitization exposures which do not meet the criteria of a traditional securitization under Reg Q, the definition of investment grade does not consider credit enhancement supporting the bank's exposure. Where the investment grade criteria considers probability of default (creditworthiness of the obligor), it does not consider loss given default where the structure of the transaction, and credit enhancement, protects the bank from losses. In these instances where whole business securitization exposures do not qualify as investment grade, the bank's exposure would receive 100% risk weight but the credit underwriting and structural features would support a lower risk weight commensurate with the actual credit risk.

The exclusion of "exposure level loss given default factors, such as credit enhancements, transaction structure, and collateral" rests on a premise that holds for an operating company but not for a non-operating company; namely, that an obligor has a probability of default based on its own financial condition, to which collateral and structure add only post-default recovery value. That premise does not hold for a non-operating company like an SPE or investment fund. Such an entity's capacity to meet its financial obligations "for the projected life of the asset or exposure" is defined by, and inseparable from, the assets pledged, the security interest, and the cash-flow structure. For such an obligor those features are not enhancements layered on top of an independently measurable default risk. They are the source of its default risk. To rate the obligor while excluding them is to assess the capacity of an entity without considering the things that give it a capacity to pay.

We urge the Agencies to reconsider the strict requirement that no credit enhancement can be taken into account as highlighted above given that in certain instances an obligor risk rating without considering such features would not be reflective of the credit risk. For certain types of securitization-like exposures that do not qualify for treatment as a securitization exposure under the capital rules, such as whole-business securitizations, the investment grade determination should be permitted to take into account exposure-level factors, such as credit enhancements, transaction structure, and collateral. If the investment grade determination is solely at the obligor level, these exposures would receive a disproportionately high risk weight compared to the risk they pose. This is the case where banks may provide financing to non-operating entities such as special purpose vehicles (SPVs) in whole business securitizations, whereby structural features such as a security interest in collateral are a critical component of the credit risk assessment against

that obligor. These are low-risk transactions; however, consideration of the transaction structure is necessary to appropriately assess the risk. Taking these features into account in such specific instances will not change in any fundamental way the obligor-level approach and would as such only require a clarification that this is allowed as long as the resulting obligor risk rating meets all the requirements as per section 111(h). Such an approach would be more consistent with how banking organizations currently assess the credit profile of a given obligor for internal credit risk rating purposes.

XI. Other Provisions of the Proposed Rules Should Be Removed or Adjusted

A. For the purposes of determining risk weights applicable to securitization exposures backed by regulatory retail exposures, the aggregate limit and granularity limit criteria should be measured at the pool level.

Under the Proposed Rules, to qualify as a regulatory retail exposure, the sum of the exposure amount and the amounts of all other retail exposures to the obligor and its affiliates may not exceed $1 million (the "aggregate limit")[29].

In the context of the securitization of retail exposures, the Proposed Rules should make clear the aggregate and granularity limits should apply and be measured solely with respect to the underlying exposures in the securitized pool. Credit exposures to obligors that are not included in the securitized pool are not relevant to the risk associated with the related securitization exposures, and the regulatory capital purpose of those limits is served by applying them to the specific pool of underlying exposures from which securitization risk weights are derived.

Therefore, for the purpose of determining the capital requirement of the underlying exposures in calculating securitization exposure risk weights under SEC-SA, if the aggregate and granularity limits are satisfied at the securitization pool level as described above, then the underlying retail exposures should be deemed to be regulatory retail exposures for purposes of the securitization framework.

B. Where there is no pari passu exposure, the Proposed Rules should permit the use of a derivative contract's exposure at default as an alternative method for determining tranche size.

For interest rate and foreign exchange derivative contracts that constitute securitization exposures, the proposal would require banks to set the risk weight equal to the risk weight of a securitization exposure that is pari passu to the derivative contract, as calculated under SEC-SA. If no such pari passu exposure exists, the risk weight of the next subordinated securitization tranche would apply.[30]

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[29] *See* NPR 1, §___.101(b) (definition of "regulatory retail exposure"); NPR 2, §___.2.

[30] *See* NPR 1, §___.132(a)(2); NPR 2, §___.43(a)(2). According to the NPRs, "A banking organization may otherwise not be able to calculate a risk weight for these derivative contracts using the SEC–SA because the attachment and detachment points under the proposed formula could equal one another, rendering the formula inoperable. The proposed treatment, consistent with the Basel standards, is intended to appropriately reflect how the credit risk

As an alternative method for calculating a derivative's risk weight where there is no *pari passu* exposure, the Proposed Rules should be revised to (1) allow the derivative contract's tranche size ("the derivative tranche size") to be calculated as a fraction, the numerator of which is the exposure at default ("EAD") of such derivative contract and the denominator of which is the outstanding balance of all underlying assets in the securitization, and (2) specify that the derivative contract's attachment and detachment points may be calculated as follows:

- If there is no securitization exposure senior to the derivative contract, (a) the detachment point of the derivative contract would be one and (b) the attachment point of the derivative contract would be one minus the derivative tranche size; and

- If there is a securitization exposure senior to the derivative contract, (a) the detachment point of the derivative contract would be the attachment point of the tranche immediately senior to the derivative contract (the "senior tranche attachment point") and (b) the attachment point of the derivative contract would be the senior tranche attachment point minus the derivative tranche size.

The risk weight for the derivative contract would then be calculated under SEC-SA using those attachment and detachment points.

This alternative approach would make the treatment of derivative contracts more risk sensitive because it aligns the risk weight more closely with the actual credit risk posed by the contract given its position in the capital structure of the securitization. The precise calculation of the derivative contract's risk weight using its EAD and its position in the capital structure would ensure that the capital requirement is commensurate with the risk profile of the derivative exposure.

C. Where the delinquency status of a portion of underlying exposures is unknown, a subpool approach is reasonable.

In Question 72 of NPR 1 and Question 46 of NPR 2, the Agencies ask:

> Recognizing that banking organizations may not always know the delinquency status of each underlying exposure, what would be the benefits and drawbacks of allowing a banking organization to use the SEC–SA if the banking organization knows the delinquency status for most, but not all, of the underlying exposures? For example, if the banking organization knew the delinquency status of 95 percent of the exposures, what would be the benefits and drawbacks of allowing the banking organization to (1) split the underlying exposures into two subpools, (2) calculate a weighted average of the K_A of the subpool comprising the underlying exposures for which the delinquency status is known, (3) assign a value of 1 for K_A of the other subpool comprising exposures for which the delinquency status is unknown, and (4) assign a K_A for the entire pool equal to the weighted average of

associated with these derivative contracts would be commensurate with or less than the credit risk associated with a pari passu tranche or the next subordinated tranche of a securitization exposure." *See* NPR 1, 91 Fed. Reg. at 15001.

the K_A for each subpool. What other approaches, if any, should the agencies consider and why?[31]

We generally agree that a subpool approach is reasonable. However, for the subpool of exposures for which the delinquency status is unknown, the value of K_A should be 0.12, rather than the value of one, as specified in clause (3) above. The value of 0.12 is the equivalent of assuming that all the exposures in that subpool are defaulted exposures. Defaulted exposures have a risk weight of 150%, which corresponds to a capital requirement of 12%.

A cap on the size of the "delinquency status unknown" subpool is not required with an approach that treats exposures in that subpool as defaulted exposures. Treating such exposures as if they are defaulted is a sufficiently conservative solution to the bank's lack of knowledge about the delinquency status of underlying exposures.

D. Question 68 of NPR 1 and Question 42 of NPR 2 regarding minimum payment thresholds under credit default swaps and whether there should be changes.

In Question 68 of NPR 1 and Question 42 of NPR 2, the Agencies ask about the benefits and drawbacks of the proposed minimum payment threshold criterion for synthetic securitizations and whether additional criteria or clarifications should be considered.[32]

SFA supports the proposed requirement that minimum payment thresholds be "consistent with standard market practice," and notes that standard market practice for derivative contracts written under ISDA Master Agreement documentation generally establishes a $1 million threshold (or the equivalent in other currencies).[33] SFA requests that the Agencies confirm in the final rule that thresholds consistent with ISDA Credit Derivatives Definitions will satisfy this criterion and that the Agencies provide guidance on how to evaluate consistency with standard market practice for non-ISDA-documented arrangements.

E. The definition of an eligible clean up call should be further expanded to include clean up calls that may be exercised with contemporaneous regulatory consent or upon adverse regulatory guidance.

In Question 69 of NPR 1 and Question 43 of NPR 2, the Agencies ask what modifications should be considered to the definition of "eligible clean-up call." Under the current capital rule, an eligible clean-up call is a clean-up call that: (i) is exercisable solely at the discretion of the originating banking organization or servicer; (ii) is not structured to avoid allocating losses; and (iii) meets one of several conditions regarding pool balance or outstanding tranches.

SFA requests that the Agencies further expand the definition of eligible clean-up call to include clean-up calls that may be exercised with contemporaneous regulatory consent or upon adverse regulatory guidance, such as supervisory feedback, and not be limited solely to rule

[31] *See* NPR 1, 91 Fed. Reg. at 14999 (Question 72); NPR 2, 91 Fed. Reg. at 15358 (Question 46).
[32] *See* NPR 1, 91 Fed. Reg. at 14996; NPR 2, 91 Fed. Reg. at 15355.
[33] *See* ISDA Credit Derivatives Definitions Section 4.5 ("Failure to Pay") and Section 4.9(d) ("Payment Requirement").

changes. In some securitization transactions (particularly synthetic securitizations), the sponsoring institution has desired to include provisions permitting optional redemption or clean-up calls subject to prior notice to, or consent from, the applicable banking regulator. Such calls serve the same economic purpose as other eligible clean-up calls—efficient wind-down of a transaction that is unnecessarily expensive under the circumstances—and should not be disqualified merely because regulatory consent is a prerequisite to exercise. The requirement for prior regulatory consent, far from undermining safety and soundness, provides an additional layer of supervisory oversight. In addition, SFA requests that the definition of eligible clean-up call be expanded to encompass calls triggered not only by changes in applicable rules or upon prior regulatory consent but also by supervisory guidance, interpretation, or other regulatory action that materially alters the capital or accounting treatment of the securitization.

F. The Agencies should retain a cap on the maximum capital requirement for securitization exposures similar to § 217.141(d) of the capital rule.

The Agencies should retain a cap on the maximum capital requirement for securitization exposures. Under § 217.141(d) of the capital rule, the total risk-based capital requirement for all tranches held in a single securitization is capped at the sum of (i) the capital requirement for the underlying exposures, calculated under subpart E as if a firm directly held those exposures, and (ii) the total expected credit losses on such underlying exposures. We recommend that the Agencies retain an equivalent cap under the ERBA, as a logical upper bound on securitization RWAs.

Conclusion

SFA appreciates your consideration of the views set forth in this letter. If you have any questions, please contact me at (202) 999-0536 (email: michael.bright@structuredfinance.org), or our counsel, Mayer Brown LLP, attention: Stuart M. Litwin at (312) 701-7373 (slitwin@mayerbrown.com), Andrew Olmem at (202) 263-3006 (aolmem@mayerbrown.com), Ryan J. Rettmann at (312) 701-8101 (rrettmann@mayerbrown.com), or Matthew G. Bisanz at (202) 263-3434 (mbisanz@mayerbrown.com).

Regards,

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