



**Title: Risk Based Capital
OFHEO Review of Unrated Securities and Counterparties**

Approved By: Armando Falcon, Jr.

Date: 10/2/02

I. PURPOSE:

To establish guidelines for OFHEO's review of an Enterprise's request for an amended ratings treatment of securities that are unrated or rated below BBB or counterparties that are unrated.

II. Scope:

These guidelines apply to the reviewing, evaluating, and making of recommendations on Enterprise requests for a change to the rating treatment of a security that is unrated or rated below BBB or a counterparty that is unrated, for purposes of the Risk-Based Capital (RBC) rule.

The Director of OFHEO may amend this guideline at his/her discretion.

III. Authority And References:

§§ 3.5.1 and 3.5.3.d of the Appendix to subpart B of 12 C.F.R Part 1750 (the Technical Appendix to the Risk-Based Capital Rule).

IV. Effective Date:

This guideline is effective immediately upon approval by the Director of OFHEO.

V. Policy:

The RBC rule provides for OFHEO review of information provided by an Enterprise justifying special rating treatment for 1) securities that are unrated or rated below BBB and 2) unrated seller-servicers in a delegated underwriting program.

For securities that are unrated or rated below BBB, the rule provides for an OFHEO review of a showing by an Enterprise that a different treatment is



**Title: Risk Based Capital
OFHEO Review of Unrated Securities and Counterparties**

warranted. Standard treatment under the rule would result in the security being subject to a 100 percent haircut.¹

For certain unrated multi-family seller-servicers that are participating in a delegated underwriting and servicing program for an Enterprise, the rule provides for a determination by OFHEO 1) whether the amount of a reserve account is adequate to support the seller-servicer's loss-sharing obligation and 2) if so, what, if any, rating higher than "BBB" shall be assigned. Without such a determination, OFHEO will assign seller/servicers a rating of "BBB" or, in certain circumstances, the rating of the issuer of the instrument backing a reserve account.²

Review of requests for an upgraded rating shall be conducted in accordance with Appendix A to this guideline.

VI. Responsibilities:

Responsibilities of the offices involved in the review of an Enterprise request are listed below. Offices other than ORAMD shall provide input to ORAMD for the recommendation memorandum.

The Office of General Counsel (OGC). OGC will review requests for changing security or counterparty ratings to determine their consistency with the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (the 1992 Act), OFHEO's regulations, and other applicable law.

The Office of Risk Analysis and Model Development (ORAMD). ORAMD is responsible for performing an analysis of the Enterprise's request and producing a Recommendation Memorandum. The Recommendation Memorandum must be sufficiently detailed to convey OFHEO's analysis, recommendation and rationale.

The Office of Information Technology (OIT). OIT will review the request to fully assess the practical implications of a change in rating in terms of data requirements and model code.

¹ 12 C.F.R. Part 1750, Subpart B, Appendix A § 3.5.1.

² Section 3.5.3 [a] 2.d. of Appendix A, 67 F.R. 11867 (March 15, 2002) (to be published at 12 C.F.R. part 1750, Subpart B, Appendix A §3.5.3 [a] 2.d.



Title: Risk Based Capital

OFHEO Review of Unrated Securities and Counterparties

The Office of Policy Analysis and Research (OPAR). OPAR is responsible for identifying and addressing any policy-level implications associated with the Enterprise security or counterparty rating request, and for providing input to ORAMD regarding those implications.

VII. Types of Records Created or Received:

- Request for Review.
- Form 40 with Recommendation Memorandum.
- Enterprise Response Memorandum.



**Title: Risk Based Capital
OFHEO Review of Unrated Securities and Counterparties**

**Appendix A
Procedures for Review of Unrated Counterparties**

1. **Initiation of OFHEO Review.** An Enterprise, in writing, submits a request to the Deputy Director of OFHEO for a review of the rating treatment of a security that is unrated or rated below BBB or of a multi-family seller-servicer participating in a delegated underwriting program. That notification should contain, at a minimum, identification of the security or counterparty; in the case of a counterparty, information about the reserve account supporting the seller-servicer's loss-sharing obligation under its delegated underwriting program; and a rationale as to why the rating should be changed. The Enterprise may also make a recommendation regarding the new rating for the security or counterparty. The OFHEO Deputy Director notifies the Office of Risk Analysis and Model Development (ORAMD), the Office of Information Technology (OIT), the Office of Policy Analysis and Research (OPAR), and the Office of General Counsel (OGC) of the request and forwards relevant materials to the appropriate Offices. OGC reviews the material to determine whether the request raises substantive legal issues that require immediate resolution. ORAMD may require requests for review to be submitted in a particular format or on forms it will specify.

2. **OFHEO Review Process.** ORAMD is responsible for evaluating the request for changing the rating and preparing related analyses and required supporting documentation. Specific responsibilities include the following:

2A. **Notify the Enterprise of Receipt of Request.** ORAMD will contact the submitting Enterprise to acknowledge receipt of the Enterprise's request and advise that OFHEO's review has begun. Contact with the Enterprise should occur within two business days upon receipt of the request from the Deputy Director's office, and be documented in ORAMD's records.

2B. **Collect Necessary Information from the Enterprise.** ORAMD will coordinate with Enterprise representatives to discuss the request, determine the rationale behind the request, and collect all information necessary for OFHEO to make a decision. ORAMD will document its contacts with the Enterprise, and maintain a record of discussions with management, requests for information, and other relevant information.



**Title: Risk Based Capital
OFHEO Review of Unrated Securities and Counterparties**

2C. **Perform Analysis** ORAMD's analysis will include at a minimum: (1) for securities rated below BBB or unrated, an assessment of the magnitude of the risks involved; (2) for unrated multi-family seller-servicers in a delegated underwriting program, a determination of a reserve account amount adequate to support the loss-sharing obligation and whether the actual amount exceeds the determined amount; (3) a determination of the scope of the requested rating (e.g., all transactions with the counterparty, only specific instruments, etc.); (3) evaluation of the quality and appropriateness of the materials provided for analysis; (4) evaluation of the methodology provided by the Enterprise; (5) comparison of the enterprise's internal rating methodology with that of a Nationally Recognized Statistical Rating Organization (NRSRO) (e.g., Moody's, Fitch, S&P, etc.); and (6) recommendation regarding the need of future OFHEO review if a new rating is determined appropriate.

ORAMD will make every effort to complete its initial analysis within 2 weeks of receipt of requested information from the Enterprises, although this time may change based on the level of complexity of analysis or because of conflicting priorities. ORAMD will provide OIT, OPAR and OGC with its analysis for review and will provide each reviewing office with a form to help ensure that ORAMD has met the above requirements. ORAMD will collect and document input from these offices within one week of assignment.

2D. **Prepare the Recommendation Memorandum and circulate within OFHEO.** The recommendation memorandum is the document that supports OFHEO's response to the request. ORAMD will produce the memorandum, together with an OFHEO Form 40 that will include a summary of the request, analysis performed (including all relevant points from 2C, above), and recommended course of action, including an appropriate method of modifying the RBC Report data if the request is approved. ORAMD is responsible for circulating the draft memorandum to OPAR, OGC, and OIT for review and comment, and revision as appropriate.

2E. **Forward the Recommendation Memorandum to the General Counsel and Associate Directors.** Once the Associate Directors of ORAMD, OIT, and OPAR and the General Counsel have completed their review and signed-off on the OFHEO Form 40, ORAMD will forward the memorandum (with revisions, if necessary) along with dissenting views, to the Director (or his designee) for a final decision.



Title: Risk Based Capital

OFHEO Review of Unrated Securities and Counterparties

2F. **OFHEO Decision.** The Director will review the final recommendation memorandum and render a decision. If OFHEO decides to make a rating change, the Director (or his designee) will also determine the appropriate method of changing the data to accommodate the counterparty rating change.

2G. **Notify Enterprise of Response to Request.** The Director (or the Director's designee) will provide notice to the Enterprise of OFHEO's decision and provide a copy to ORAMD and OGC for their records. If OFHEO decides to make a rating change, the Enterprise will be instructed on the specific rating determined, how to modify its RBC Report if necessary, and whether the Enterprise will be required to resubmit its RBC Report to OFHEO. If the Director does not grant the request, the response will set forth the basis of the denial.