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Comptroller of the Currency  
Administrator of National Banks

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Washington, DC 20219

March 17, 1999

**Interpretive Letter #858**  
**April 1999**  
**12 CFR 1**

Re: Philadelphia Authority for Industrial Development Pension  
Funding Bonds (City of Philadelphia Retirement System)  
Series 1999A - 1999C

Dear [ ]:

This responds to your letter on behalf of [ ] requesting that the Office of the Comptroller of the Currency (OCC) conclude that the Philadelphia Authority for Industrial Development Pension Funding Bonds, Series 1999A - 1999C (Bonds) are Type I investment securities as defined in 12 C.F.R. § 1.2(i), and qualify for a 20 percent risk-weight under the OCC's risk-based capital regulations. Based on your representations, and for the reasons discussed below, we conclude that the Bonds are Type I investment securities that qualify for a 20 percent risk weight under those regulations.

**Background**

The Philadelphia Authority for Industrial Development (Authority) is issuing the Bonds pursuant to, *inter alia*, the Municipal Pension Plan Funding Standard and Recovery Act,<sup>1</sup> to fund a portion of the unfunded actuarial accrued liabilities (Unfunded Liability) for the retirement system of the City of Philadelphia, Pennsylvania (City). You represent that the Bonds will be issued and secured under a Trust Indenture dated January 15, 1999 (Indenture) between the Authority and [ ], as trustee (Trustee).

The City's Home Rule Charter and the Pension Plan Act impose funding and other requirements on the City's pensions plans. The Home Rule Charter requires the City to maintain an actuarially sound pension and retirement system for all its officers and employees,

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<sup>1</sup> Act No. 205 of the General Assembly of the Commonwealth of Pennsylvania, approved December 18, 1984 (P.S. 1005) as amended (Pension Plan Act or Act).

and to obtain an annual actuarial valuation and computation of any related Unfunded Liability.<sup>2</sup> The Pension Plan Act requires the City to budget for and provide minimum annual contributions to its pension plans, payable from revenues of the City, that take the Unfunded Liability into consideration.<sup>3</sup> The Pension Plan Act also provides alternatives for reducing or eliminating the Unfunded Liability (described as “Funding Alternatives” in the Act).<sup>4</sup> The Funding Alternative chosen by the City is a service agreement between the City and the Authority under which the Authority will provide financial services to the City, including the funding of all or a portion of its Unfunded Liability (Service Agreement).<sup>5</sup> You represent that the Funding Alternative and the Service Agreement were approved by ordinance (Bill No. 980789), and adopted by the City’s City Council on December 19, 1998.

The Pension Plan Act requires all payments under the Service Agreement to be paid in full when due and to be included in the City’s annual budget.<sup>6</sup> Moreover, the City’s Home Rule Charter requires the City to appropriate monies for the amounts due under contracts, like the Service Agreement, in its annual operating budget.<sup>7</sup> The City’s Home Rule Charter requires

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<sup>2</sup> 53 P.S. § 895.302(d).

<sup>3</sup> 53 P.S. § 102 and § 404(a).

<sup>4</sup> 53 P.S. § 202.

<sup>5</sup> You represent that the Service Agreement requires the City to pay amounts sufficient to pay when due, *inter alia*, the principal or redemption price of, and interest on, the Bonds. You also represent that the Service Agreement provides that the City’s obligations are absolute and unconditional, and are not subject to any set-off or diminution.

<sup>6</sup> 53 P.S. §§ 895.302 and 1001. Failure to pay the full amount of the payment requirements of the Funding Alternative when due, may be remedied by the institution of legal proceedings for mandamus. 53 P.S. § 1001. Any person beneficially interested, including the Authority, has standing to institute a legal proceeding for mandamus. *Id.* The Indenture and the Service Agreement purportedly authorize the Trustee to proceed by mandamus to compel the budgeting and payment of all amounts due under the Service Agreement. The Public Employee Retirement Study Commission (Commission) may also issue an order requiring the City to comply with the Pension Plan Act. 53 P.S. § 895.307. If the City fails to comply with any lawful order of the Commission, the Commission may institute legal proceedings for injunction, mandamus or other appropriate remedy at law or in equity to enforce compliance with, or restrain violations of, the Commission’s orders. *Id.*

<sup>7</sup> Under the City’s Home Rule Charter, the City Council may by ordinance enter into a contract with a duration of more than one year without making appropriations beyond the current year. Section 2-309 of the City’s Home Rule Charter. Those contracts are valid and binding on the City even though no appropriations have been made for the ensuing years for

the City to balance its budget each year by raising revenue sufficient to pay all budgeted obligations.<sup>8</sup> As a result, the City is obligated, by reason of the mandatory inclusion of the Service Agreement obligations in its annual budget, to raise taxes, if necessary, to make its payments under the Service Agreement.

You assert that the Bonds are limited obligations of the Authority, payable from amounts received from the City pursuant to the Service Agreement. Although the Authority has no taxing power, you represent that the City is obligated by the Pension Plan Act, the City's Home Rule Charter, and the Service Agreement to appropriate monies from the revenues of the City, including taxes, to satisfy its budget obligations.<sup>9</sup>

You believe that the Bonds qualify as Type I securities regardless of the applicable "appropriations clause" in the City's Home Rule Charter. You state that, despite the appropriations clause, the City's obligations under the Service Agreement are required to be included in the City's budget under the Pension Plan Act and the City's Charter. Thus, you argue that Philadelphia's City Council is legally required to include those amounts in its budget and to appropriate sums to pay those amounts, with no discretion to omit the obligation.

You request that the OCC conclude that the Bonds qualify as a Type I investment securities as defined in 12 C.F.R. § 1.2(i)(4), and that they receive a 20 percent risk-weight under the OCC's risk based capital guidelines, on the basis that the Bonds constitute indirect general obligations of the City.

### **Applicable Law**

A national bank is permitted to "purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe."<sup>10</sup> Section 24(Seventh) states that the limitations on bank purchases of securities do not apply to obligations of the United States or general obligations of any State or of any political

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which the contract is in operation; but it is the duty of the City Council to make appropriations from year to year to pay amounts coming due under those contracts. *Id.*

<sup>8</sup> Section 2-302 of the City's Home Rule Charter.

<sup>9</sup> The Philadelphia City Council may by ordinance authorize contracts for services to be rendered over a period of more than one year without making appropriations beyond the current year. The Council must make subsequent appropriations from year to year to pay amounts coming due under its contracts. Section 2-309 of the City's Home Rule Charter. Such expenditures are to be met out of annual operating appropriations and thus out of current revenues. *Id.*

<sup>10</sup> 12 U.S.C. § 24(Seventh)

subdivision of a State.<sup>11</sup> Part 1 of OCC regulations implement the investment securities provisions of section 24(Seventh).<sup>12</sup> Under Part 1, “Type I” investment securities include general obligations of a State or any political subdivision.<sup>13</sup> A “political subdivision” includes a city.<sup>14</sup>

General obligations may be supported indirectly by political subdivisions with powers of taxation.<sup>15</sup> Where an obligor does not have powers of taxation, an obligation may be supported indirectly by a political subdivision having those powers and still qualify as a general obligation.<sup>16</sup> Accordingly, a general obligation of a political subdivision includes an obligation payable by an obligor that does not possess general powers of taxation, when a party possessing general powers of taxation has unconditionally promised to provide funds to cover all required payments on the obligation.<sup>17</sup> In addition, a political subdivision that possesses general powers of taxation can indirectly support a general obligation by committing its full faith and credit in support of the obligation in an agreement in which the political subdivision unconditionally promises to make payments for services provided by the issuer of the obligation.<sup>18</sup> Finally, a political subdivision can indirectly support a general obligation where a statutory provision or agreement unconditionally commits the political subdivision to provide funds sufficient for the timely payment of interest on, and principal of, the obligation.<sup>19</sup>

A bond’s status as an indirect general obligation is not necessarily affected by the existence of an “appropriations clause.” Appropriations clauses generally include language that states that certain payments, that are statutory or contractual obligations to be made periodically by a State

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<sup>11</sup> *Id.*

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

<sup>13</sup> 12 C.F.R. § 1.2(i)(4).

<sup>14</sup> 12 C.F.R. § 1.2(h).

<sup>15</sup> 12 C.F.R. § 1.2(b).

<sup>16</sup> 12 C.F.R. § 1.100.

<sup>17</sup> 12 C.F.R. §§ 1.2(b)(2) and 1.100(a).

<sup>18</sup> 12 C.F.R. § 1.100(b)(2). The payments must be sufficient, together with any other available funds, for the timely payment of the interest on, and principal of, the obligation. *Id.*

<sup>19</sup> 12 C.F.R. § 1.100(b)(4). The payments must be sufficient, together with any other available funds, for the timely payment of the interest on, and principal of, the obligation. *Id.*

or political subdivision, require appropriation by a body such as a legislature or city council.<sup>20</sup> A security that otherwise qualifies as an indirect general obligation may be considered supported by the full faith and credit of a State or political subdivision if the bank determines, on the basis of past actions by the legislative body or city council in similar situations involving similar types of projects, that it is reasonably probable that the obligor will obtain all necessary appropriations.<sup>21</sup>

OCC risk-based capital regulations contain four risk weights for national bank assets and off-balance sheet items, ranging from zero to 100 percent.<sup>22</sup> The 20 percent risk-weight category includes “claims representing general obligations of any public-sector entity in an OECD country [which includes the U.S.] and that portion of any claims guaranteed by any such public sector entity.”<sup>23</sup> In the U.S., these obligations must meet the requirements of 12 C.F.R. § [1.2(b)].<sup>24</sup> In contrast, revenue obligations of a public-sector entity in an OECD country that are repayable “solely from revenues generated by the project financed through the issuance of the obligations” receive a 50 percent risk weight.<sup>25</sup>

## **Discussion**

We conclude that the Bonds qualify as Type I investment securities and should be subject to a 20-percent risk weight under Part 3. The City, with general powers of taxation, indirectly supports the obligation at issue by committing to provide funds that cover all the required payments on the Bonds, as Part 1 requires.<sup>26</sup> The unconditional nature of the City’s Home Rule Charter, the Pension Plan Act and the terms of the Service Agreement, commit the City to appropriate sufficient revenues to cover service on the Bonds. The obligation must be included in the City’s annual budget and be paid from, if necessary, taxes imposed by the City pursuant to its taxing power. The Authority, an entity without taxing powers, will service the Bonds with the funds appropriated by the City.

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<sup>20</sup> OCC Interpretive Letter No. 791 (July 10, 1997) *reprinted in* [1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-218; OCC Interpretive Letter No. 675 (March 14, 1995) *reprinted in* [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,623.

<sup>21</sup> *Id.*

<sup>22</sup> 12 C.F.R. Part 3, Appendix A.

<sup>23</sup> *Id.*, at section 3(a)(2)(ix).

<sup>24</sup> *Id.*

<sup>25</sup> *Id.*, at 3(a)(3)(i).

<sup>26</sup> 12 C.F.R. § 1.2(b)(2).

The existence of the “appropriations clause” in the City’s Home Rule Charter does not bar the conclusion that the Bonds are Type I investment securities. The City’s Home Rule Charter provides that multiple year service contracts entered into by the City are valid and binding on the City even though appropriations must be made for the ensuing years for which the contract is in operation. The City’s Home Rule Charter requires the City Council to make appropriations from year to year to pay amounts coming due under the Service Agreement. You represent that those Home Rule Charter provisions apply not only to the Service Agreement, but to other agreements between the City and the Authority, the City and Pennsylvania Convention Center Authority, and the City and the Philadelphia Municipal Authority. You state that historically, amounts due under those agreements are appropriated and paid when due and always included in the City’s operating budgets. Indeed, if the City fails to make adequate annual appropriations under the Service Agreement and include the obligations in its annual budget, the obligation can also be enforced by the institution of legal proceedings by the Commission or by the Authority. Thus, national banks have a reasonable basis for concluding that the City will meet its obligations on the Bonds.

The Bonds meet the requirements of 12 C.F.R. § 1.2(b)(2) for a general obligation of a political subdivision, and therefore qualify for a 20 percent risk weight under the OCC’s risk-based capital regulations. The Bonds are obligations of a public sector entity in the U.S. since the Authority constitutes an entity established by the City and the Bonds ultimately are supported by payment from the City’s general revenues.

### **Conclusion**

For the foregoing reasons, and based on your representations, national banks may purchase the Bonds as Type I investment securities and treat them as having a 20 percent risk-weight under Part 3. The OCC does not endorse specific investments and this letter should not be used in a manner that suggests otherwise. If you have any questions, please contact me at (202) 874-5210.

Sincerely,

/s/

Tena M. Alexander  
Senior Attorney  
Securities and Corporate Practices Division