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Comptroller of the Currency  
Administrator of National Banks

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Washington, DC 20219

October 29, 2001

**Interpretive Letter #927**  
**March 2002**  
**12 CFR 3**

VIA FACSIMILE

Dear [ ]:

This letter is in response to the issues you raised in your October 11 letter to the OCC regarding the appropriate risk-based capital treatment for [ ]'s securitization transactions. The OCC has determined that, for risk-based capital purposes, the bank must: (i) reflect recourse treatment on the securitized assets; and (ii) demonstrate to the satisfaction of the OCC that its policies and practices have been sufficiently modified to warrant application of non-recourse treatment to new securitization transactions. As you were previously instructed by on-site OCC examiners, [ ]'s Report of Condition and Income (Call Report) for the third quarter 2001 should be filed in a manner consistent with this recourse determination for risk-based capital purposes.

The OCC reviewed [ ]'s securitization program in a recent bank examination and determined that certain practices constitute a sale of assets with recourse for risk-based capital purposes. These practices related to the classification of certain delinquent accounts as fraud losses, resulting in repurchase by the bank at par, when the losses were actually attributable to credit quality. Consequently, the assets that were previously treated as sold under generally accepted accounting principles and for risk-based capital purposes will be risk weighted as if they were still on the bank's balance sheet and included in risk-weighted assets for risk-based capital purposes.

The general rule on recourse, contained in the glossary section of the Call Report instructions, describes the appropriate capital treatment for implicit recourse.<sup>1</sup> The instructions state,

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<sup>1</sup> See the glossary entry "Sales of Assets for Risk-Based Capital Purposes" in the Call Report instructions. These instructions are incorporated by reference in the OCC's risk-based capital regulations. See 12 CFR Part 3, Appendix A, Section 3(b)(1)(iii), footnote 14.

"Regardless of the legal structure of the transaction, if risk of loss is retained by the seller, either contractually or otherwise ... the seller should treat the transaction as an asset sale with recourse for purposes of risk-based capital and Schedule RC-R even if the sale ... is stated as being without recourse."

In your letter, you requested clarification of how the securitized assets should be treated prospectively. You state that you have "committed to change [your] accounting policies to eliminate any implication that [your] characterization of certain loan defaults as fraud losses gives rise to a right of recourse against the bank". Despite this commitment, the bank's past practices warrant continued recourse treatment for risk-based capital purposes on a prospective basis for the securitized assets, the securities backed by those assets, and the master trust from which the securities were issued.

The general presumption with securitization transactions is that a bank is not exposed to risk of loss beyond its contractual obligation. It is this presumption that allows banks to treat securitized assets as sold for risk-based capital purposes (i.e., not apply recourse treatment). Once a bank provides support to a securitization beyond the bank's contractual obligation, the presumption of the bank's limited exposure to loss no longer holds. When a bank provides non-contractual credit support to a securitization, the expectation is raised among securitization investors and bank supervisors that the bank will provide similar future support if needed. Allowing a bank to provide support to a securitization and then later allowing that securitization to receive the risk-based capital benefits of sales treatment can create an incentive for banks to repeatedly support a deal and subsequently alter their practices so as not to trigger recourse treatment going forward. Such a situation could result in the bank effectively providing on-going support to investors, resulting in no risk transference from the bank to third party investors, with the bank holding capital that is not commensurate with its risk exposure. Consequently, long-standing general OCC policy is that once a securitization has been "tainted", the transferred assets are treated as assets sold with recourse for risk-based capital purposes, even if a bank immediately stops its practice of providing support to investors.

The OCC has communicated its policy with respect to implicit recourse in a number of ways over the years. As we have described, the Call Report instructions clearly require recourse treatment for risk-based capital purposes where a bank provides support "contractually or otherwise". The 1994 Bank Accounting Advisory Series (BAAS) included an example of an implicit recourse situation involving the repurchase of performing and delinquent assets from a securitization trust and the subsequent issuance of a new securitization backed by the performing assets. Regulatory sales treatment was disallowed for the subsequent securitization of the repurchased assets. The BAAS noted that all future securitizations by the bank would require close scrutiny to determine whether implicit recourse existed. Recently issued revisions to the BAAS (September, 2001) continue to include an example of implicit recourse in which risk-based capital is required for securitized assets after a bank's prior actions have demonstrated the retention of a risk of loss. The OCC's policy regarding implicit recourse has also been described in the Comptroller's Handbook on Asset Securitization (November 1997) and the preambles to the 2000, 1997, and 1994 proposed rules on recourse.<sup>2</sup>

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<sup>2</sup> See "Risk-Based Capital Standards; Recourse and Direct Credit Substitutes; Proposed Rule", Federal Register,

In your letter, you requested clarification of whether the OCC would permit sales treatment for risk-based capital purposes for new securities that were exchanged for existing securities, where the new securities would be identical to the existing securities. The OCC would continue to require recourse treatment for the assets underlying these new securities. Recourse treatment is linked not only to the securities issued out of the existing master trust, but also to the receivables that back those securities. Issuing new securities that are identical to existing securities would not eliminate the recourse associated with the trust or the outstanding receivable balances that back those securities.

In order to avoid recourse treatment on any new securitization transactions involving new assets in a new master trust, the bank must demonstrate to the OCC's satisfaction that it has changed the practices that have resulted in recourse treatment and that it will not provide support to future securitizations. Factors that might be considered include an improved ability by the bank to distinguish between fraud losses and credit losses, trust documents that more clearly define how losses are to be shared between the bank and the trust, and demonstration over time that the bank's practices do not result in support to investors beyond the bank's contractual obligation.

We hope that this letter allows you to better understand our position with respect to your institution's risk-based capital treatment for securitization transactions. Please feel free to contact Tommy Snow at (202) 874-5070 if you have any questions.

Sincerely,

/s/

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Kevin J. Bailey  
Senior Advisor  
Bank Supervision Policy

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March 8, 2000 (Volume 65, Number 46); "Risk-Based Capital Standards; Recourse and Direct Credit Substitutes; Proposed Rule", Federal Register, November 5, 1997 (Volume 62, Number 214); and "Risk-Based Capital Requirements-Recourse and Direct Credit Substitutes", Federal Register, May 25, 1994 (Volume 59, Number 100).