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December 5, 2013

Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549-1090

Re: Securities and Exchange Commission (“Commission”) Guidance Regarding Definitions of Mortgage Related Security and Small Business Related Security [Release No. 34-67448; File No. S7-06-12]

Dear Ms. Murphy:

I am writing to convey the comments of the Office of the Comptroller of the Currency (“OCC”) in response to the above-referenced guidance. The Commission solicited comments to assist in its efforts to develop new standards of creditworthiness. These standards would replace the references to credit ratings issued by nationally recognized statistical ratings organizations (“NRSROs”) in the definitions of “mortgage related security” and “small business related security” in the Securities Exchange Act of 1934 (“Exchange Act”).<sup>1</sup> The Dodd-Frank Wall Street Reform and Consumer Protection Act (“the Dodd-Frank Act”) replaced the references to credit ratings in those definitions, sections 3(a)(41) and 3(a)(53)(A) of the Exchange Act, respectively, with a requirement that the securities “meet the credit-worthiness standards as established by the Commission.”<sup>2</sup>

The new standards adopted by the Commission will affect depository institutions for which the OCC has direct oversight authority. These institutions, national banks, Federal savings associations, and Federal branches of foreign banks (collectively referred to as “banks”), have statutory authority to invest without limitation in mortgage related securities and small business related securities that meet the creditworthiness standards established by the Commission.<sup>3</sup> The OCC has in place a regulatory framework that references the Exchange Act’s definitions.<sup>4</sup>

In the Dodd-Frank Act, Congress directed the agencies to review their regulations and remove references to, or requirements of reliance on credit ratings and substitute a standard of

<sup>1</sup> Sections 3(a)(41) and 3(a)(53)(A) of the Exchange Act, 15 U.S.C. §§ 78c(a)(41) and (53)(A).

<sup>2</sup> Section 939(e), Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010).

<sup>3</sup> 12 U.S.C. § 24(Seventh)(national banks); 12 U.S.C. § 1464(c)(1)(R) and (S)(Federal savings associations); 12 U.S.C. § 3102(b)(Federal branches).

<sup>4</sup> 12 C.F.R. Part 1.

creditworthiness that each agency determined appropriate. In doing this, the agencies were to strive for uniformity. Section 939A(b) states that the agencies “shall seek to establish, to the extent feasible, uniform standards of credit-worthiness for use by each such agency, taking into account the entities regulated by each such agency and the purposes for which such entities would rely on such standards of credit-worthiness.”<sup>5</sup>

In response to the Dodd-Frank Act requirement, the OCC replaced references to credit ratings in its regulation, 12 C.F.R. Part 1, governing securities eligible for investment by national banks and Federal branches. Part 1 used credit ratings as a factor for determining credit quality, liquidity/marketability, and appropriate concentration levels of investment securities. The former definition of “investment grade” meant a security rated in one of the four highest rating categories by one or more NRSROs or one NRSRO if the security was only rated by one NRSRO. The OCC amended the definition of “investment grade” to remove the references to credit ratings and NRSROs and replaced the references with a non-ratings based standard of creditworthiness. The OCC’s amended definition in 12 C.F.R. § 1.2(d) states:

Investment grade means the issuer of a security has an adequate capacity to meet financial commitments under the security for the projected life of the asset or exposure. An issuer has an adequate capacity to meet financial commitments if the risk of default by the obligor is low and the full and timely repayment of principal and interest is expected.<sup>6</sup>

With respect to a structured security, the determination that full and timely repayment of principal and interest is expected may be influenced more by the quality of the underlying collateral, the cash flow rules, and the structure of the security itself than by the condition of the entity that is technically the issuer.<sup>7</sup>

The OCC also replaced references to credit ratings in 12 C.F.R. Part 160, which in part governs securities eligible for investment by Federal savings associations. A Federal savings association now must make this same determination when purchasing certain municipal revenue bonds.<sup>8</sup> A comparable creditworthiness standard applies to investments in commercial paper and corporate debt securities by Federal savings associations.<sup>9</sup>

In conjunction with its final rule removing the references to credit ratings, the OCC also issued guidance for implementing the rule.<sup>10</sup> To comply with the new standard, a bank may choose to

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<sup>5</sup> A comment filed in response to the Commission’s solicitation of comments on the guidance supports uniformity: the Mortgage Bankers Association strongly urged the Commission to adopt creditworthiness standards similar to the OCC’s standard.

<sup>6</sup> See 77 Fed. Reg. 35253 (June 13, 2012), revising 12 C.F.R. Part 1 (national banks and Federal branches) and 12 C.F.R. Part 160 (Federal savings associations).

<sup>7</sup> 77 Fed. Reg. 35253, 35254 (June 13, 2012)(final rule); 77 Fed. Reg. 35259, 35262 (June 13, 2012)(guidance).

<sup>8</sup> 12 C.F.R. § 160.42.

<sup>9</sup> To be eligible investments for Federal savings associations, commercial paper and corporate debt securities must meet the creditworthiness standards of the Federal Deposit Insurance Corporation (“FDIC”). See 12 U.S.C. § 1831e; 12 C.F.R. §§ 160.3 and 160.40(a). The FDIC adopted a creditworthiness standard in 12 C.F.R. § 362.11(b)(1) that is comparable to the OCC’s standard in 12 C.F.R. § 1.2(d).

<sup>10</sup> 77 Fed. Reg. 35259 (June 13, 2012).

use credit ratings as part of its investment grade determination. However, if so, the bank should supplement the external ratings with its own due diligence processes and additional analyses (its own or a third-party's) that are appropriate for the institution's risk profile and for the size and complexity of the instrument. The OCC's guidance advises that, in general, securities with good to very strong credit quality will meet the new creditworthiness standard.

The OCC adopted its new creditworthiness standard following issuance of two advance notices of proposed rulemaking ("ANPRs") and a subsequent notice of proposed rulemaking and guidance on implementation.<sup>11</sup> Together, the ANPRs generally described and requested comment on the following four alternative standards for measuring creditworthiness: (1) a credit quality based standard; (2) an investment quality based standard; (3) reliance on internal risk ratings; and (4) reliance on external information. Under any of the proposed alternative standards, a bank would be required to document its reviews, which would be subject to examiner review and classification, similar to the process used for loan classifications.

The OCC also sought comment on proposed criteria to evaluate potential creditworthiness standards. These included:

- Fosters prudent risk management;
- Is transparent, replicable, and well defined;
- Allows different banks to assign the same or similar assessment of credit quality to the same or similar credit exposures;
- Allows for supervisory review;
- Differentiates among investments in the same asset class with different credit risk; and
- Provides for the timely and accurate measurement of negative and positive changes in investment quality, to the extent practicable.

Commenters generally agreed with these proposed criteria, and most commenters argued that external credit ratings are a valuable tool for banks (especially small banks) to measure credit risk. Community and regional banks contended that the inability to use external credit ratings in evaluating investments could disadvantage them when compared with larger banks with advanced analytical capabilities. Community and regional banks were especially concerned about the cost and burden of developing in-house systems and management capabilities to apply new standards and supported a cost-effective, simple standardized approach to measuring credit risk. Larger internationally active banks expressed concern that they would be disadvantaged compared with foreign banks that may be able to continue to use external credit ratings.

After consideration of comments received on the two ANPRs, the OCC issued a notice of proposed rulemaking ("NPRM") and proposed substantive guidance to assist banks in meeting due diligence requirements for implementing the new standard.<sup>12</sup> In the NPRM, the OCC proposed using the credit quality based standard, which had been used for assessments of creditworthiness of unrated securities. The OCC carefully considered a second round of

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<sup>11</sup> 75 Fed. Reg. 49423 (Aug. 13, 2010)(national banks and Federal branches); 75 Fed. Reg. 63107 (Oct. 14, 2010)(Federal savings associations).

<sup>12</sup> 76 Fed. Reg. 73526 (Nov. 29, 2011).

comments on the NPRM from banks, bank trade groups, individuals, and bank service providers. The OCC adopted in its final rule the credit quality based standard as proposed.

The OCC's standard of creditworthiness applies to most types of securities eligible for investment by OCC-regulated depository institutions. For example, the standard applies to an asset-backed security that is not a mortgage related security or small business related security but is eligible for investment by national banks. Application of the OCC's standard to mortgage related securities and small business related securities, as defined by the SEC, would permit OCC-regulated institutions to use a uniform creditworthiness standard for all types of permissible securities investments that must satisfy a creditworthiness standard.

Other types of depository institutions, such as insured state-chartered banks and state-chartered banks that are members of the Federal Reserve System, are subject to the same limitations and conditions with respect to purchasing and holding investment securities as are national banks.<sup>13</sup> Moreover, the Federal Deposit Insurance Corporation ("FDIC") has adopted a creditworthiness standard for insured Federal and state savings associations investing in corporate debt securities comparable to that adopted by the OCC.<sup>14</sup> Consequently, the majority of depository institutions, when investing in securities subject to a creditworthiness standard, apply the OCC's standard or the FDIC's comparable standard. Application of the OCC's creditworthiness standard in the SEC's definitions would therefore permit most state-chartered banks and savings associations that are not supervised by the OCC also to apply a uniform creditworthiness standard to investments in securities.

The OCC urges the Commission to adopt the OCC's creditworthiness standard in the definitions of "mortgage related security" and "small business related security." Adopting the OCC's standard best complies with the directive in section 939A(b) of the Dodd-Frank Act to strive for uniformity in creditworthiness standards.

The OCC appreciates the opportunity to comment on this guidance and would welcome the opportunity to discuss any questions or provide additional information regarding these comments. OCC points of contact are Ellen Broadman, Director, Securities and Corporate Practices (202-649-5510), and Kerri Corn, Director for Market Risk (202-649-6398).

Sincerely,



Darrin Benhart  
Deputy Comptroller  
Commercial Credit Risk

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<sup>13</sup> 12 U.S.C. §§ 1831a & 335. *See also* the FDIC's FIL-48-2012 (Nov. 16, 2012) and the Federal Reserve Board's SR 12-15 (Nov. 15, 2012)(advising insured state-chartered banks and state member banks to comply with the OCC's amended creditworthiness standard).

<sup>14</sup> The FDIC's standard requires a savings association, prior to acquiring a corporate debt security, and periodically thereafter, to determine that the issuer of the security "has adequate capacity to meet all financial commitments under the security for the projected life of the security." 77 Fed. Reg. 43151 (July 24, 2012). *See also* 12 U.S.C. § 1831e(d); the FDIC's FIL-34-2012.