BY ELECTRONIC MAIL

February 21, 2012

Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Re: Permissible Investments for Federal and State Savings Associations: Corporate Debt Securities 76 *Federal Register* 78086, Dec. 15, 2011, RIN 3064-AD88

Guidance on Due Diligence Requirements for Savings Associations in Determining Whether a Corporate Debt Security is Eligible for Investment, 76 *Federal Register 7*8090, Dec. 15, 2011

Dear Mr. Feldman:

The American Bankers Association (ABA),[1] the ABA Securities Association (ABASA),[2] and the Financial Services Roundtable[3] (the Associations) appreciate the opportunity to respond to the requests for comment by the Federal Deposit Insurance Corporation (FDIC) on (1) the proposal to eliminate references to credit ratings in its rules for permissible investments in corporate debt securities by federal and state savings associations, and (2) on proposed guidance on eligible corporate debt securities. These proposals implement Section 939(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)[4] which removed references to credit ratings provided by Nationally Recognized Statistical Rating Organizations (NRSROs) in the Federal Deposit Insurance Act (FDI Act)[5] and directed FDIC to establish a new standard of creditworthiness tor corporate debt.

The proposal would remove references to NRSRO ratings in FDIC's rules at 12 C.F.R. § 362.11(b)(1) and replace the current investment grade standard with a newly established credit quality standard. The proposed guidance would clarify steps savings associations should take to demonstrate that they have properly verified that their investments meet the newly established credit quality standards.

While we generally support the proposal, we remain concerned that the compliance burdens on all savings associations, especially small savings associations, will significantly limit their options for available investments corporate bonds.

---

[1] The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $13 trillion banking industry and its 2 million employees. ABA's extensive resources enhance the success of the nation's banks and strengthen America's economy and communities. Learn more at www.aba.com.
[2] ABASA is a separately chartered affiliate of the ABA that represents those holding company members of the ABA that are actively engaged in capital markets, investment banking, and broker-dealer activities.
[3] The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $92.7 trillion in managed assets, $1.2 trillion in revenue, and 2.3 million jobs.
[4] *Pub. L.* 111-203, Section 939A, 125 Stat. 1376, 1887 (July 21, 2010).
[5] 12 U.S.C. 1831e(d)(4).

BACKGROUND

FDIC's current rules governing permissible investments in corporate bonds include references to credit ratings when determining whether particular bonds are "investment grade." The proposal would delete the investment grade test for permissible investments in corporate bonds in 12 C.F.R. § 362.10(b). It would further amend 12 C.F.R. § 362.11(b)(1) to replace the reference to "investment grade" with a new standard of creditworthiness: that the issuer of the security has adequate capacity to meet all financial commitments under the security for the projected life of the investment. In the preamble, FDIC explains that "an issuer would satisfy this requirement if the savings association appropriately determines that the obligor presents low default risk and is likely to make timely payments of principal and interest."[6] Corporate bonds purchased by savings associations would have to meet this test at acquisition and periodically thereafter.

Savings associations would be required to perform due diligence sufficient to demonstrate that an investment security meets the above standard. The proposed guidance emphasizes that the scope of the required due diligence should be a function of the security's credit quality, the complexity of the issuer's financial structure, and the size of the investment. Thus, the proposal states that the more complex an issuer's financial structure is, the more credit-related due diligence an association should perform, even when the credit quality is perceived to be very high.[7]

FDIC expects savings associations to consider a variety of factors relevant to the particular security when determining whether a security is a permissible investment, such as consideration of internal analyses, third-party research and analytics including external credit ratings, internal risk ratings, default statistics, and other sources of information as appropriate for the particular security. Importantly, under the proposal external ratings, including ratings by NRSROs, could continue to be a factor in an institution's assessment of an issuer's financial capacity when supplemented with appropriate due diligence processes and analyses.

The proposed guidance lists as some appropriate factors savings associations should consider the following:

- Confirm spread to U.S. Treasuries is consistent with bonds of similar credit quality;
- Confirm risk of default is low and consistent with bonds of similar credit quality;
- Confirm capacity to pay through internal credit analysis that can be supplemented with other third-party analytics;
- Understand applicable market demographics/economics; and
- Understand current levels and trends in operating margins, operating efficiency, profitability, return on assets and return on equity.

The guidance emphasizes the need for an adequate investment portfolio risk management process with a particular focus on credit risk concentration limits. The proposal notes that such limits may apply to concentrations relating to a single or related issuer, a geographical area, and obligations with similar characteristics.

---

[6] 76 *Fed. Reg.* 78086 at 78087.
[7] The proposal provides that bank management should ensure they understand the security's structure and how the security will perform in different default environments, and should be particularly diligent when purchasing structured securities.

DISCUSSION

Our members are very concerned about the unintended consequences of the proposal. Because of the emphasis on due diligence, more of every savings association's resources will be required to assess and periodically monitor any given corporate debt security. In addition, because a virtually identical creditworthiness standard will be imposed on all other investments by federal savings associations, savings associations of all sizes (and particularly federal savings associations) will, of necessity, be constrained in the numbers of securities they can consider for their portfolios.[8] As a result, it is highly likely that concentration issues will become more prevalent as savings associations commit their limited resources to investments requiring less due diligence or for which due diligence has already been conducted. In addition, our members are concerned that institutions will be subject to after-the-fact criticism by examiners despite having conducted reasonable due diligence with respect to the association's investments.

1. Differentiations Based on Size and Complexity

FDIC has asked whether the guidance should provide differentiations based on the size and scope of the association with respect to consideration of the factors relevant to whether an association has satisfied its due diligence requirements or whether a particular corporate bond has good credit quality. The Associations believe such differentiation is absolutely critical for savings associations to be able to manage their investment portfolios while avoiding undue concentrations.

Our members are very concerned that without greater differentiation between savings associations based on their size and/or complexity, the judgments made by examiners will be highly subjective leading to much "second guessing" of associations' reasonable investment decisions. In addition, we also believe that a lack of reasonable differentiation will result in fewer permissible corporate bonds in which small savings associations, in particular, may be willing to invest, leading, in turn, to potential concentration concerns.

We believe there is a significant difference in the capacity of smaller institutions versus larger institutions to develop sophisticated risk systems or to pay third parties to conduct due diligence for them. This is especially the case for purchases of small amounts of investment securities or purchases that are very small relative to an association's capital. For example, if a small savings association purchases a low-denomination corporate bond, it is not cost effective to hire an outside party to conduct ongoing due diligence.

Accordingly, we urge FDIC to provide an abbreviated number of factors that smaller institutions may consider when fulfilling their due diligence obligations. We note that the *1998 Interagency Supervisory Policy Statement on Investment Securities and End-User Derivatives Activities* states that "[n]ot all investment instruments may need to be subjected to a pre-purchase analysis. Relatively simple or standardized instruments, the risks of which are well known to the institution, would likely require no or significantly less analysis than would more volatile, complex instruments."[9] For example, FDIC could specify that less due diligence is necessary for an investment that is a minimal percent of capital. We would be happy to discuss further with FDIC staff ways to further differentiate their due diligence guidelines based on the size or other characteristics of smaller savings associations.

---

[8] We note that in the Regulatory Flexibility Act analysis ion the proposal, FDIC has found that the amount of "other investment securities" (which would include corporate debt) by savings associations reported in the June 2011 Thrift Financial Report was only 2.40 percent of aggregate total assets. However, FDIC's proposal cannot be considered in isolation. The Office of the Comptroller of the Currency (OCC), which has jurisdiction over the other permissible investments of federal savings associations, is subject to a similar mandate to remove references to NRSRO ratings from its regulations. OCC has issued a proposal with a virtually identical standard of creditworthiness. Thus, all investments by federal savings associations will be subject to increased scrutiny by examiners.

[9] 63 *Fed. Reg.* 20191 at 20196.

2. Transition Period

The Associations strongly urge FDIC to provide a reasonable transition period for compliance with the due diligence requirements. This is necessary, we believe, because institutions' due diligence processes will be under far greater scrutiny by examiners as a result of the new creditworthiness standard than was previously the case. Associations of all sizes will likely be required to establish or upgrade in-house systems, analytical capabilities and/or management capabilities. As a result, we recommend that any final rule provide a transition period of one year before compliance is required to make the necessary systems changes. Finally, we urge FDIC in the final rule to provide savings associations be given an additional year beyond the transition period to review existing securities portfolios.

CONCLUSION

In conclusion, the Associations generally support FDIC's proposed rule and proposed guidance with the modifications discussed above. We believe significant differentiation based on savings associations' size and/or complexity will be necessary for the proposals to be workable. In addition, we believe the transition period described above is necessary to allow savings associations to adjust their due diligence processes to conform to the proposals going forward.

If you have any questions about the foregoing, please do not hesitate to contact the undersigned.

Sincerely,

Cristeena G. Naser

Cristeena G. Naser
Senior Counsel, American Bankers Association
Associate General Counsel, ABA Securities Association

Richard M. Whiting

Richard Whiting
Executive Director and General Counsel
The Financial Services Roundtable