

Regulators Should Set Regulatory Capital Rules that Properly Reflect the Risks Inherent in Mortgages and Mortgage-Related Products

MBA RECOMMENDS

Regulatory capital rules need to be adjusted for changing accounting principles so that the regulatory capital rules continue to reflect the actual risk inherent in mortgages and mortgage-related products.

BACKGROUND

On June 12, 2009, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 166, Accounting for Transfers of Financial Assets, an Amendment of FASB Statement No. 140 (FAS 166) and Statement of Financial Accounting Standards No. 167, Amendments to FASB Interpretation No. 46(R) (FAS 167). FAS 166 and FAS 167 removed the concept of a qualifying special-purpose entity (QSPE) from generally accepted accounting principles (GAAP) and altered the criteria under which special purpose entities, like mortgage-backed securities trusts (MBS), must be included in the issuer's or servicer's consolidated financial statements. The net impact to the mortgage banking and commercial mortgage securities industries will be for hundreds of billions of dollars of securitized assets and liabilities to come onto the balance sheets of issuers, servicers or special servicers as of January 1, 2010.

The Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Fed), the Federal Deposit Insurance Corporation (FDIC), and Office of Thrift Supervision (OTS) (collectively "agencies") generally use GAAP as a starting point for assessing regulatory capital requirements for an exposure. During the fall of 2009, the agencies issued Notice of Rulemaking, Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance; Impact of Modifications to Generally Accepted Accounting Principles; Consolidation of Asset-Backed Commercial Paper Programs; and Other Related

Issues (Proposed Rule). The Proposed Rule states that the agencies have determined that the qualitative analysis under FAS 167 coupled with the enhanced requirements for recognizing the transfer of financial assets under FAS 166 "converge in many respects with the agencies' assessment of a banking organization's risk exposure to a structured finance transaction and other transactions affected by the 2009 GAAP modifications." Accordingly, the agencies in the Proposed Rule will not grant any regulatory capital relief for the assets and liabilities coming onto bank balance sheets as a result of the implementation of FAS 166 and FAS 167 on January 1, 2010, for calendar year reporting banks. MBA commented on the rule in October of 2009, and the agencies have not yet issued a final rule.

PRINCIPLES OF REFORM

For most static pool structures, like residential mortgage-backed securities (RMBS) and commercial mortgage backed securities (CMBS and collectively MBS), the appropriate regulatory capital treatment is to continue to require risk-based capital (RBC) and leverage ratio treatment for only the variable interest retained and not for all of the consolidated variable interest entity (VIE) assets. There is no business case for the sponsors to provide credit support for these securitizations, hence no case for RBC and leverage ratio treatment to attach beyond the retained variable interests.

Accordingly, MBA believes that the primary risk-weighting rules and leverage ratio rules should be revised for certain VIEs that meet the following criteria:

- If the primary beneficiary is the transferor, the transfer meets the three criteria for sale accounting in paragraph 9 of FAS 166.
- The beneficial interest holders of the VIE have no recourse to the general credit of the primary beneficiary other than standard representations and warranties;
- The VIE's assets can be used only to settle the obligations of the VIE; and
- There are no explicit arrangements or implicit variable interests that could require the primary beneficiary to provide financial support (for example, liquidity arrangements and obligations to purchase assets) to the VIE, other than servicing advances, which are only required if the servicer deems them to be collectible.

For VIEs meeting the criteria above, RBC and leverage ratio calculations should only include the variable interest retained.



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