DEPARTMENT OF THE TREASURY
Office of the Comptroller of the Currency
12 CFR Part 3
[Docket No. 03-22]
RIN 1557-AC77

FEDERAL RESERVE SYSTEM
12 CFR Parts 208 and 225
[Regulations H and Y; Docket No. R-1162]

FEDERAL DEPOSIT INSURANCE CORPORATION
12 CFR Part 325
RIN 3064-AC75

DEPARTMENT OF THE TREASURY
Office of Thrift Supervision
12 CFR Part 567
[No. 2003-47]
RIN 1550-AB81

Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance: Asset-Backed Commercial Paper Programs and Early Amortization Provisions

AGENCIES: Office of the Comptroller of the Currency, Treasury; Board of Governors of the Federal Reserve System; Federal Deposit Insurance Corporation; and Office of Thrift Supervision, Treasury.

ACTION: Joint notice of proposed rulemaking.

SUMMARY: The Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (Board), Federal Deposit Insurance Corporation (FDIC), and Office of Thrift Supervision (OTS) (collectively, the agencies) are proposing to amend their risk-based capital standards by removing a sunset provision in order to permit sponsoring banks, bank holding companies, and thrifts (collectively, sponsoring banking organizations) to continue to exclude from their risk-weighted asset base those assets in asset-backed commercial paper (ABCP) programs that are consolidated onto sponsoring banking organizations' balance sheets as a result of a recently issued accounting interpretation, Financial Accounting Standards Board Interpretation No. 46, Consolidation of Variable Interest Entities (FIN 46). The removal of the sunset provision is contingent upon the agencies implementing alternative, more risk-sensitive risk-based capital requirements for credit exposures arising from involvement with ABCP programs.

In a related joint interim final rule published concurrently with this notice of proposed rulemaking, the agencies amended their risk-based capital standards to permit sponsoring banking organizations to remove such consolidated ABCP program assets from their risk-weighted asset base for purposes of calculating their risk-based capital ratios. Under the interim rule, sponsoring banking organizations must continue to include in risk-weighted assets the

credit equivalent amount of any exposures, such as credit enhancements, that organizations provide to ABCP programs. The agencies also amended their risk-based capital standards to exclude from tier 1 and total capital any minority interests in ABCP programs that are consolidated by sponsoring banking organizations under FIN 46. This interim risk-based capital treatment will expire on April 1, 2004.

The continuation of the risk-based capital treatment set forth in the interim rule would have no bearing on the accounting rules for balance sheet consolidation. In addition, continuation of this risk-based capital treatment would not affect the denominator of the tier 1 leverage capital ratio, which would continue to be based primarily on on-balance sheet assets as reported under generally accepted accounting principles (GAAP). Thus, in accordance with FIN 46, banking organizations would have to include all assets of consolidated ABCP programs in on-balance sheet assets for purposes of calculating the tier 1 leverage capital ratio.

The agencies also are proposing to require banking organizations to hold risk-based capital against liquidity facilities with an original maturity of one year or less that organizations provide to ABCP programs, regardless of whether the organization sponsors the program or must consolidate the program under GAAP. This treatment recognizes that such facilities expose banking organizations to credit risk and is consistent with the industry's practice of internally allocating economic capital against this risk associated with such facilities. A separate capital charge on liquidity facilities provided to an ABCP program would not be required if a banking organization must or chooses to consolidate the program for purposes of risk-based capital.

In addition, the agencies are proposing a risk-based capital charge for certain types of securitizations of revolving retail credit facilities (for example, credit card receivables) that incorporate early amortization provisions. The effect of these capital proposals will be to more closely align the risk-based capital requirements with the associated risk of the exposures.

Finally, the agencies are proposing to amend their risk-based capital standards by deleting tables and attachments that summarize risk categories, credit conversion factors, and transitional arrangements.

DATES: Comments on the joint notice of proposed rulemaking must be received by [INSERT DATE 45 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]**.**

ADDRESSES: Comments should be directed to:

OCC: You should send comments to the Public Information Room, Office of the Comptroller of the Currency, Mailstop 1-5, Attention: Docket No. 03-22, 250 E Street, SW, Washington, DC 20219. Due to delays in the delivery of paper mail in the Washington area and at the OCC, commenters are encouraged to submit comments by fax or e-mail. Comments may be sent by fax to (202) 874-4448, or by e-mail to regs.comments@occ.treas.gov. You can make an appointment to inspect and photocopy the comments by calling the Public Information Room at (202) 874-5043.

Board: Comments should refer to Docket No. R- 1162 and may be mailed to Ms. Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th and Constitution Avenue, NW, Washington, DC 20551. However, because paper mail in the Washington area and at the Board of Governors is subject to delay, please consider submitting your comments by e-mail to regs.comments@federalreserve.gov, or faxing them to the Office of the Secretary at 202/452-3819 or 202/452-3102. Members of the public may inspect comments in Room MP-500 of the Martin Building between 9:00 a.m. and 5:00 p.m. weekdays pursuant to § 261.12, except as provided in § 261.14, of the Board's Rules Regarding Availability of Information, 12 CFR 261.12 and 261.14.

FDIC: Written comments should be addressed to Robert E. Feldman, Executive Secretary, Attention: Comments/OES, Federal Deposit Insurance Corporation, 550 17th Street, NW, Washington, DC 20429. Comments may be hand delivered to the guard station at the rear of the 550 17th Street Building (located on F Street), on business days between 7:00 a.m. and 5:00 p.m. (Fax number: (202) 898-3838; Internet address: comments@fdic.gov). Comments may be inspected and photocopied in the FDIC Public Information Center, Room 100, 801 17th Street, NW, Washington, DC, between 9:00 a.m. and 4:30 p.m. on business days.

OTS: Send comments to Regulation Comments, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW, Washington, DC 20552, Attention: No. 2003-47.
Delivery: Hand deliver comments to the Guard's Desk, East Lobby Entrance, 1700 G Street, NW, from 9:00 a.m. to 4:00 p.m. on business days, Attention: Regulation Comments, Chief Counsel's Office, Attention: No. 2003-47.
Facsimiles: Send facsimile transmissions to FAX Number (202) 906-6518, Attention: No. 2003-47.
E-Mail: Send e-mails to regs.comments@ots.treas.gov, Attention: No. 2003-47 and include your name and telephone number. Due to temporary disruptions in mail service in the Washington, DC area, commenters are encouraged to send comments by fax or e-mail, if possible.

Availability of comments: OTS will post comments and the related index on the OTS Internet Site at *www.ots.treas.gov*. In addition, you may inspect comments at the Public Reading Room, 1700 G Street, NW, by appointment. To make an appointment for access, call (202) 906-5922, send an e-mail to *public.info@ots.treas.gov*, or send a facsimile transmission to (202) 906-7755. (Please identify the materials you would like to inspect to assist us in serving you.) We schedule appointments on business days between 10:00 a.m. and 4:00 p.m. In most cases, appointments will be available the business day after the date we receive a request.

FOR FURTHER INFORMATION CONTACT:

OCC: Amrit Sekhon, Risk Expert, Capital Policy Division, (202) 874-5211; Mauricio Claver-Carone, Attorney, or Ron Shimabukuro, Special Counsel, Legislative and Regulatory Activities Division, (202) 874-5090, Office of the Comptroller of the Currency, 250 E Street, SW, Washington, DC 20219.

Board: Thomas R. Boemio, Senior Supervisory Financial Analyst, (202) 452-2982, David Kerns, Supervisory Financial Analyst, (202) 452-2428, Barbara Bouchard, Assistant Director, (202) 452-3072, Division of Banking Supervision and Regulation; or Mark E. Van Der Weide, Counsel, (202) 452-2263, Legal Division. For the hearing impaired *only*, Telecommunication Device for the Deaf (TDD), (202) 263-4869.

FDIC: Jason C. Cave, Chief, Policy Section, Capital Markets Branch, (202) 898-3548, Robert F. Storch, Chief Accountant, (202) 898-8906, Division of Supervision and Consumer Protection; Michael B. Phillips, Counsel, (202) 898-3581, Supervision and Legislation Branch, Legal Division, Federal Deposit Insurance Corporation, 550 17th Street, NW, Washington, DC 20429.

OTS: Michael D. Solomon, Senior Program Manager for Capital Policy, (202) 906-5654, David W. Riley, Project Manager, Supervision Policy, (202) 906-6669; or Teresa A. Scott, Counsel (Banking and Finance), (202) 906-6478, Office of Thrift Supervision, 1700 G Street, NW, Washington, DC 20552.

SUPPLEMENTARY INFORMATION:

I. Asset-Backed Commercial Paper Programs

Background

An asset-backed commercial paper (ABCP) program typically is a program through which a banking organization provides funding to its corporate customers by sponsoring and administering a bankruptcy-remote special purpose entity that purchases asset pools from, or extends loans to, those customers. The asset pools in an ABCP program might include, for example, trade receivables, consumer loans, or asset-backed securities. The ABCP program raises cash to provide funding to the banking organization's customers through the issuance of commercial paper into the market. Typically, the sponsoring banking organization provides liquidity and credit enhancements to the ABCP program, which aid the program in obtaining high quality credit ratings that facilitate the issuance of the commercial paper.[1]

In January 2003, the Financial Accounting Standards Board (FASB) issued interpretation No. 46, "Consolidation of Variable Interest Entities" (FIN 46), requiring the consolidation of variable interest entities (VIEs) onto the balance sheets of companies deemed to be the primary beneficiaries of those entities.[2] FIN 46 likely will result in the consolidation of many ABCP programs onto the balance sheets of banking organizations beginning in the third quarter of 2003. In contrast, under pre-FIN 46 accounting standards, the sponsors of ABCP programs normally have not been required to consolidate the assets of these programs. Banking organizations that are required to consolidate ABCP program assets will have to include all of

1 For the purposes of this proposed rule, a banking organization is considered the sponsor of an ABCP program if it establishes the program; approves the sellers permitted to participate in the program; approves the asset pools to be purchased by the program; or administers the ABCP program by monitoring the assets, arranging for debt placement, compiling monthly reports, or ensuring compliance with the program documents and with the program's credit and investment policy.

2 Under FIN 46, the FASB broadened the criteria for determining when one entity is deemed to have a controlling financial interest in another entity and, therefore, when an entity must consolidate another entity in its financial statements. An entity generally does not need to be analyzed under FIN 46 if it is designed to have "adequate capital," as described in FIN 46, and its shareholders control the entity with their share votes and are allocated its profits and losses. If the entity fails these criteria, it typically is deemed a VIE and each stakeholder in the entity (a group that can include, but is not limited to, legal-form equity holders, creditors, sponsors, guarantors, and servicers) must assess whether it is the entity's "primary beneficiary" using the FIN 46 criteria. This analysis considers whether effective control exists by evaluating the entity's risks and rewards. In the end, the stakeholder who holds the majority of the entity's risks or rewards is the primary beneficiary and must consolidate the VIE.

the program assets (mostly receivables and securities) and liabilities (mainly commercial paper) on their September 30, 2003 balance sheets for purposes of the bank Reports of Condition and Income (Call Report), the Thrift Financial Report (TFR), and the bank holding company financial statements (FR Y-9C Report). If no changes were made to regulatory capital standards, the resulting increase in the asset base would lower both the tier 1 leverage and risk-based capital ratios of banking organizations that must consolidate the assets held in ABCP programs.

The agencies believe that the consolidation of ABCP program assets could result in risk-based capital requirements that do not appropriately reflect the risks faced by banking organizations involved with these programs. In the view of the agencies, banking organizations generally face limited risk exposure to ABCP programs. This risk usually is confined to the credit enhancements and liquidity facility arrangements that banking organizations provide to these programs. In addition, operational controls and structural provisions, along with overcollateralization or other credit enhancements provided by the companies that sell assets into ABCP programs mitigate the risk to which sponsoring banking organizations are exposed.

Because of the limited risks, in a related joint interim rule published elsewhere in today's Federal Register, the agencies amended their risk-based capital standards to permit sponsoring banking organizations to exclude ABCP program assets that must be consolidated by the organization under FIN 46 from risk-weighted assets for purposes of calculating the risk-based capital ratios through the end of the first quarter of 2004. The agencies also amended their risk-based capital rules to exclude from tier 1 and total risk-based capital any minority interest in sponsored ABCP programs that are consolidated under FIN 46. Exclusion of minority interests associated with consolidated ABCP programs is appropriate when such programs' assets are not included in a sponsoring organization's risk-weighted asset base and, thus, are not assessed a risk-based capital charge. This interim risk-based capital treatment will expire on April 1, 2004. The period during which the interim rule is in effect provides the agencies with additional time to develop appropriate risk-based capital requirements for banking organizations' sponsorship and other involvement with ABCP programs and to receive comments from the industry on this proposal.

The interim risk-based capital treatment does not alter any accounting requirements as established by GAAP or the manner in which banking organizations report consolidated on-balance sheet assets. In addition, the risk-based capital treatment set forth in the interim final rule and its proposed continuation in this joint notice of proposed rulemaking does not affect the denominator of the tier 1 leverage capital ratio, which would continue to be based primarily on on-balance sheet assets as reported under GAAP. Thus, as a result of FIN 46, banking organizations must include all assets of consolidated ABCP programs in on-balance sheet assets for purposes of calculating the tier 1 leverage capital ratio.

In contrast to most other cases where minority interests in consolidated subsidiaries are included as a component of tier 1 capital and, hence, are incorporated into the tier 1 leverage capital ratio calculation, minority interests related to sponsoring banking organizations' ABCP program assets consolidated as a result of FIN 46 are not to be included in tier 1 capital. Thus, the reported tier 1 leverage capital ratio for a sponsoring banking organization would likely be lower than it would be if only the ABCP program assets were consolidated. The agencies do not anticipate that the exclusion of minority interests related to consolidated ABCP programs assets would significantly affect the tier 1 leverage capital ratio of sponsoring banking organizations because the amount of equity in ABCP programs generally is small relative to the capital levels of the sponsoring organizations.

Proposed Risk-Based Capital Treatment for ABCP Exposures

In this notice of proposed rulemaking, the agencies are proposing to amend their risk-based capital standards by removing the April 1, 2004 sunset provision so that ABCP program assets consolidated under FIN 46 and any associated minority interests continue to be excluded from risk-weighted assets and tier 1 capital, respectively, when sponsoring banking organizations calculate their tier 1 and total risk-based capital ratios. The proposed removal of the sunset provision is contingent upon the agencies implementing an alternative, more risk-sensitive approach to the risk exposures arising from ABCP programs.

Accordingly, the agencies are proposing to amend their risk-based capital requirements to assess more appropriate capital charges against the credit exposures that arise from ABCP programs, including liquidity facilities with an original maturity of one year or less (that is, short-term liquidity facilities). The agencies believe that this proposal would result in a capital requirement that is more commensurate with the credit risk to which banking organizations are exposed as a result of their sponsorship and other involvement with ABCP programs. The capital charge for short-term liquidity facilities that are provided to ABCP programs generally would apply even if FIN 46 would not require the program to be consolidated.

Liquidity facilities extended to ABCP programs are commitments to lend to, or purchase assets from, the programs in the event that funds are needed to repay maturing commercial paper. Typically, this need for liquidity is due to a timing mismatch between cash collections on the underlying assets in the program and scheduled repayments of the commercial paper issued by the program. Currently, liquidity facilities with an original maturity of over one year (that is, long-term liquidity facilities) are converted to an on-balance sheet credit equivalent amount using the 50 percent credit conversion factor. Short-term liquidity facilities are converted to an on-balance sheet credit equivalent amount utilizing the zero percent credit conversion factor. As a result, such short-term facilities currently are not subject to a risk-based capital charge.

In the agencies' view, a banking organization that provides liquidity facilities to ABCP programs is exposed to credit risk regardless of the tenure of the liquidity facilities. For example, an ABCP program may draw on a liquidity facility at the first sign of deterioration in the credit quality of an asset pool to buy out the assets and remove them from the program. In such an event, a draw exposes the banking organization providing the liquidity facility to credit risk. The agencies believe that the existing risk-based capital rules do not adequately reflect the risks associated with short-term liquidity facilities extended to ABCP programs.

Although the agencies are of the view that liquidity facilities expose banking organizations to credit risk, the agencies also believe that the short tenure of commitments with an original maturity of one year or less exposes banking organizations to a lower degree of credit risk than longer tenure commitments. This difference in degree of credit risk exposure should be reflected in any potential capital requirement. The agencies, therefore, are proposing to convert short-term liquidity facilities provided to ABCP programs to on-balance sheet credit equivalent amounts utilizing the 20 percent credit conversion factor, as opposed to the 50 percent credit conversion factor applied to commitments with an original maturity of greater than one year. This amount would then be risk-weighted according to the underlying assets or the obligor, after considering any collateral or guarantees, or external credit ratings, if applicable. For example, if a short-term liquidity facility provided to an ABCP program covered an asset-backed security (ABS) externally rated AAA, then the amount of the security would be converted at 20 percent to an on-balance sheet credit equivalent amount and assigned to the 20 percent risk category appropriate for AAA-rated ABS.[3]

In many cases, a banking organization may have multiple exposures that may be drawn under varying circumstances within a single ABCP program (for example, both a credit enhancement and a liquidity facility). The agencies do not intend to subject a banking organization to duplicative risk-based capital requirements against these multiple exposures where they overlap and cover the same underlying asset pool. Rather, a banking organization must hold risk-based capital only once for the position covered by the overlapping exposures. Where the overlapping exposures are subject to different risk-based capital requirements, the banking organization must apply the risk-based capital treatment resulting in the highest capital charge to the overlapping portion of the exposures.

For example, assume a banking organization provides a program-wide credit enhancement covering 10 percent of the underlying asset pools in an ABCP program and pool-specific liquidity facilities covering 100 percent of each of the underlying asset pools. The banking organization would be required to hold capital against 10 percent of the underlying asset pools because it is providing the program-wide credit enhancement. The banking organization also would be required to hold capital against 90 percent of the liquidity facilities it is providing to each of the underlying asset pools. Moreover, if a banking organization had to consolidate ABCP program assets onto its balance sheet for risk-based capital purposes because, for example, the organization was not the sponsor of the program, the organization would not be required also to hold risk-based capital against any credit enhancements or liquidity facilities that cover those same program assets.

If different banking organizations provide overlapping exposures, however, each organization must hold capital against the entire maximum amount of its exposure. As a result, while duplication of capital charges will not occur for individual banking organizations, it may occur where multiple banking organizations have overlapping exposures to the same ABCP program.

The agencies also are proposing that banking organizations that are subject to the market risk capital rules would not be permitted to apply those rules to any liquidity facilities held in the trading book. Rather, organizations will be required to convert the notional amount of all liquidity facilities to ABCP programs using the appropriate credit conversion factor to determine the credit equivalent amount for liquidity facilities that are structured or characterized as derivatives or other trading book assets. Thus, for example, all liquidity facilities to ABCP programs with an original maturity of one year or less will be subject to a 20 percent conversion factor as described above, regardless of whether the exposure is carried in the trading account or the banking book. The agencies request comment on this prohibition and its implications.

In order for a liquidity facility, either short- or long-term, provided to an ABCP program not to be considered a recourse obligation or a direct credit substitute, draws on the facility must

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3 See 12 CFR part 3, appendix A, Section 4(d) (OCC); 12 CFR parts 208 and 225, appendix A, III.B.3.c. (FRB); 12 CFR part 325, appendix A, II.B.5.d. (FDIC); 12 CFR 567.6(b) (OTS).

be subject to a reasonable asset quality test that precludes funding assets that are 60 days or more past due or in default. Assets that are past due 60 days or more generally are considered ineligible for financing based upon standard industry practice and rating agency guidelines for trade receivables. The funding of assets past due 60 days or more using a liquidity facility exposes the institution to a greater degree of credit risk compared to the purchase of assets of a more current nature. It is the agencies' view that liquidity facilities that are eligible for the 20 percent or 50 percent conversion factors should not be used to fund assets with the higher degree of credit risk typically associated with seriously delinquent assets.

In addition, if the assets a banking organization would be required to fund pursuant to a liquidity facility are initially externally rated exposures, the facility can be used to fund only those exposures that are externally rated investment grade at the time of funding. Furthermore, the liquidity facility must contain provisions that, prior to any draws, reduce the banking organization's funding obligation to cover only those assets that would meet the funding criteria under the facility's asset quality tests. In other words, the amount of coverage provided by the liquidity facility must decrease as assets that meet the asset quality test decrease so that the liquidity facility would cover only those assets satisfying the asset quality test. If the asset quality tests were violated, the liquidity facility would be considered a direct credit substitute and would be converted at 100 percent as opposed to 20 or 50 percent.

Additional Risk-Based Capital Considerations

The agencies recognize that FIN 46 may affect whether consolidation is required of other VIE structures in addition to ABCP programs sponsored by banking organizations. While the current proposal would permit banking organizations to exclude from risk-weighted assets only sponsored ABCP program assets, the agencies seek comment on whether other structures or asset types affected by FIN 46 should be eligible for risk-based capital treatment similar to that proposed for banking organization-sponsored ABCP program assets. In addition, the agencies request feedback on whether banking organizations expect any difficulties in tracking these consolidated ABCP program assets on an ongoing basis. The agencies also request comment on any alternative regulatory capital approaches that should be considered, beyond what has been proposed.

II. Early Amortization Capital Charge

The Agencies also are seeking comment on the assessment of a risk-based capital charge against the risks associated with early amortization, a common feature in securitizations of revolving retail credit exposures (for example, credit card receivables). When assets are securitized, the extent to which the selling or sponsoring entity transfers the risks associated with the assets depends on the structure of the securitization and the nature of the underlying assets. The early amortization provision often present in securitizations of revolving retail credit facilities increases the likelihood that investors will be repaid before being subject to any risk of significant credit losses. For example, if a securitized asset pool begins to experience credit deterioration to the point where the early amortization provision is triggered, then the asset-backed securities begin to pay down rapidly. This occurs because, after an early amortization provision is triggered, if new receivables are generated from the accounts designated to the securitization trust, they are no longer sold to investors, but instead are retained on the sponsoring banking organization's balance sheet.

Early amortization provisions raise several distinct concerns about the risks to selling banking organizations. First, the seller's interest in the securitized assets effectively is subordinated to the interests of the investors by the payment allocation formula applied during early amortization. Investors effectively get paid first, and, as a result, the seller's residual interest likely will absorb a disproportionate share of credit losses.

Second, early amortization can create liquidity problems for selling organizations. For example, a credit card issuer must fund a steady stream of new credit card receivables when a securitization trust is no longer able to purchase new receivables due to early amortization. The selling organization must either find an alternative buyer for the receivables or else the receivables will accumulate on the seller's balance sheet, creating the need for another source of funding and potentially the need for additional regulatory capital.

Third, the first two risks to the selling banking organization can create an incentive for the seller to provide implicit support to the securitization transaction – credit enhancement beyond any pre-existing contractual obligations – to prevent an early amortization. Incentives to provide implicit support are, to some extent, present in other types of securitizations because of concerns about damage to the selling organization's reputation and its ability to securitize assets going forward if one of its transactions performs poorly. However, the early amortization provision creates additional and more direct financial incentives to prevent early amortization through the provision of implicit support.

This is not the first time that the agencies have addressed the question of whether to impose a capital charge on securitizations of revolving credit exposures incorporating early amortization provisions. On March 8, 2000, the agencies published a notice of proposed rulemaking on recourse and direct credit substitutes (65 FR 12320). In that proposal, the agencies proposed a fixed conversion factor of 20 percent to be applied to the amount of assets under management in all revolving securitizations that contained early amortization features, in recognition of the risks associated with these structures. The agencies acknowledge that the March 2000 proposal was not particularly risk sensitive and would have required the same amount of capital for all securitizations of revolving credit exposures that contained early amortization features, regardless of the risk present in the securitization transaction. In a subsequent November 2001 rulemaking (66 FR 59614), which implemented many of the proposals in the March 2000 proposal, the agencies reiterated their concerns with early amortization, indicating that the risks associated with securitization, including those posed by an early amortization feature, are not fully captured in the current capital rules.

In the interim, the Basel Committee on Banking Supervision (BSC) has set forth a more risk-sensitive proposal that would assess capital against securitizations of revolving exposures with early amortization features based on key indicators of risk, such as excess spread levels. Virtually all securitizations of revolving retail credit facilities that include early amortization provisions rely on excess spread as an early amortization trigger. For example, early amortization generally commences once excess spread falls below zero for a given period of time. International supervisors recognize that there is a connection between early amortization and excess spread levels. In a separate rulemaking, the agencies currently are seeking comment on the proposals the BSC has set forth for large, internationally active banking organizations.[4] The risk-based capital charge, on which comment is sought in this proposed rulemaking for the exposures arising from early amortization structures, is based on the proposal set forth by the Basel Supervisors Committee.[5]

The agencies believe that the risks associated with early amortization exist for all banking organizations that utilize securitizations of revolving exposures to fund their operations. Further, the agencies acknowledge that while early amortization events are infrequent, an increasing number of securitizations have been forced to unwind and repay investors earlier than planned. Given these concerns, the agencies are requesting comment on whether to impose a more risk-sensitive approach for assessing capital against securitizations of revolving retail credit exposures that incorporate early amortization provisions, which would apply to all banking organizations that use these vehicles to fund their operations.

Such an early amortization capital charge would be applied to securitizations of revolving retail credit facilities that include early amortization provisions, which are expected predominantly to be credit card securitizations. Since risk-based capital already is held against the on-balance sheet seller's interest, such a capital charge would be assessed against only the off-balance sheet investors' interest and only in the event that the excess spread in the transaction has declined to a predetermined level. The proposed capital requirement would assess increasing amounts of risk-based capital as the level of excess spread approaches the early amortization trigger (typically, a three-month average excess spread of zero). Therefore, as the probability of an early amortization event increases, the capital charge against the off-balance sheet portion of the securitization also would increase.

At this time, the agencies are only requesting comment on whether to assess risk-based capital against securitizations of revolving retail credit exposures (defined to include personal and business credit card accounts), even though there are some transactions that securitize revolving corporate exposures, such as certain collateralized loan obligations. The agencies are considering the appropriateness of applying an early amortization capital charge to securitizations of non-retail revolving credit exposures and request comment on this issue.

The maximum risk-based capital requirement that would be assessed under the proposal would be equal to the greater of (i) the capital requirement for residual interests or (ii) the capital requirement that would have applied if the securitized assets were held on the securitizing banking organization's balance sheet. The latter capital charge generally is 8 percent for credit card receivables. For example, if a banking organization, after securitizing a credit card portfolio, retains a combination of an interest-only strips receivable, a spread account, and a subordinated tranche that equaled 12 percent of the transaction, then under the agencies' risk-based capital standards the organization would be assessed a dollar-for-dollar capital charge against the 12 percent of retained, subordinated securitization exposures, net of any associated

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4 On August 4, 2003, the agencies published an advanced notice of proposed rulemaking (ANPR) in the Federal Register seeking public comment on the implementation of the new Basel Capital Accord in the United States. The ANPR presents an overview of the proposed implementation in the United States of the advanced approaches to determining risk-based capital requirements for credit and operational risk.

5 The credit conversion factors used in this proposed rulemaking mirror those in the agencies' July 2003 Advanced Notice of Proposed Rulemaking for non-controlled early amortization of uncommitted retail credit lines.

deferred tax liabilities. In this example, there would be no incremental charge for early amortization risk. Alternatively, if the amount of the retained exposures were less than 8 percent, which is the risk-based capital charge for credit card receivables held on the balance sheet, then the charge against the retained securitization exposures plus any early amortization capital charge would be limited to 8 percent. Potentially, if the exposure were limited by contract, the risk-based capital requirement could be limited to that contractual amount under the low-level exposure rule.

In order to determine whether a banking organization securitizing revolving retail credit facilities containing early amortization provisions must hold risk-based capital against the off-balance sheet portion of its securitization (that is, the investors' interest), the three-month average excess spread must be compared against the difference between (i) the point at which the securitization trust would be required by the securitization documents to trap excess spread (spread trapping point) in a spread or reserve account and (ii) the excess spread level at which early amortization would be triggered. This differential would be referred to as the excess spread differential (ESD). If the securitization documents do not require excess spread to be trapped, then for purposes of this calculation the spread trapping point is deemed to be 450 basis points higher than the early amortization trigger. If such a securitization does not employ the concept of excess spread as a transaction's determining factor of when an early amortization is triggered, then a 10 percent credit conversion factor is applied to the outstanding principal balance of the investors' interest at the securitization's inception, regardless of the level of the transaction's excess spread. Once the difference between the spread trapping point and the early amortization trigger is determined, this difference must be divided into four equal segments.

For example, if the spread trapping point is 4.5 percent and the early amortization trigger is zero, then the 450 basis point difference would be divided into four equal segments of 112.5 basis points. A credit conversion factor of zero percent would be applied to the outstanding principal balance of the off-balance sheet investors' interest if a securitization's three-month average excess spread equaled or exceeded the spread trapping point (4.5 percent in the example). Credit conversion factors of 5 percent, 10 percent, 50 percent, and 100 percent are assigned to each segment in descending order beginning at the spread trapping point as the securitization approaches early amortization as follows:

Example of Credit Conversion Factor Assignment by Segment

Segment of Excess Spread Differential	Credit Conversion Factor
450 bp or more	0 percent
Less than 450 bp to 337.5 bp	5 percent
Less than 337.5 bp to 225 bp	10 percent
Less than 225 bp to 112.5 bp	50 percent
Less than 112.5 bp	100 percent

In this example, if the three-month average excess spread is greater than 450 or equal to basis points, the banking organization would not incur a risk-based capital charge for early amortization. However, once the three-month average excess spread declines below 450 basis points, a positive credit conversion factor would be applied against the outstanding principal balance of the off-balance sheet investors' interest to calculate the credit equivalent amount of assets that is to be risk weighted according to the asset type, typically the 100 percent risk weight category.

On the other hand, if the spread trapping point instead were 6 percent and the early amortization trigger were 2 percent, then the ESD would be 4 percent, resulting in four equal segments of 100 basis points. The 5 percent credit conversion factor would be applied to the off-balance sheet investors' interest when the three-month average excess spread declined to between 6 percent and 5 percent.

The agencies seek comment on whether to adopt such a treatment of securitization of revolving credit facilities containing early amortization mechanisms. Would such a treatment satisfactorily address the potential risks such transactions pose to originators? Are there other approaches, treatments, or factors that the agencies should consider? Comments also are invited on the interplay and timing between this proposal and the proposed capital treatment for securitization structures contained in the agencies' July 2003 advanced notice of proposed rulemaking regarding the implementation of the proposed Basel Capital Accord.

III. Elimination of Summary Sections of Rules Text

The agencies also are proposing to amend their risk-based capital standards by deleting tables and attachments that summarize the risk categories, credit conversion factors, and transitional arrangements. These tables and attachments have become outdated and unnecessary because the substance of these summaries is included in the main text of the risk-based capital standards. Furthermore, these summary tables and attachments were originally provided to assist banking organizations unfamiliar with the new framework during the transition period when the agencies' risk-based capital requirements were initially implemented. Deleting the tables and attachments will remove unnecessary regulatory text.

IV. Regulatory Analysis

Regulatory Flexibility Act Analysis

Pursuant to section 605(b) of the Regulatory Flexibility Act, the Agencies have determined that this proposed rule would not have a significant impact on a substantial number of small entities in accordance with the spirit and purposes of the Regulatory Flexibility Act (5 U.S.C. 601 et seq.). The agencies believe that this proposed rule should not impact a substantial number of small banking organizations because such organizations typically do not sponsor ABCP programs, provide liquidity facilities to such programs, or engage in securitizations of revolving retail credit facilities. Accordingly, a regulatory flexibility analysis is not required.

Paperwork Reduction Act

The Agencies have determined that this proposed rule does not involve a collection of information pursuant to the provisions of the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 et seq.).

Unfunded Mandates Reform Act of 1995

OCC: Section 202 of the Unfunded Mandates Reform Act of 1995, Pub. L. 104-4

(Unfunded Mandates Act) requires that an agency prepare a budgetary impact statement before promulgating a rule that includes a Federal mandate that may result in expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of $100 million or more in any one year. If a budgetary impact statement is required, section 205 of the Unfunded Mandates Act also requires an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a rule. The OCC believes that exclusion of consolidated ABCP program assets from risk-weighted assets for risk-based capital purposes will not result in a significant impact for national banks because the exclusion of consolidated ABCP program assets is designed to offset the effect of FIN 46 on risk-based capital. With respect to the proposed capital treatment of liquidity facilities, because national banks that provide liquidity facilities to ABCP programs currently exceed regulatory minimum capital requirements, the OCC does not believe these banks will be required to raise additional capital. Finally, while the OCC and the other Federal banking agencies do not currently collect data on the excess spread levels for individual revolving securitizations, the OCC does not believe that the proposed capital charge on revolving securitizations will have a significant impact on the capital requirements of national banks because currently, most revolving securitizations are operating with excess spread levels above the proposed capital triggers.

OTS: Section 202 of the Unfunded Mandates Reform Act of 1995, Pub. L. 104-4 (Unfunded Mandates Act) requires that an agency prepare a budgetary impact statement before promulgating a rule that includes a Federal mandate that may result in expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of $100 million or more in any one year. If a budgetary impact statement is required, section 205 of the Unfunded Mandates Act also requires an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a rule.

Plain Language

Section 722 of the GLB Act requires the Federal banking agencies to use "plain language" in all proposed and final rules published after January 1, 2000. In light of this requirement, the agencies have sought to present their proposed rules in a simple and straightforward manner. The agencies invite comments on whether there are additional steps the agencies could take to make the rules easier to understand.

List of Subjects

12 CFR Part 3

Administrative practice and procedure, Capital, National banks, Reporting and recordkeeping requirements, Risk.

12 CFR Part 208

Accounting, Agriculture, Banks, banking, Confidential business information, Crime, Currency, Federal Reserve System, Mortgages, Reporting and recordkeeping requirements, Securities.

12 CFR Part 225

Administrative practice and procedure, Banks, banking, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities.

12 CFR Part 325

Administrative practice and procedure, Bank deposit insurance, Banks, banking, Capital adequacy, Reporting and recordkeeping requirements, Savings associations, State non-member banks.

12 CFR Part 567

Capital, Reporting and recordkeeping requirements, Savings associations.

Department of Treasury
Office of the Comptroller of the Currency
12 CFR Chapter 1

Authority and Issuance

For the reasons set out in the joint preamble, part 3 of chapter I of title 12 of the Code of Federal Regulations is proposed to be amended as follows:

PART 3--MINIMUM CAPITAL RATIOS; ISSUANCE OF DIRECTIVES

1. The authority citation for part 3 continues to reads as follows:

Authority: 12 U.S.C. 93a, 161, 1818, 1828(n), 1828 note, 1831n note, 1835, 3907, and 3909.

2. Appendix A to part 3 is amended as follows:

A. In section 1, paragraphs (c)(3) and (c)(30) are republished.

B. In section 2, paragraph (a)(3) is revised.

C. In section 3, paragraphs (b)(2)(ii), (b)(3)(i), and (b)(4)(i) are revised; and new paragraph (b)(3)(ii) is added.

D. In section 4:

i. Paragraphs (a)(5) through (a)(16) are redesignated as paragraphs (a)(7) through (a)(18); newly redesignated paragraphs (a)(15) through (a)(18) are redesignated as paragraphs (a)(16) through (a)(19); and new paragraphs (a)(5), (a)(6) and (a)(15) are added.

ii. Paragraphs (j) and (k) are revised;

iii. New paragraphs (l) and (m) are added.

E. In section 5, Tables 1 through 4 are removed.

Appendix A to Part 3—Risk-Based Capital Guidelines

Section 1. Purpose, Applicability of Guidelines and Definitions

*****

(c) ***

(3) Asset-backed commercial paper program means a program that issues commercial paper backed by assets or other exposures held in a bankruptcy-remote, special-purpose entity.

*****

(30) Sponsor means a bank that:

(i) Establishes an asset-backed commercial paper program;

(ii) Approves the sellers permitted to participate in an asset-backed commercial paper program;

(iii) Approves the asset pools to be purchased by an asset-backed commercial paper program; or

(iv) Administers the asset-backed commercial paper program by monitoring the assets, arranging for debt placement, compiling monthly reports, or ensuring compliance with the program documents and with the program's credit and investment policy.

Section 2. Components of Capital

*****

(a) ***

(3) Minority interests in the equity accounts of consolidated subsidiaries, except that the following are not included in Tier 1 capital or total capital:

(i) Minority interests in a small business investment company or investment fund that holds nonfinancial equity investments and minority interests in a subsidiary that is engaged in a nonfinancial activities and is held under one of the legal authorities listed in section 1(c)(21) of this appendix A.

(ii) Minority interests in consolidated asset-backed commercial paper programs sponsored by a bank if the consolidated assets are excluded from risk-weighted assets pursuant to section 4(j)(1) of this appendix A.

*****

Section 3. Risk Categories/Weights for On-Balance Sheet Assets and Off-Balance Sheet Items

*****

(b) ***

(2) ***

(ii) Unused portion of commitments, including home equity lines of credit, and eligible liquidity facilities (as defined in accordance with section 4(l)(2) of this appendix A) provided to asset-backed commercial paper programs, in form or in substance, with an original maturity exceeding one-year[17]; and

*****

(3) *** (i) Trade-related contingencies which are short-term self-liquidating instruments used to finance the movement of goods and are collateralized by the underlying shipment (an example is a commercial letter of credit); and

(ii) Unused portion of eligible liquidity facilities (as defined in accordance with section 4(l)(2) of this appendix A) provided to an asset-backed commercial paper program, in form or in substance, with an original maturity of one year or less.

(4) *** (i) Unused portion of commitments, including liquidity facilities not provided to asset-backed commercial paper programs, with an original maturity of one year or less;

*****

Section 4. Recourse, Direct Credit Substitutes and Positions in Securitizations

*****

(a) ***

(5) Early amortization trigger means a contractual requirement that, if triggered, would cause a securitization to begin repaying investors prior to the originally scheduled payment dates.

(6) Excess spread generally means gross finance charge collections and other income received by the trust or special purpose entity minus certificate interest, servicing fees, charge-offs, and other trust or special purpose entity expenses.

---

17 Participations in commitments are treated in accordance with section 4 of this appendix A.

*****

(15) Revolving retail credit means an exposure to an individual or a business where the borrower is permitted to vary both the drawn amount and the amount of repayment within an agreed limit under a line of credit (such as personal or business credit card accounts).

*****

(j) Asset-backed commercial paper programs subject to consolidation. (1) A bank that qualifies as a primary beneficiary and must consolidate an asset-backed commercial paper program as a variable interest entity under generally accepted accounting principles may exclude the consolidated asset-backed commercial paper program assets from risk-weighted assets if the bank is the sponsor of the consolidated asset-backed commercial paper program.

(2) If a bank excludes such consolidated asset-backed commercial paper program assets from risk-weighted assets, the bank must assess the appropriate risk-based capital charge against any risk exposures of the bank arising in connection with such asset-backed commercial paper program, including direct credit substitutes, recourse obligations, residual interests, liquidity facilities, and loans, in accordance with sections 3 and 4(b) of this appendix A.

(3) If a bank either elects not to exclude consolidated asset-backed commercial paper program assets from its risk-weighted assets in accordance with section 4(j)(1) of this appendix A, or is not permitted to exclude consolidated asset-backed commercial paper program assets, the bank must assess a risk-based capital charge based on the appropriate risk weight of the consolidated asset-backed commercial paper program assets in accordance with section 3(a) of this appendix A. In such case, direct credit substitutes and recourse obligations (including residual interests), and loans that sponsoring banks provide to such asset-backed commercial paper programs are not subject to any capital charge under section 4 of this appendix A.

(k) Other variable interest entities subject to consolidation. If a bank is required to consolidate the assets of a variable interest entity under generally accepted accounting principles, the bank must assess a risk-based capital charge based on the appropriate risk weight of the consolidated assets in accordance with section 3(a) of this appendix A. In such case, direct credit substitutes and recourse obligations (including residual interests), and loans that sponsoring banks provide to such asset-backed commercial paper programs are not subject to any capital charge under section 4 of this appendix A.

(l) Liquidity facility provided to an asset-backed commercial paper program. (1) Noneligible liquidity facilities treated as recourse or direct credit substitute. Liquidity facilities extended to asset-backed commercial paper programs that do not meet the criteria for an eligible liquidity facility provided to an asset-backed commercial paper program in accordance with section 4(l)(2) of this appendix A must be treated as recourse or as a direct credit substitute, and assessed the appropriate risk-based capital charge in accordance to section 4 of this appendix A.

(2) Eligible liquidity facility. In order for a liquidity facility provided to an asset-backed commercial paper program to be eligible for either the 50 percent or 20 percent credit conversion factors under section 3(b)(2) or 3(b)(3)(ii) of this appendix A, the liquidity facility must satisfy

the following criteria:

(i) At the time of draw, the liquidity facility must be subject to a reasonable asset quality test that:

(A) Precludes funding of assets that are 60 days or more past due or in default; and

(B) If the assets that a liquidity facility is required to fund are externally rated securities (at the time they are transferred into the program), the facility must be used to fund only securities that are externally rated investment grade at the time of funding. If the assets are not externally rated at the time they are transferred into the program, then they are not subject to this investment grade requirement.

(ii) The liquidity facility must provide that, prior to any draws, the bank's funding obligation is reduced to cover only those assets that satisfy the funding criteria under the asset quality test of the liquidity facility.

(m) Early amortization. (1) Additional capital charge for revolving retail securitization with early amortization trigger. A bank that originates a securitization of revolving retail credits that contains early amortization triggers must risk weight the off-balance sheet portion of such a securitization (investors' interest) by multiplying the outstanding principal amount of the investors' interest by the appropriate credit conversion factor in accordance with Table F in section 4(m)(3) of this appendix A, and then assigning the resulting credit equivalent amount to the appropriate risk weight category pursuant to section 3(a) of this appendix A. In order to determine the appropriate credit conversion factor, the bank must compare the most recent three-month average excess spread level of the securitization to the excess spread ranges in Table F of section 4(m)(3) of this appendix A, and apply the corresponding credit conversion factor.

(2) Excess spread differential. Before the bank can apply Table F in section 4(m)(3) of this appendix A, the bank must calculate the upper and lower bounds for each excess spread range. To calculate the upper and lower bounds, the bank must first determine the excess spread differential of the securitization. The excess spread differential is equal to the difference between the point at which the bank is required by the securitization to divert and trap excess spread (spread trapping point) in a spread or reserve account and the excess spread level at which early amortization of the securitization is triggered (early amortization trigger). If the securitization does not require excess spread to be diverted to a spread or reserve account at a certain excess spread level, the spread differential is equal to 4.5 percentage points. If the securitization does not use excess spread as an early amortization trigger, then a 10 percent credit conversion factor is applied to the outstanding principal balance of the investors' interest at the securitization's inception.

(3) Excess spread differential segments. Once the excess spread differential is determined, the standard excess spread differential value must be calculated by dividing the excess spread differential by 4. The upper and lower bounds for each of the excess spread differential segments is calculated using the spread trapping point and the standard excess spread differential value in accordance with the formulas provided in Table F of section 4(m)(3) of this appendix A. As provided in Table F of section 4(m)(3) of this appendix A, if the three-month excess spread level equals or exceeds the spread trapping point, the credit conversion factor is

zero (resulting in no capital charge on the investors' interest). If the spread trapping point exceeds the three-month excess spread level, then the corresponding credit conversion factor applied to the investors' interest increases in steps from 5 percent to 100 percent as the three-month excess spread level approaches the early amortization trigger.

Table F—Credit Conversion Factors for Revolving Retail Securitizations with Early Amortization Triggers

Excess Spread Ranges	Credit Conversion Factor
Excess spread equals or exceeds the spread trapping point	0%
Upper Bound < Spread Trapping Point Lower Bound = Spread Trapping Point – (1 x SESDV)	5%
Upper Bound < Spread Trapping Point – (1 x SESDV) Lower Bound = Spread Trapping Point – (2 x SESDV)	10%
Upper Bound < Spread Trapping Point – (2 x SESDV) Lower Bound = Spread Trapping Point – (3 x SESDV)	50%
Upper Bound < Spread Trapping Point – (3 x SESDV) Lower Bound = None	100%

Note: SESDV is the standard excess spread differential value.

(5) Limitations on risk-based capital requirements. For a bank subject to the early amortization requirements in section 4(m) of this appendix A, the total risk-based capital requirement for all of the bank's exposures to a securitization of revolving retail credits is limited to the greater of the risk-based capital requirement for residual interests, as defined in accordance with section 4(a)(14) of this appendix A, or the risk-based capital requirement for the underlying securitized assets calculated as if the bank continued to hold the assets on its balance sheet.

*****

3. Appendix B to part 3 is amended by adding a new sentence at the end of section 2, paragraph (a).

Appendix B to Part 3—Risk-Based Capital Guidelines; Market Risk Adjustment

*****

Section 2. Definitions

*****

(a) *** Liquidity facilities provided to asset-backed commercial paper programs in a bank's trading account are excluded from covered positions, and instead, are subject to the risk-based capital requirements as provided in appendix A of this part.

*****

[THIS SIGNATURE PAGE RELATES TO THE JOINT PROPOSED RULE ON "RISK-BASED CAPITAL GUIDELINES; ASSET-BACKED COMMERCIAL PAPER PROGRAMS AND EARLY AMORTIZATION PROVISIONS"]

September 4, 2003
Date

John D. Hawke, Jr. (signed)
John D. Hawke, Jr.
Comptroller of the Currency

Federal Reserve System
12 CFR Chapter II

Authority and Issuance

For the reasons set forth in the joint preamble, the Board of Governors of the Federal Reserve System proposes to amend parts 208 and 225 of chapter II of title 12 of the Code of Federal Regulations as follows:

PART 208 -- MEMBERSHIP OF STATE BANKING INSTITUTIONS IN THE FEDERAL RESERVE SYSTEM (REGULATION H)

1. The authority citation for part 208 continues to read as follows:

Authority: 12 U.S.C. 24, 36, 92a, 93a, 248(a), 248(c), 321-338a, 371d, 461, 481-486, 601, 611, 1814, 1816, 1818, 1820(d)(9), 1823(j), 1828(o), 1831, 1831o, 1831p-1, 1831r-1, 1831w, 1831x, 1835a, 1882, 2901-2907, 3105, 3310, 3331-3351, and 3906-3909; 15 U.S.C. 78b, 78l(b), 78l(g), 78l(i), 78o-4(c)(5), 78q, 78q-1, and 78w; 31 U.S.C. 5318; 42 U.S.C. 4012a, 4104a, 4104b, 4106, and 4128.

2. In Appendix A to part 208, the following amendments are proposed:

a. Section II.A.1.c. is revised.

b. In section III.B.3 --

i. Paragraph a., Definitions, is revised.

ii. Paragraph g., Limitations on risk-based capital requirements, is redesignated as paragraph h.

iii. A new paragraph g., Early amortization triggers, is added.

iv. A new paragraph iv., is added to the redesignated paragraph h.

c. Section III.B.6. is revised.

d. In section III.D --

i. The last sentence of the introductory paragraph is removed.

ii. In paragraph 2., Items with a 50 percent conversion factor, the third undesignated paragraph is revised and the fourth undesignated paragraph is removed.

iii. In paragraph 3, Items with a 20 percent conversion factor, the first undesignated paragraph is designated as 3.a. and a new paragraph 3.b. is added.

iv. The first sentence in paragraph 4., Items with a zero percent conversion factor, is revised.

v. Footnote 54 is removed and reserved.

e. Attachments IV, V, and VI are removed.

3. Amend Appendix E to part 208by adding two new sentences at the end of section 2.(a).

APPENDIX A TO PART 208—CAPITAL ADEQUACY GUIDELINES FOR STATE MEMBER BANKS: RISK-BASED MEASURE

*****

II. ***

A. ***

1. ***

c. Minority interest in equity accounts of consolidated subsidiaries. This element is included in Tier 1 because, as a general rule, it represents equity that is freely available to absorb losses in operating subsidiaries whose assets are included in a bank's risk-weighted asset base. While not subject to an explicit sublimit within Tier 1, banks are expected to avoid using minority interest in the equity accounts of consolidated subsidiaries as an avenue for introducing into their capital structures elements that might not otherwise qualify as Tier 1 capital or that would, in effect, result in an excessive reliance on preferred stock within Tier 1. Minority interests in small business investment companies, investment funds that hold nonfinancial equity investments (as defined in section II.B.5.b. of this appendix A), and subsidiaries engaged in nonfinancial activities, are not included in the bank's Tier 1 or total capital base if the bank's interest in the company or fund is held under one of the legal authorities listed in section II.B.5.b. In addition, minority interests in consolidated asset-backed commercial paper programs (as defined in section III.B.6. of this appendix) that are sponsored by a bank are not to be included in the bank's Tier 1 or total capital base when the bank excludes the consolidated assets of such programs from risk-weighted assets pursuant to section III.B.6. of this appendix.

*****

III. ***

B. ***

3. ***

a. Definitions – i. Credit derivative means a contract that allows one party (the "protection purchaser") to transfer the credit risk of an asset or off-balance sheet credit exposure to another party (the "protection provider"). The value of a credit derivative is dependent, at least in part, on the credit performance of the "reference asset."

ii. Credit-enhancing representations and warranties means representations and warranties that are made or assumed in connection with a transfer of assets (including loan servicing assets) and that obligate the bank to protect investors from losses arising from credit risk in the assets transferred or the loans serviced. Credit-enhancing representations and warranties include promises to protect a party from losses resulting from the default or nonperformance of another party or from an insufficiency in the value of the collateral. Credit-enhancing representations and warranties do not include:

1. Early default clauses and similar warranties that permit the return of, or premium refund clauses covering, 1-4 family residential first mortgage loans that qualify for a 50 percent risk weight for a period not to exceed 120 days from the date of transfer. These warranties may cover only those loans that were originated within 1 year of the date of transfer;

2. Premium refund clauses that cover assets guaranteed, in whole or in part, by the U.S. Government, a U.S. Government agency or a government-sponsored enterprise, provided the premium refund clauses are for a period not to exceed 120 days from the date of transfer; or

3. Warranties that permit the return of assets in instances of misrepresentation, fraud or incomplete documentation.

iii. Direct credit substitute means an arrangement in which a bank assumes, in form or in substance, credit risk associated with an on- or off-balance sheet credit exposure that was not previously owned by the bank (third-party asset) and the risk assumed by the bank exceeds the pro rata share of the bank's interest in the third-party asset. If the bank has no claim on the third-party asset, then the bank's assumption of any credit risk with respect to the third party asset is a direct credit substitute. Direct credit substitutes include, but are not limited to:

1. Financial standby letters of credit that support financial claims on a third party that exceed a bank's pro rata share of losses in the financial claim;

2. Guarantees, surety arrangements, credit derivatives, and similar instruments backing financial claims that exceed a bank's pro rata share in the financial claim;

3. Purchased subordinated interests or securities that absorb more than their pro rata share of losses from the underlying assets;

4. Credit derivative contracts under which the bank assumes more than its pro rata share of credit risk on a third party exposure;

5. Loans or lines of credit that provide credit enhancement for the financial obligations of an account party;

6. Purchased loan servicing assets if the servicer is responsible for credit losses or if the servicer makes or assumes credit-enhancing representations and warranties with respect to the loans serviced. Mortgage servicer cash advances that meet the conditions of section III.B.3.a.viii. of this appendix are not direct credit substitutes; and

7. Clean-up calls on third party assets. Clean-up calls that are 10 percent or less of the original pool balance that are exercisable at the option of the bank are not direct credit

substitutes.

8. Liquidity facilities extended to ABCP programs that are not eligible liquidity facilities (as defined in section III.B.3.a. of this appendix).

iv. Early amortization triggers mean contractual requirements that, if triggered, would cause a securitization to begin repaying investors prior to the originally scheduled payment dates.

v. Eligible liquidity facility means a facility subject to a reasonable asset quality test at the time of draw that precludes funding against assets that are 60 days or more past due or in default. In addition, if the assets that an eligible liquidity facility is required to fund against are externally rated exposures at the inception of the facility, the facility can be used to fund only exposures that are externally rated investment grade at the time of funding. Furthermore, an eligible liquidity facility must contain provisions that, prior to any draws, reduces the bank's funding obligation to cover only those assets that would meet the funding criteria under the facility’s asset quality tests.

vi. Excess Spread means gross finance charge collections and other income received by the trust or special purpose entity (SPE) minus certificate interest, servicing fees, charge-offs, and other trust or SPE expenses.

vii. Externally rated means that an instrument or obligation has received a credit rating from a nationally-recognized statistical rating organization.

viii. Face amount means the notional principal, or face value, amount of an off-balance sheet item; the amortized cost of an asset not held for trading purposes; and the fair value of a trading asset.

ix. Financial asset means cash or other monetary instrument, evidence of debt, evidence of an ownership interest in an entity, or a contract that conveys a right to receive or exchange cash or another financial instrument from another party.

x. Financial standby letter of credit means a letter of credit or similar arrangement that represents an irrevocable obligation to a third-party beneficiary:

1. To repay money borrowed by, or advanced to, or for the account of, a second party (the account party), or

2. To make payment on behalf of the account party, in the event that the account party fails to fulfill its obligation to the beneficiary.

xi. Mortgage servicer cash advance means funds that a residential mortgage loan servicer advances to ensure an uninterrupted flow of payments, including advances made to cover foreclosure costs or other expenses to facilitate the timely collection of the loan. A mortgage servicer cash advance is not a recourse obligation or a direct credit substitute if:

1. The servicer is entitled to full reimbursement and this right is not subordinated to other

claims on the cash flows from the underlying asset pool; or

2. For any one loan, the servicer's obligation to make nonreimbursable advances is contractually limited to an insignificant amount of the outstanding principal balance of that loan.

xii. Nationally recognized statistical rating organization (NRSRO) means an entity recognized by the Division of Market Regulation of the Securities and Exchange Commission (or any successor Division) (Commission) as a nationally recognized statistical rating organization for various purposes, including the Commission's uniform net capital requirements for brokers and dealers.

xiii. Recourse means the retention, by a bank, in form or in substance, of any credit risk directly or indirectly associated with an asset it has transferred and sold that exceeds a pro rata share of the bank's claim on the asset. If a bank has no claim on a transferred asset, then the retention of any risk of credit loss is recourse. A recourse obligation typically arises when a bank transfers assets and retains an explicit obligation to repurchase the assets or absorb losses due to a default on the payment of principal or interest or any other deficiency in the performance of the
underlying obligor or some other party. Recourse may also exist implicitly if a bank provides credit enhancement beyond any contractual obligation to support assets it has sold. The following are examples of recourse arrangements:

1. Credit-enhancing representations and warranties made on the transferred assets;

2. Loan servicing assets retained pursuant to an agreement under which the bank will be responsible for credit losses associated with the loans being serviced. Mortgage servicer cash advances that meet the conditions of section III.B.3.a.viii. of this appendix are not recourse arrangements;

3. Retained subordinated interests that absorb more than their pro rata share of losses from the underlying assets;

4. Assets sold under an agreement to repurchase, if the assets are not already included on the balance sheet;

5. Loan strips sold without contractual recourse where the maturity of the transferred loan is shorter than the maturity of the commitment under which the loan is drawn;

6. Credit derivatives issued that absorb more than the bank's pro rata share of losses from the transferred assets; and

7. Clean-up calls at inception that are greater than 10 percent of the balance of the original pool of transferred loans. Clean-up calls that are 10 percent or less of the original pool balance that are exercisable at the option of the bank are not recourse arrangements.

8. Liquidity facilities extended to ABCP programs that are not eligible liquidity facilities (as defined in section III.B.3.a. of this appendix).

xiv. Residual interest means any on-balance sheet asset that represents an interest (including a beneficial interest) created by a transfer that qualifies as a sale (in accordance with generally accepted accounting principles) of financial assets, whether through a securitization or otherwise, and that exposes the bank to credit risk directly or indirectly associated with the transferred assets that exceeds a pro rata share of the bank's claim on the assets, whether through subordination provisions or other credit enhancement techniques. Residual interests generally include credit-enhancing I/Os, spread accounts, cash collateral accounts, retained subordinated interests, other forms of over-collateralization, and similar assets that function as a credit enhancement. Residual interests further include those exposures that, in substance, cause the bank to retain the credit risk of an asset or exposure that had qualified as a residual interest before it was sold. Residual interests generally do not include interests purchased from a third party, except that purchased credit-enhancing I/Os are residual interests for purposes of this appendix.

xv. Revolving retail credit facility means an exposure to an individual where the borrower is permitted to vary both the drawn amount and the amount of repayment within an agreed limit under a line of credit (such as credit card accounts). Revolving retail credits include business credit card accounts.

xvi. Risk participation means a participation in which the originating party remains liable to the beneficiary for the full amount of an obligation (e.g., a direct credit substitute) notwithstanding that another party has acquired a participation in that obligation.

xvii. Securitization means the pooling and repackaging by a special purpose entity of assets or other credit exposures into securities that can be sold to investors. Securitization includes transactions that create stratified credit risk positions whose performance is dependent upon an underlying pool of credit exposures, including loans and commitments.

xviii. Sponsor means a bank that establishes an asset-backed commercial paper program; approves the sellers permitted to participate in the program; approves the asset pools to be purchased by the program; or administers the asset-backed commercial paper program by monitoring the assets, arranging for debt placement, compiling monthly reports, or ensuring compliance with the program documents and with the program's credit and investment policy.

xix. Structured finance program means a program where receivable interests and asset-backed securities issued by multiple participants are purchased by a special purpose entity that repackages those exposures into securities that can be sold to investors. Structured finance programs allocate credit risks, generally, between the participants and credit enhancement provided to the program.

xx. Traded position means a position that is externally rated and is retained, assumed, or issued in connection with an asset securitization, where there is a reasonable expectation that, in the near future, the rating will be relied upon by unaffiliated investors to purchase the position; or an unaffiliated third party to enter into a transaction involving the position, such as a purchase, loan, or repurchase agreement.

*****

g. Early Amortization Triggers. i. A bank that originates securitizations of revolving retail credit facilities that contain early amortization triggers must incorporate the off-balance sheet portion of such a securitization (that is, the investors' interest) into the bank's risk-weighted assets by multiplying the outstanding principal amount of the investors' interest by the appropriate credit conversion factor and then assigning the resultant credit equivalent amount to the appropriate risk weight category. The credit conversion factor to be applied to such a securitization generally is a function of the securitization's most recent three-month average excess spread level, the point at which excess spread in the securitization must be trapped in a spread or reserve account, and the excess spread level at which an early amortization of the securitization is triggered.

ii. In order to determine the appropriate credit conversion factor to be applied to the outstanding principal balance of the investors' interest, the originating bank must compare the securitization's most recent three-month average excess spread level against the difference between (i) the point at which the bank is required by the securitization documents to divert and trap excess spread (spread trapping point) in a spread or reserve account and (ii) the excess spread level at which early amortization of the securitization is triggered (early amortization trigger). The difference between the spread trapping point and the early amortization trigger is referred to as the excess spread differential (ESD). In a securitization of revolving retail credit facilities that employs the concept of excess spread to determine when an early amortization is triggered but where the securitization's transaction documents do not require excess spread to be diverted to a spread or reserve account at a certain level, the ESD is deemed to be 4.5 percentage points.

iii. If a securitization of revolving retail credit facilities does not employ the concept of excess spread as the transaction's determining factor of when an early amortization is triggered, then a 10 percent credit conversion factor is applied to the outstanding principal balance of the investors' interest at the securitization's inception.

vi. The ESD must then be divided to create four equal ESD segments. For example, when the ESD is 4.5 percent, this amount is divided into 4 equal ESD segments of 112.5 basis points. A credit conversion factor of zero percent would be applied to the outstanding principal balance of the investors' interest if the securitization's three-month average excess spread equaled or exceeded the securitization's spread trapping point (4.5 percent in the example). Credit conversion factors of 5 percent, 10 percent, 50 percent, and 100 percent are then assigned to each of the four equal ESD segments in descending order beginning at the spread trapping point as the securitization approaches early amortization. For instance, when the ESD is 4.5 percent, the credit conversion factors would be applied to the outstanding balance of the investors' interest as follows:

Example of Credit Conversion Factor Assignment by Segment of Excess Spread Differential

Segment of Excess Spread Differential	Credit Conversion Factor
450 bp or more	0 percent

Less than 450 bp to 337.5 bp	5 percent
Less than 337.5 bp to 225 bp	10 percent
Less than 225 bp to 112.5 bp	50 percent
Less than 112.5 bp	100 percent

h. Limitations on risk-based capital requirements. ***

iv. For a bank subject to the early amortization treatment in section III.B.3.g. of this appendix, the total risk-based capital requirement for all of the bank's exposures to a securitization of revolving retail credit facilities is limited to the greater of the risk-based capital requirement for residual interests, as defined in section III.B.3.a. of this appendix, or the risk-based capital requirement for the underlying securitized assets calculated as if the bank continued to hold the assets on its balance sheet.

*****

6. Asset-backed commercial paper programs. a. An asset-backed commercial paper (ABCP) program typically is a program through which a bank provides funding to its corporate customers by sponsoring and administering a bankruptcy-remote special purpose entity that purchases asset pools from, or extends loans to, the bank's customers. The ABCP program raises the cash to provide the funding through the issuance of commercial paper in the market.

b. A bank that qualifies as a primary beneficiary and must consolidate an ABCP program that is defined as a variable interest entity under GAAP may exclude the consolidated ABCP program assets from risk-weighted assets provided that the bank is the sponsor of the consolidated ABCP program. If a bank excludes such consolidated ABCP program assets, the bank must assess the appropriate risk-based capital charge against any risk exposures of the bank arising in connection with such ABCP programs, including direct credit substitutes, recourse obligations, residual interests, liquidity facilities, and loans, in accordance with sections III.B.3, III.C. and III.D. of this appendix.

*****

III. ***

D. ***

2. Items with a 50 percent conversion factor. ***

*****

Commitments are defined as any legally binding arrangements that obligate a bank to extend credit in the form of loans or leases; to purchase loans, securities, or other assets; or to participate in loans and leases. They also include overdraft facilities, revolving credit, home equity and mortgage lines of credit, eligible liquidity facilities to asset-backed commercial paper programs-,(in form or in substance), and similar transactions. Normally, commitments involve a written contract or agreement and a commitment fee, or some other form of consideration. Commitments are included in weighted-risk assets regardless of whether they contain "material adverse change" clauses or other provisions that are intended to relieve the issuer of its funding obligation under certain conditions. In the case of commitments structured as syndications, where the bank is obligated solely for its pro rata share, only the bank's proportional share of the syndicated commitment is taken into account in calculating the risk-based capital ratio. Banks that are subject to the market risk rules are required to convert the notional amount of long-term covered positions carried in the trading account that act as eligible liquidity facilities to ABCP programs, in form or in substance, at 50 percent to determine the appropriate credit equivalent amount for those facilities even though they are structured or characterized as derivatives or other trading book assets.

*****

3. Items with a 20 percent conversion factor. ***

a. ***

b. Undrawn portions of eligible liquidity facilities with an original maturity of one year or less that banks provide to asset-backed commercial paper (ABCP) programs also are converted at 20 percent. The resulting credit equivalent amount is then assigned to the risk category appropriate to the underlying assets or the obligor, after consideration of any collateral or guarantees, or external credit ratings, if applicable. Banks that comply with the market risk rules are required to convert the notional amount of short-term covered positions carried in the trading account that act as liquidity facilities to ABCP programs, in form or in substance, at 20 percent to determine the appropriate credit equivalent amount for those facilities even though they are structured or characterized as derivatives or other trading book assets. Liquidity facilities extended to ABCP programs that do not meet the following criteria are to be considered recourse obligations or direct credit substitutes and assessed the appropriate risk-based capital requirement in accordance with section III.B.3. of this appendix. Eligible liquidity facilities must be subject to a reasonable asset quality test at the time of draw that precludes funding against assets in the ABCP program that are 60 days or more past due or in default. In addition, if the assets that eligible liquidity facilities are required to fund against are externally rated exposures, the facility can be used to fund only those exposures that are externally rated investment grade at the time of funding. Furthermore, liquidity facilities should contain provisions that, prior to any draws, reduces the bank's funding obligation to cover only those assets that would meet the funding criteria under the facilities' asset quality tests.

4. *** These include unused portions of commitments, with the exception of eligible liquidity facilities provided to ABCP programs, with an original maturity of one year or less,[54] or which are unconditionally cancelable at any time, provided a separate credit decision is made before each drawing under the facility. ***

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54 [Reserved]

APPENDIX E TO PART 208 – CAPITAL ADEQUACY GUIDELINES FOR STATE MEMBER BANKS; MARKET RISK MEASURE

*****

Section 2. Definitions ***

(a) *** Covered positions exclude all positions in a bank's trading account that, in form or in substance, act as eligible liquidity facilities (as defined in III.B.3.a. of appendix A of this part) to asset-backed commercial paper programs (as defined in section III.B.6. of appendix A of this part). Such excluded positions are subject to the risk-based capital requirements set forth in appendix A of this part.

*****

PART 225 – BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL (REGULATION Y)

1. The authority citation for part 225 continues to read as follows:

Authority: 12 U.S.C. 1817(j)(13), 1818, 1828(o), 1831i, 1831p-1, 1843(c)(8), 1844(b), 1972(1), 3106, 3108, 3310, 3331-3351, 3907, and 3909; 15 U.S.C. 6801 and 6805.

2. In Appendix A to part 225, the following amendments are proposed:

a. Section II.A.1.c. is revised.

b. In section III.B.3 --

i. Paragraph a., Definitions, is revised.

ii. Paragraph g., Limitations on risk-based capital requirements, is redesignated as paragraph h.

iii. A new paragraph g., Early amortization triggers, is added.

iv. A new paragraph iv., is added to the redesignated paragraph h.

c. Section III.B.6. is revised.

d. In section III.D—

i. The last sentence of the introductory paragraph is removed.

ii. In paragraph 2., Items with a 50 percent conversion factor, the third undesignated paragraph is revised and the fourth undesignated paragraph is removed;

iii. In paragraph 3, Items with a 20 percent conversion factor, the first undesignated paragraph is designated as 3.a. and a new paragraph 3.b. is added;

iv. The first sentence in the paragraph 4., Items with a zero percent conversion factor, is revised.

d. Attachments IV, V, and VI are removed.

3. Amend Appendix E to part 225 by adding two new sentences at the end of section 2.(a).

APPENDIX A TO PART 225—CAPITAL ADEQUACY GUIDELINES FOR BANK HOLDING COMPANIES: RISK-BASED MEASURE

*****

II. ***

A. ***

1. ***

c. Minority interest in equity accounts of consolidated subsidiaries. This element is included in Tier 1 because, as a general rule, it represents equity that is freely available to absorb losses in operating subsidiaries whose assets are included in a bank organization's risk-weighted asset base. While not subject to an explicit sublimit within Tier 1, banking organizations are expected to avoid using minority interest in the equity accounts of consolidated subsidiaries as an avenue for introducing into their capital structures elements that might not otherwise qualify as Tier 1 capital or that would, in effect, result in an excessive reliance on preferred stock within Tier 1. Minority interests in small business investment companies, investment funds that hold nonfinancial equity investments (as defined in section II.B.5.b. of this appendix A), and subsidiaries engaged in nonfinancial activities are not included in the banking organization's Tier 1 or total capital base if the organization's interest in the company or fund is held under one of the legal authorities listed in section II.B.5.b. In addition, minority interests in consolidated asset-backed commercial paper programs (as defined in section III.B.6. of this appendix) that are sponsored by a banking organization are not to be included in the organization's Tier 1 or total capital base if the bank holding company excludes the consolidated assets of such programs from risk-weighted assets pursuant to section III.B.6. of this appendix.

*****

III. ***

B. ***

3. ***

a. Definitions – i. Credit derivative means a contract that allows one party (the "protection purchaser") to transfer the credit risk of an asset or off-balance sheet credit exposure to another party (the "protection provider"). The value of a credit derivative is dependent, at least in part, on the credit performance of the "reference asset."

ii. Credit-enhancing representations and warranties means representations and warranties that are made or assumed in connection with a transfer of assets (including loan servicing assets) and that obligate the bank holding company to protect investors from losses arising from credit risk in the assets transferred or the loans serviced. Credit-enhancing representations and warranties include promises to protect a party from losses resulting from the default or nonperformance of another party or from an insufficiency in the value of the collateral. Credit-enhancing representations and warranties do not include:

1. Early default clauses and similar warranties that permit the return of, or premium refund clauses covering, 1-4 family residential first mortgage loans that qualify for a 50 percent risk weight for a period not to exceed 120 days from the date of transfer. These warranties may cover only those loans that were originated within 1 year of the date of transfer;

2. Premium refund clauses that cover assets guaranteed, in whole or in part, by the U.S. Government, a U.S. Government agency or a government-sponsored enterprise, provided the premium refund clauses are for a period not to exceed 120 days from the date of transfer; or

3. Warranties that permit the return of assets in instances of misrepresentation, fraud or incomplete documentation.

iii. Direct credit substitute means an arrangement in which a bank holding company assumes, in form or in substance, credit risk associated with an on- or off-balance sheet credit exposure that was not previously owned by the bank holding company (third-party asset) and the risk assumed by the bank holding company exceeds the pro rata share of the bank holding company's interest in the third-party asset. If the bank holding company has no claim on the third-party asset, then the bank holding company's assumption of any credit risk with respect to the third party asset is a direct credit substitute. Direct credit substitutes include, but are not limited to:

1. Financial standby letters of credit that support financial claims on a third party that exceed a bank holding company's pro rata share of losses in the financial claim;

2. Guarantees, surety arrangements, credit derivatives, and similar instruments backing financial claims that exceed a bank holding company's pro rata share in the financial claim;

3. Purchased subordinated interests or securities that absorb more than their pro rata share of losses from the underlying assets;

4. Credit derivative contracts under which the bank holding company assumes more than its pro rata share of credit risk on a third party exposure;

5. Loans or lines of credit that provide credit enhancement for the financial obligations of an account party;

6. Purchased loan servicing assets if the servicer is responsible for credit losses or if the

servicer makes or assumes credit-enhancing representations and warranties with respect to the loans serviced. Mortgage servicer cash advances that meet the conditions of section III.B.3.a.viii. of this appendix are not direct credit substitutes; and

7. Clean-up calls on third party assets. Clean-up calls that are 10 percent or less of the original pool balance that are exercisable at the option of the bank holding company are not direct credit substitutes.

8. Liquidity facilities extended to ABCP programs that are not eligible liquidity facilities (as defined in section III.B.3.a. of this appendix).

iv. Early Amortization Triggers mean contractual requirements that, if triggered, would cause a securitization to begin repaying investors prior to the originally scheduled payment dates.

v. Eligible liquidity facility means a facility subject to a reasonable asset quality test at the time of draw that precludes funding against assets that are 60 days or more past due or in default. In addition, if the assets that an eligible liquidity facility is required to fund against are externally rated exposures at the inception of the facility, the facility can be used to fund only those exposures that are externally rated investment grade at the time of funding. Furthermore, an eligible liquidity facility must contain provisions that, prior to any draws, reduces the bank holding company's funding obligation to cover only those assets that would meet the funding criteria under the facility's asset quality tests.

vi. Excess Spread means gross finance charge collections and other income received by the trust or special purpose entity (SPE) minus certificate interest, servicing fees, charge-offs, and other trust or SPE expenses.

vii. Externally rated means that an instrument or obligation has received a credit rating from a nationally-recognized statistical rating organization.

viii. Face amount means the notional principal, or face value, amount of an off-balance sheet item; the amortized cost of an asset not held for trading purposes; and the fair value of a trading asset.

ix. Financial asset means cash or other monetary instrument, evidence of debt, evidence of an ownership interest in an entity, or a contract that conveys a right to receive or exchange cash or another financial instrument from another party.

x. Financial standby letter of credit means a letter of credit or similar arrangement that represents an irrevocable obligation to a third-party beneficiary:

1. To repay money borrowed by, or advanced to, or for the account of, a second party (the account party), or

2. To make payment on behalf of the account party, in the event that the account party fails to fulfill its obligation to the beneficiary.

xi. Mortgage servicer cash advance means funds that a residential mortgage loan servicer advances to ensure an uninterrupted flow of payments, including advances made to cover foreclosure costs or other expenses to facilitate the timely collection of the loan. A mortgage servicer cash advance is not a recourse obligation or a direct credit substitute if:

1. The servicer is entitled to full reimbursement and this right is not subordinated to other claims on the cash flows from the underlying asset pool; or

2. For any one loan, the servicer's obligation to make nonreimbursable advances is contractually limited to an insignificant amount of the outstanding principal balance of that loan.

xii. Nationally recognized statistical rating organization (NRSRO) means an entity recognized by the Division of Market Regulation of the Securities and Exchange Commission (or any successor Division) (Commission) as a nationally recognized statistical rating organization for various purposes, including the Commission's uniform net capital requirements for brokers and dealers.

xiii. Recourse means the retention, by a bank holding company, in form or in substance, of any credit risk directly or indirectly associated with an asset it has transferred and sold that exceeds a pro rata share of the banking organization's claim on the asset. If a banking organization has no claim on a transferred asset, then the retention of any risk of credit loss is recourse. A recourse obligation typically arises when a bank holding company transfers assets and retains an explicit obligation to repurchase the assets or absorb losses due to a default on the payment of principal or interest or any other deficiency in the performance of the underlying obligor or some other party. Recourse may also exist implicitly if a bank holding company provides credit enhancement beyond any contractual obligation to support assets it has sold. The following are examples of recourse arrangements:

1. Credit-enhancing representations and warranties made on the transferred assets;

2. Loan servicing assets retained pursuant to an agreement under which the bank holding company will be responsible for credit losses associated with the loans being serviced. Mortgage servicer cash advances that meet the conditions of section III.B.3.a.viii. of this appendix are not recourse arrangements;

3. Retained subordinated interests that absorb more than their pro rata share of losses from the underlying assets;

4. Assets sold under an agreement to repurchase, if the assets are not already included on the balance sheet;

5. Loan strips sold without contractual recourse where the maturity of the transferred loan is shorter than the maturity of the commitment under which the loan is drawn;

6. Credit derivatives issued that absorb more than the bank holding company's pro rata share of losses from the transferred assets; and

7. Clean-up calls at inception that are greater than 10 percent of the balance of the

original pool of transferred loans. Clean-up calls that are 10 percent or less of the original pool balance that are exercisable at the option of the bank are not recourse arrangements.

8. Liquidity facilities extended to ABCP programs that are not eligible liquidity facilities (as defined in section III.B.3.a. of this appendix).

xiv. Residual interest means any on-balance sheet asset that represents an interest (including a beneficial interest) created by a transfer that qualifies as a sale (in accordance with generally accepted accounting principles) of financial assets, whether through a securitization or otherwise, and that exposes the bank holding company to credit risk directly or indirectly associated with the transferred assets that exceeds a pro rata share of the bank holding company's claim on the assets, whether through subordination provisions or other credit enhancement techniques. Residual interests generally include credit-enhancing I/Os, spread accounts, cash collateral accounts, retained subordinated interests, other forms of over-collateralization, and similar assets that function as a credit enhancement. Residual interests further include those exposures that, in substance, cause the bank holding company to retain the credit risk of an asset or exposure that had qualified as a residual interest before it was sold. Residual interests generally do not include interests purchased from a third party, except that purchased credit-enhancing I/Os are residual interests for purposes of this appendix.

xv. Revolving retail credit facility means an exposure to an individual where the borrower is permitted to vary both the drawn amount and the amount of repayment within an agreed limit under a line of credit (such as credit card accounts). Revolving retail credits include business credit card accounts.

xvi. Risk participation means a participation in which the originating party remains liable to the beneficiary for the full amount of an obligation (e.g., a direct credit substitute) notwithstanding that another party has acquired a participation in that obligation.

xvii. Securitization means the pooling and repackaging by a special purpose entity of assets or other credit exposures into securities that can be sold to investors. Securitization includes transactions that create stratified credit risk positions whose performance is dependent upon an underlying pool of credit exposures, including loans and commitments.

xviii. Sponsor means a bank holding company that establishes an asset-backed commercial paper program; approves the sellers permitted to participate in the program; approves the asset pools to be purchased by the program; or administers the asset-backed commercial paper program by monitoring the assets, arranging for debt placement, compiling monthly reports, or ensuring compliance with the program documents and with the program's credit and investment policy.

xix. Structured finance program means a program where receivable interests and asset-backed securities issued by multiple participants are purchased by a special purpose entity that repackages those exposures into securities that can be sold to investors. Structured finance programs allocate credit risks, generally, between the participants and credit enhancement provided to the program.

xx. Traded position means a position that is externally rated and is retained, assumed, or issued in connection with an asset securitization, where there is a reasonable expectation that, in the near future, the rating will be relied upon by unaffiliated investors to purchase the position; or an unaffiliated third party to enter into a transaction involving the position, such as a purchase, loan, or repurchase agreement.

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g. Early Amortization Triggers. i. A bank holding company that originates securitizations of revolving retail credit facilities that contain early amortization triggers must incorporate the off-balance sheet portion of such a securitization (that is, the investors' interest) into the bank's risk-weighted assets by multiplying the outstanding principal amount of the investors' interest by the appropriate credit conversion factor and then assigning the resultant credit equivalent amount to the appropriate risk weight category. The credit conversion factor to be applied to such a securitization generally is a function of the securitization's most recent three-month average excess spread level, the point at which excess spread in the securitization must be trapped in a spread or reserve account, and the excess spread level at which an early amortization of the securitization is triggered.

ii. In order to determine the appropriate credit conversion factor to be applied to the outstanding principal balance of the investors' interest, the originating bank holding company must compare the securitization's most recent three-month average excess spread level against the difference between (i) the point at which the organization is required by the securitization documents to divert and trap excess spread (spread trapping point) in a spread or reserve account and (ii) the excess spread level at which early amortization of the securitization is triggered (early amortization trigger). The difference between the spread trapping point and the early amortization trigger is referred to as the excess spread differential (ESD). In a securitization of revolving retail credit facilities that employs the concept of excess spread to determine when an early amortization is triggered but where the securitization's transaction documents do not require excess spread to be diverted to a spread or reserve account at a certain level, the ESD is deemed to be 4.5 percentage points.

iii. If a securitization of revolving retail credit facilities does not employ the concept of excess spread as the transaction's determining factor of when an early amortization is triggered, then a 10 percent credit conversion factor is applied to the outstanding principal balance of the investors' interest at the securitization's inception.

iv. The ESD must then be divided to create four equal ESD segments. For example, when the ESD is 4.5 percent, this amount is divided into 4 equal ESD segments of 112.5 basis points. A credit conversion factor of zero percent would be applied to the outstanding principal balance of the investors' interest if the securitization's three-month average excess spread equaled or exceeded the securitization's spread trapping point (4.5 percent in the example). Credit conversion factors of 5 percent, 10 percent, 50 percent, and 100 percent are then assigned to each of the four equal ESD segments in descending order beginning with the spread trapping point as the securitization approaches early amortization. For instance, when the ESD is 4.5 percent, the credit conversion factors would be applied to the outstanding balance of the investors' interest as follows:

Example of Credit Conversion Factor Assignment by Segment of Excess Spread Differential

Segment of Excess Spread Differential	Credit Conversion Factor
450 bp or more	0 percent
Less than 450 bp to 337.5 bp	5 percent
Less than 337.5 bp to 225 bp	10 percent
Less than 225 bp to 112.5 bp	50 percent
Less than 112.5 bp	100 percent

h. Limitations on risk-based capital requirements. ***

iv. For a bank holding company subject to the early amortization treatment in section III.B.3.g. of this appendix, the total risk-based capital requirement for all of the bank's exposures to a securitization of revolving retail credit facilities is limited to the greater of the risk-based capital requirement for residual interests, as defined in section III.B.3.a. of this appendix, or the risk-based capital requirement for the underlying securitized assets calculated as if the bank holding company continued to hold the assets on its balance sheet.

*****

6. Asset-backed commercial paper programs. a. An asset-backed commercial paper (ABCP) program typically is a program through which a bank holding company provides funding to its corporate customers by sponsoring and administering a bankruptcy-remote special purpose entity that purchases asset pools from, or extends loans to, the banking organization's customers. The ABCP program raises the cash to provide the funding through the issuance of commercial paper in the market.

b. A bank holding company that qualifies as a primary beneficiary and must consolidate an ABCP program that is defined as a variable interest entity under GAAP may exclude the consolidated ABCP program assets from risk-weighted assets provided that the bank is the sponsor of the consolidated ABCP program. If a bank holding company excludes such consolidated ABCP program assets, the bank holding company must assess the appropriate risk-based capital charge against any risk exposures of the organization arising in connection with such ABCP programs, including direct credit substitutes, recourse obligations, residual interests, liquidity facilities, and loans, in accordance with sections III.B.3, III.C. and III.D. of this appendix.

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III. ***

D. ***
2. Items with a 50 percent conversion factor. ***

*****

Commitments are defined as any legally binding arrangements that obligate a banking organization to extend credit in the form of loans or leases; to purchase loans, securities, or other assets; or to participate in loans and leases. They also include overdraft facilities, revolving credit, home equity and mortgage lines of credit, eligible liquidity facilities to asset-backed commercial paper programs (in form or in substance), and similar transactions. Normally, commitments involve a written contract or agreement and a commitment fee, or some other form of consideration. Commitments are included in weighted-risk assets regardless of whether they contain “material adverse change” clauses or other provisions that are intended to relieve the issuer of its funding obligation under certain conditions. In the case of commitments structured as syndications, where the banking organization is obligated solely for its pro rata share, only the organization’s proportional share of the syndicated commitment is taken into account in calculating the risk-based capital ratio. Banking organizations that are subject to the market risk rules are required to convert the notional amount of long-term covered positions carried in the trading account that act as eligible liquidity facilities to ABCP programs, in form or in substance, at 50 percent to determine the appropriate credit equivalent amount for those facilities even though they are structured or characterized as derivatives or other trading book assets.

*****

3. Items with a 20 percent conversion factor. ***

a. ***

b. Undrawn portions of eligible liquidity facilities with an original maturity of one year or less, that banking organizations provide to asset-backed commercial paper (ABCP) programs also are converted at 20 percent. The resulting credit equivalent amount is then assigned to the risk category appropriate to the underlying assets or the obligor, after consideration of any collateral or guarantees, or external credit ratings, if applicable. Banking organizations that are subject to the market risk rules are required to convert the notional amount of short-term covered positions carried in the trading account that act as eligible liquidity facilities to ABCP programs, in form or in substance, at 20 percent to determine the appropriate credit equivalent amount for those facilities even though they are structured or characterized as derivatives or other trading book assets. Liquidity facilities extended to ABCP programs that do not meet the following criteria are to be considered recourse obligations or direct credit substitutes and assessed the appropriate risk-based capital requirement in accordance with section III.B.3. of this appendix. Eligible liquidity facilities must be subject to a reasonable asset quality test at the time of draw that precludes funding against assets in the ABCP program that are 60 days or more past due or in default. In addition, if the assets that eligible liquidity facilities are required to fund against are externally rated exposures, the facility can be used to fund only those exposures that are externally rated investment grade at the time of funding. Furthermore, liquidity facilities must contain provisions that, prior to any draws, reduces the banking organization's funding obligation to cover only those assets that would meet the funding criteria under the facilities’ asset quality tests.

4. *** These include unused portions of commitments, with the exception of eligible liquidity facilities provided to ABCP programs, with an original maturity of one year or less, or which are unconditionally cancelable at any time, provided a separate credit decision is made before each drawing under the facility. ***

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APPENDIX E TO PART 225 – CAPITAL ADEQUACY GUIDELINES FOR BANK HOLDING COMPANIES; MARKET RISK MEASURE

*****

Section 2. Definitions ***

(a) *** Covered positions exclude all positions in a banking organization's trading account that, in form or in substance, act as eligible liquidity facilities (as defined in section III.B.3.a. of appendix A of this part) to asset-backed commercial paper programs (as defined in section III.B.6. of appendix A of this part). Such excluded positions are subject to the risk-based capital requirements set forth in appendix A of this part.

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[THIS SIGNATURE PAGE RELATES TO THE JOINT PROPOSED RULE ON "RISK-BASED CAPITAL GUIDELINES; ASSET-BACKED COMMERCIAL PAPER PROGRAMS AND EARLY AMORTIZATION PROVISIONS"]

By order of the Board of Governors of the Federal Reserve System, September 12, 2003.

Jennifer J. Johnson (signed)
Jennifer J. Johnson
Secretary of the Board

Federal Deposit Insurance Corporation
12 CFR Chapter III

Authority and Issuance

For the reasons set forth in the joint preamble, the Board of Directors of the Federal Deposit Insurance Corporation proposes to amend part 325 of chapter III of title 12 of the Code of Federal Regulations as follows:

PART 325 – CAPITAL MAINTENANCE

1. The authority citation for part 325 continues to read as follows:

Authority: 12 U.S.C. 1815(a), 1815(b), 1816, 1818(a), 1818(b), 1818(c), 1818(t), 1819(Tenth), 1828(c), 1828(d), 1828(i), 1828(n), 1828(o), 1831o, 1835, 3907, 3909, 4808; Pub. L. 102-233, 105 Stat. 1761, 1789, 1790 (12 U.S.C. 1831n note); Pub. L. 102-242, 105 Stat. 2236, 2355, as amended by Pub. L. 103-325, 108 Stat. 2160, 2233 (12 U.S.C. 1828 note); Pub. L. 102-242, 105 Stat. 2236, 2386, as amended by Pub. L. 102-550, 106 Stat. 3672, 4089 (12 U.S.C. 1828 note).

2. In Appendix A to part 325, the following amendments are proposed:

a. Section I.A.1. is revised.

b. In section II.B.5 --

i. Paragraph (a), Definitions, is revised.

ii. Paragraph (h), Limitations on risk-based capital requirements, is redesignated as paragraph (i) and paragraph (i), Alternative Capital Calculation for Small Business Obligations, is redesignated as paragraph (j).

iii. A new paragraph (h), Early amortization triggers, is added.

iv. A new paragraph (4), is added to the redesignated paragraph (i).

c. Section II.B.6. is revised.

d. In section II.D --

i. The last sentence of the introductory paragraph is removed;

ii. In paragraph 2., Items With a 50 Percent Conversion Factor, the third undesignated paragraph is revised;

iii. In paragraph 3, Items With a 20 Percent Conversion Factor, the first undesignated paragraph is designated as 3.a. and a new paragraph 3.b. is added;

iv. The first sentence in paragraph 4., Items With a Zero Percent Conversion Factor, is revised.

e. Tables III and IV are removed.

3. In Appendix C to part 325, the following amendment is proposed:

a. In section 2(a), two new sentences are added at the end of the paragraph.

APPENDIX A TO PART 325—STATEMENT OF POLICY ON RISK-BASED CAPITAL

*****

I. ***

A. ***

1. Core capital elements (Tier 1) consists of:

i. Common stockholders' equity capital (includes common stock and related surplus, undivided profits, disclosed capital reserves that represent a segregation of undivided profits, and foreign currency translation adjustments, less net unrealized holding losses on available-for-sale equity securities with readily determinable fair values);

ii. Noncumulative perpetual preferred stock,[2] including any related surplus; and

iii. Minority interests in the equity capital accounts of consolidated subsidiaries.

At least 50 percent of the qualifying total capital base should consist of Tier 1 capital. Core (Tier 1) capital is defined as the sum of core capital elements minus all intangible assets (other than mortgage servicing assets, nonmortgage servicing assets and purchased credit card relationships eligible for inclusion in core capital pursuant to § 325.5(f),[3] minus credit-enhancing interest-only strips that are not eligible for inclusion in core capital pursuant to § 325.5(f), minus any disallowed deferred tax assets, and minus any amount of nonfinancial equity investments required to be deducted pursuant to section II.B.(6) of this Appendix.

Although nonvoting common stock, noncumulative perpetual preferred stock, and minority interests in the equity capital accounts of consolidated subsidiaries are normally included in Tier 1 capital, voting common stockholders' equity generally will be expected to be the dominant form of Tier 1 capital. Thus, banks should avoid undue reliance on nonvoting equity, preferred stock and minority interests.

Although minority interests in consolidated subsidiaries are generally included in

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2 Preferred stock issues where the dividend is reset periodically based, in whole or in part, upon the bank's current credit standing, including but not limited to, auction rate, money market or remarketable preferred stock, are assigned to Tier 2 capital, regardless of whether the dividends are cumulative or noncumulative.

3 An exception is allowed for intangible assets that are explicitly approved by the FDIC as part of the bank's regulatory capital on a specific case basis. These intangibles will be included in capital for risk-based capital purposes under the terms and conditions that are specifically approved by the FDIC.

regulatory capital, exceptions to this general rule will be made if the minority interests fail to provide meaningful capital support to the consolidated bank. Such a situation could arise if the minority interests are entitled to a preferred claim on essentially low risk assets of the subsidiary. Similarly, although credit-enhancing interest-only strips and intangible assets in the form of mortgage servicing assets, nonmortgage servicing assets and purchased credit card relationships are generally recognized for risk-based capital purposes, the deduction of part or all of the credit-enhancing interest-only strips, mortgage servicing assets, nonmortgage servicing assets and purchased credit card relationships may be required if the carrying amounts of these assets are excessive in relation to their market value or the level of the bank's capital accounts. Credit-enhancing interest-only strips, mortgage servicing assets, nonmortgage servicing assets, purchased credit card relationships and deferred tax assets that do not meet the conditions, limitations and restrictions described in § 325.5(f) and (g) of this part will not be recognized for risk-based capital purposes.

Minority interests in small business investment companies, investment funds that hold nonfinancial equity investments (as defined in section II.B.(6)(ii) of this appendix A), and subsidiaries that are engaged in nonfinancial activities are not included in the bank's Tier 1 or total capital base if the bank's interest in the company or fund is held under one of the legal authorities listed in section II.B.(6)(ii) of this appendix A. In addition, minority interests in consolidated asset-backed commercial paper programs that are sponsored by a bank are not to be included in the bank's Tier 1 or total capital base if the bank excludes the consolidated assets of such programs from risk-weighted assets pursuant to section II.B.6. of this appendix.

*****

II. ***

B. ***

5. ***

a. Definitions – (1) Credit derivative means a contract that allows one party (the "protection purchaser") to transfer the credit risk of an asset or off-balance sheet credit exposure to another party (the "protection provider"). The value of a credit derivative is dependent, at least in part, on the credit performance of the "reference asset."

(2) Credit-enhancing interest only strip is defined in § 325.2(g).

(3) Credit-enhancing representations and warranties means representations and warranties that are made or assumed in connection with a transfer of assets (including loan servicing assets) and that obligate the bank to protect investors from losses arising from credit risk in the assets transferred or the loans serviced. Credit-enhancing representations and warranties include promises to protect a party from losses resulting from the default or nonperformance of another party or from an insufficiency in the value of the collateral. Credit-enhancing representations and warranties do not include:

(i) Early default clauses and similar warranties that permit the return of, or premium refund clauses covering, 1-4 family residential first mortgage loans that qualify for a 50 percent risk weight for a period not to exceed 120 days from the date of transfer. These warranties may cover only those loans that were originated within 1 year of the date of transfer;

(ii) Premium refund clauses that cover assets guaranteed, in whole or in part, by the U.S. Government, a U.S. Government agency or a government-sponsored enterprise, provided the premium refund clauses are for a period not to exceed 120 days from the date of transfer; or

(iii) Warranties that permit the return of assets in instances of misrepresentation, fraud or incomplete documentation.

(4) Direct credit substitute means an arrangement in which a bank assumes, in form or in substance, credit risk associated with an on- or off-balance sheet credit exposure that was not previously owned by the bank (third-party asset) and the risk assumed by the bank exceeds the pro rata share of the bank's interest in the third-party asset. If the bank has no claim on the third-party asset, then the bank's assumption of any credit risk with respect to the third party asset is a direct credit substitute. Direct credit substitutes include, but are not limited to:

(i) Financial standby letters of credit, which includes any letter of credit or similar arrangement, however named or described, that support financial claims on a third party that exceed a bank's pro rata share of losses in the financial claim;

(ii) Guarantees, surety arrangements, credit derivatives, and irrevocable guarantee-type instruments backing financial claims such as outstanding loans, or other financial claims, or that back off-balance-sheet items against which risk-based capital must be maintained;

(iii) Purchased subordinated interests or securities that absorb more than their pro rata share of credit losses from the underlying assets. Purchased subordinated interests that are credit-enhancing interest-only strips are subject to the higher capital charge specified in section II.B.5.(f) of this Appendix A;

(iv) Entering into a credit derivative contract under which the bank assumes more than its pro rata share of credit risk on a third party asset or exposure;

(v) Loans or lines of credit that provide credit enhancement for the financial obligations of an account party;

(vi) Purchased loan servicing assets if the servicer:

(A) Is responsible for credit losses with the loans being serviced,

(B) Is responsible for making servicer cash advances (unless the advances are not direct credit substitutes because they meet the conditions specified in section II.B.5(a)(9) of this Appendix A), or

(C) Makes or assumes credit-enhancing representations and warranties with respect to the loans serviced; and

(vii) Clean-up calls on third party assets. Clean-up calls that are exercisable at the option of the bank (as servicer or as an affiliate of the servicer) when the pool balance is 10 percent or less of the original pool balance are not direct credit substitutes.

(viii.) Liquidity facilities extended to ABCP programs that are not eligible liquidity facilities (as defined in section II.B.5.a. of this appendix).

(5) Early amortization triggers mean contractual requirements that, if triggered, would cause a securitization to begin repaying investors prior to the originally scheduled payment dates.

(6) Eligible liquidity facility means a facility subject to a reasonable asset quality test at the time of draw that precludes funding against assets in the ABCP program that are 60 days or more past due or in default. In addition, if the assets that an eligible liquidity facility is required to fund against are externally rated exposures at the inception of the facility, the facility can be used to fund only those exposures that are externally rated investment grade at the time of funding. Furthermore, an eligible liquidity facility must contain provisions that, prior to any draws, reduces the bank's funding obligation to cover only those assets that would meet the funding criteria under the facility's asset quality tests.

(7) Excess Spread means gross finance charge collections and other income received by the trust or special purpose entity (SPE) minus certificate interest, servicing fees, charge-offs, and other trust or SPE expenses.

(8) Externally rated means that an instrument or obligation has received a credit rating from a nationally-recognized statistical rating organization.

(9) Face amount means the notional principal, or face value, amount of an off-balance sheet item; the amortized cost of an asset not held for trading purposes; and the fair value of a trading asset.

(10) Financial asset means cash or other monetary instrument, evidence of debt, evidence of an ownership interest in an entity, or a contract that conveys a right to receive or exchange cash or another financial instrument from another party.

(11) Financial standby letter of credit means a letter of credit or similar arrangement that represents an irrevocable obligation to a third-party beneficiary:

(i) To receive money borrowed by, or advanced to, or advanced to, or for the account of, a second party (the account party), or

(ii) To make payment on behalf of the account party, in the event that the account party fails to fulfill its obligation to the beneficiary.

(12) Mortgage servicer cash advance means funds that a residential mortgage servicer advances to ensure an uninterrupted flow of payments or the timely collection of residential mortgage loans, including disbursements made to cover foreclosure costs or other expenses arising from a mortgage loan to facilitate its timely collection. A mortgage servicer cash

advance is not a recourse obligation or a direct credit substitute if:

(i) The mortgage servicer is entitled to full reimbursement or, for any one residential mortgage loan, nonreimbursable advances are contractually limited to an insignificant amount of the outstanding principal on that loan, and

(ii) the servicer's entitlement to reimbursement in not subordinated.

(13) Nationally recognized statistical rating organization (NRSRO) means an entity recognized by the Division of Market Regulation of the Securities and Exchange Commission (or any successor Division) (Commission) as a nationally recognized statistical rating organization for various purposes, including the Commission's uniform net capital requirements for brokers and dealers (17 CFR 240.15c3-1).

(14) Recourse means an arrangement in which a bank retains, in form or in substance, of any credit risk directly or indirectly associated with an asset it has sold (in accordance with generally accepted accounting principles) that exceeds a pro rata share of the bank's claim on the asset. If a bank has no claim on an asset it has sold, then the retention of any credit risk is recourse. A recourse obligation typically arises when an institution transfers assets in a sale and retains an obligation to repurchase the assets or absorb losses due to a default of principal or interest or any other deficiency in the performance of the underlying obligor or some other party. Recourse may exist implicitly where a bank provides credit enhancement beyond any contractual obligation to support assets it has sold. The following are examples of recourse arrangements:

(i) Credit-enhancing representations and warranties made on the transferred assets;

(ii) Loan servicing assets retained pursuant to an agreement under which the bank:

(A) Is responsible for losses associated with the loans being serviced,

(B) Is responsible for making mortgage servicer cash advances (unless the advances are not a recourse obligation because they meet the conditions specified in section II.B.5(a)(12) of this Appendix A), or

(C) Makes or assumes credit-enhancing representations and warranties on the serviced loans;

(iii) Retained subordinated interests that absorb more than their pro rata share of losses from the underlying assets;

(iv) Assets sold under an agreement to repurchase, if the assets are not already included on the balance sheet;

(v) Loan strips sold without contractual recourse where the maturity of the transferred portion of the loan is shorter than the maturity of the commitment under which the loan is drawn;

(vi) Credit derivative contracts under which the bank retains more than its pro rata share of credit risk on transferred assets; and

(vii) Clean-up calls. Clean-up calls that are exercisable at the option of the bank (as servicer or as an affiliate of the servicer) when the pool balance is 10 percent or less of the original pool balance are not recourse arrangements.

(viii.) Liquidity facilities extended to ABCP programs that are not eligible liquidity facilities (as defined in section II.B.5.a. of this appendix).

(15) Residual interest means any on-balance sheet asset that represents an interest (including a beneficial interest) created by a transfer that qualifies as a sale (in accordance with generally accepted accounting principles) of financial assets, whether through a securitization or otherwise, and that exposes a bank to credit risk directly or indirectly associated with the transferred assets that exceeds a pro rata share of the bank's claim on the assets, whether through subordination provisions or other credit enhancement techniques. Residual interests generally include credit-enhancing I/Os, spread accounts, cash collateral accounts, retained subordinated interests, other forms of over-collateralization, and similar assets that function as a credit enhancement. Residual interests further include those exposures that, in substance, cause the bank to retain the credit risk of an asset or exposure that had qualified as a residual interest before it was sold. Residual interests generally do not include interests purchased from a third party, except that purchased credit-enhancing I/Os are residual interests.

(16) Revolving retail credit facility means an exposure to an individual where the borrower is permitted to vary both the drawn amount and the amount of repayment within an agreed limit under a line of credit (such as credit card accounts). Revolving retail credits include business credit card accounts.

(17) Risk participation means a participation in which the originating party remains liable to the beneficiary for the full amount of an obligation (e.g., a direct credit substitute) notwithstanding that another party has acquired a participation in that obligation.

(18) Securitization means the pooling and repackaging by a special purpose entity of assets or other credit exposures into securities that can be sold to investors. Securitization includes transactions that generally create stratified credit risk positions whose performance is dependent upon an underlying pool of credit exposures, including loans and commitments.

(19) Sponsor means a bank that establishes an asset-backed commercial paper program; approves the sellers permitted to participate in the program; approves the asset pools to be purchased by the program; or administers the asset-backed commercial paper program by monitoring the assets, arranging for debt placement, compiling monthly reports, or ensuring compliance with the program documents and with the program's credit and investment policy.

(20) Structured finance program means a program where receivable interests and asset-backed securities issued by multiple participants are purchased by a special purpose entity that repackages those exposures into securities that can be sold to investors. Structured finance programs allocate credit risks, generally, between the participants and credit enhancement provided to the program.

(21) Traded position means a position or asset-backed security that is retained, assumed

or issued in connection with a securitization that is externally rated, where there is a reasonable expectation that, in the near future, the rating will be relied upon by

(i) Unaffiliated investors to purchase the position; or

(ii) An unaffiliated third party to enter into a transaction involving the position, such as a purchase, loan, or repurchase agreement.

*****

(h) Early Amortization Triggers. i. A bank that originates securitizations of revolving retail credit facilities that contain early amortization triggers must incorporate the off-balance sheet portion of such a securitization (that is, the investors' interest) into the bank's risk-weighted assets by multiplying the outstanding principal amount of the investors' interest by the appropriate credit conversion factor and then assigning the resultant credit equivalent amount to the appropriate risk weight category. The credit conversion factor to be applied to such a securitization generally is a function of the securitizations' most recent three-month average excess spread level, the point at which excess spread in the securitization must be trapped in a spread or reserve account, and the excess spread level at which an early amortization of the securitization is triggered.

ii. In order to determine the appropriate credit conversion factor to be applied to the outstanding principal balance of the investors' interest, the originating bank must compare the securitization's most recent three-month average excess spread level against the difference between (i) the point at which the bank is required by the securitization documents to divert and trap excess spread (spread trapping point) in a spread or reserve account and (ii) the excess spread level at which early amortization of the securitization is triggered (early amortization trigger). The difference between the spread trapping point and the early amortization trigger is referred to as the excess spread differential (ESD). In a securitization of revolving retail credit facilities that employs the concept of excess spread to determine when an early amortization is triggered but where the securitization's transaction documents do not require excess spread to be diverted to a spread or reserve account at a certain level, the ESD is deemed to be 4.5 percentage points.

iii. If a securitization of revolving retail credit facilities does not employ the concept of excess spread as the transaction's determining factor of when an early amortization is triggered, then a 10 percent credit conversion factor is applied to the outstanding principal balance of the investors' interest at the securitization's inception.

iv. The ESD must then be divided to create four equal ESD segments. For example, when the ESD is 4.5 percent, this amount is divided into 4 equal ESD segments of 112.5 basis points. A credit conversion factor of zero percent would be applied to the outstanding principal balance of the investors' interest if the securitization's three-month average excess spread equaled or exceeded a securitization's spread trapping point (4.5 percent in the example). Credit conversion factors of 5 percent, 10 percent, 50 percent, and 100 percent are then assigned to each of the four equal ESD segments in descending order beginning at the spread trapping point as the securitization approaches early amortization. For instance, when the ESD is 4.5 percent, the credit conversion factors would be applied to the outstanding balance of the investors' interest as follows:

Example of Credit Conversion Factor Assignment by Segment of Excess Spread Differential

Segment of Excess Spread Differential	Credit Conversion Factor
450 bp or more	0 percent
Less than 450 bp to 337.5 bp	5 percent
Less than 337.5 bp to 225 bp	10 percent
Less than 225 bp to 112.5 bp	50 percent
Less than 112.5 bp	100 percent

i. <u>Limitations on risk-based capital requirements</u>. ***

(4) For a bank subject to the early amortization treatment in section III.B.3.g. of this appendix, the total risk-based capital requirement for all of the bank's exposures to a securitization of revolving retail credit facilities is limited to the greater of the risk-based capital requirement for residual interests, as defined in section III.B.3.a. of this appendix, or the risk-based capital requirement for the underlying securitized assets calculated as if the bank continued to hold the assets on its balance sheet.

*****

6. <u>Asset-backed commercial paper programs</u>. a. An asset-backed commercial paper (ABCP) program typically is a program through which a bank provides funding to its corporate customers by sponsoring and administering a bankruptcy-remote special purpose entity that purchases asset pools from, or extends loans to, the bank's customers. The ABCP program raises the cash to provide the funding through the issuance of commercial paper in the market.

b. A bank that qualifies as a primary beneficiary and must consolidate an ABCP program that is defined as a variable interest entity under GAAP may exclude the consolidated ABCP program assets from risk-weighted assets provided that the bank is the sponsor of the consolidated ABCP program. If a bank excludes such consolidated ABCP program assets, the bank must assess the appropriate risk-based capital charge against any risk exposures of the bank arising in connection with such ABCP programs, including direct credit substitutes, recourse obligations, residual interests, liquidity facilities, and loans, in accordance with sections II.B.5, II.C. and II.D. of this appendix.

*****

II. ***

D. ***

2. Items With a 50 Percent Conversion Factor. ***

*****

Commitments, for risk-based capital purposes, are defined as any legally binding arrangements that obligate a bank to extend credit in the form of loans or lease financing receivables; to purchase loans, securities, or other assets; or to participate in loans and leases. Commitments also include overdraft facilities, revolving credit, home equity and mortgage lines of credit, eligible liquidity facilities to asset-backed commercial paper programs (in form and in substance), and similar transactions. Normally, commitments involve a written contract or agreement and a commitment fee, or some other form of consideration. Commitments are included in weighted-risk assets regardless of whether they contain material adverse change clauses or other provisions that are intended to relieve the issuer of its funding obligation under certain conditions. Banks that are subject to the market risk rules are required to convert the notional amount of long-term covered positions carried in the trading account that act as eligible liquidity facilities to ABCP programs, in form or in substance, at 50 percent to determine the appropriate credit equivalent amount for those facilities even though they are structured or characterized as derivatives or other trading book assets.

*****

3. Items with a 20 percent conversion factor. ***

a. ***

b. Undrawn portions of eligible liquidity facilities with an original maturity of one year or less that banks provide to asset-backed commercial paper (ABCP) programs also are converted at 20 percent. The resulting credit equivalent amount is then assigned to the risk category appropriate to the underlying assets or the obligor, after consideration of any collateral or guarantees, or external credit ratings, if applicable. Banks that are subject to the market risk rules are required to convert the notional amount of short-term covered positions carried in the trading account that act as eligible liquidity facilities to ABCP programs, in form or in substance, at 20 percent to determine the appropriate credit equivalent amount for those facilities even though they are structured or characterized as derivatives or other trading book assets. Liquidity facilities extended to ABCP programs that do not meet the following criteria are to be considered recourse obligations or direct credit substitutes and assessed the appropriate risk-based capital requirement in accordance with section II.B.5. of this appendix. Eligible liquidity facilities must be subject to a reasonable asset quality test at the time of draw that precludes funding against assets in the ABCP program that are 60 days or more past due or in default. In addition, if the assets that eligible liquidity facilities are required to fund against are externally rated exposures, the facility can be used to fund only those exposures that are externally rated investment grade at the time of funding. Furthermore, eligible liquidity facilities must contain provisions that, prior to any draws, reduces the bank's funding obligation to cover only those assets that would meet the funding criteria under the facilities' asset quality tests.

***

4. *** These include unused portions of commitments, with the exception of eligible liquidity facilities provided to ABCP programs, with an original maturity of one year or less, or which are unconditionally cancelable at any time, provided a separate credit decision is made before each drawing under the facility. ***

*****

APPENDIX C TO PART 325 – RISK-BASED CAPITAL FOR STATE NON-MEMBER BANKS; MARKET RISK

*****

Section 2. Definitions.

(a) *** Covered positions exclude all positions in a bank's trading account that, in form or in substance, act as eligible liquidity facilities (as defined in section II.B.5.a.of appendix A of this part), to asset-backed commercial paper programs (as defined in section II.B.6. of appendix A of this part). Such excluded positions are subject to the risk-based capital requirements set forth in appendix A of this part.

*****

[THIS SIGNATURE PAGE RELATES TO THE NOTICE OF RULEMAKING ON "RISK-BASED CAPITAL GUIDELINES; CAPITAL ADEQUACY GUIDELINES; CAPITAL MAINTENANCE: ASSET-BACKED COMMERCIAL PAPER PROGRAMS AND EARLY AMORTIZATION PROVISIONS"]

By order of the Board of Directors.
Dated at Washington, DC, this 5th day of September, 2003.
Federal Deposit Insurance Corporation.

Robert E. Feldman (signed)
Robert E. Feldman,
Executive Secretary.
(SEAL)

DEPARTMENT OF THE TREASURY
Office of Thrift Supervision
12 CFR Chapter V

Authority and Issuance

For the reasons set out in the preamble, part 567 of the chapter V of title 12 of the Code of Federal Regulations is amended as follows:

PART 567 – CAPITAL

1. The authority citation for part 567 continues to read as follows:

Authority: 12 U.S.C. 1462, 1462a, 1463, 1464, 1467a, 1828 (note).

2. Section 567.1 is amended by adding definitions early amortization trigger, excess spread, qualifying liquidity facility, and revolving retail credit.

§ **567.1 Definitions**

*****

Early amortization trigger. The term early amortization trigger means a contractual requirement that, if triggered, would cause a securitization to begin repaying investors prior to the originally scheduled payment dates.

***

Excess spread. The term excess spread means gross finance charge collections and other income received by the trust or special purpose entity minus certificate interest, servicing fees, charge-offs, and other trust or special purpose entity expenses.

***

Qualifying liquidity facility. The term qualifying liquidity facility means a liquidity facility provided to an ABCP program provided that: (1) At the time of the draw, the liquidity facility must be subject to a reasonable asset quality test that precludes funding against or purchase of assets from the ABCP program that are 60 days or more past due or in default;

(2) If the assets that the liquidity facility is required to fund are externally rated securities, (at the time they are transferred into the program) the facility can be used to fund only exposures that are externally rated investment grade at the time of funding; and

(3) The liquidity facility must provide that, prior to any draws, the savings association's funding obligation is reduced to cover only those assets that satisfy the funding criteria under the asset quality test of the liquidity facility.

***

Revolving retail credit. The term revolving retail credit means an exposure to an individual or a business where the borrower is permitted to vary both the drawn amount and the amount of repayment within an agreed limit under a line of credit (such as personal or business credit card accounts).

*****

3. Amend § 567.5 by revising paragraph (a)(1)(iii) to read as follows:

§ 567.5 Components of Capital

(a) ***

(1) ***

(iii) Minority interests in the equity accounts of subsidiaries that are fully consolidated. However, minority interests in consolidated ABCP programs sponsored by a savings association are excluded from the association's core capital or total capital base if the consolidated assets are excluded from risk-weighted assets pursuant to § 567.6 (a)(3).

*****

4. Amend § 567.6 by:

A. Revising paragraph (a)(2)(ii)(B);

B. Redesignating paragraphs (a)(2)(iii) as paragraph (a)(2)(iii)(A);

C. Adding paragraphs (a)(2)(iii)(B);

D. Revising paragraph (a)(2)(iv)(A);

E. Deleting paragraph (a)(3)(iv);

F. Adding paragraph (b)(9).

§ 576.6 Risk-based capital credit risk-weight categories.

(a) ***

(2) ***

(ii) ***

(B) Unused portions of commitments, including home equity lines of credit and qualifying liquidity facilities with an original maturity exceeding one year except those listed in paragraph (a)(2)(iv) of this section.

***

(iii) 20 percent credit conversion factor (Group C). (A) Trade-related contingencies, i.e., short-term, self-liquidating instruments used to finance the movement of goods and collateralized by the underlying shipment. A commercial letter of credit is an example of such an instrument.

(B) Undrawn portions of qualifying liquidity facilities with an original maturity of one year or less that a savings association provides to ABCP programs.

(iv) Zero percent credit conversion factor (Group D). (A) Unused commitments, with the exception of liquidity facilities provided to ABCP programs, with an original maturity of one year or less.

*****

(b) ***

(9) Early amortization. (i) A savings association that originates a securitization of revolving retail credits that contains early amortization triggers must risk weight the off-balance sheet portion of such a securitization (investors' interest) by multiplying the outstanding principal amount of the investors' interest by the appropriate credit conversion factor as provided by paragraph (b)(9)(ii) or (iii) of this section and then assigning the resultant credit equivalent amount to the appropriate risk weight category.

(ii) Calculation of Credit Conversion Factor. (A) The credit conversion factor to be applied to such a securitization generally is a function of the securitizations' most recent three-month average excess spread level, the point at which excess spread in the securitization must be trapped in a spread or reserve account (spread trapping point), and the excess spread level at which an early amortization of the securitization is triggered (early amortization trigger). This difference between the spread trapping point and the early amortization trigger is the excess spread differential.

(B) The excess spread differential must then be divided by four to create the standard excess spread differential value. This value will be used to determine the appropriate credit conversion factor in accordance with Table D of this section. The upper and lower bounds for each of the excess spread differential segments is calculated using the spread trapping point and the standard excess spread differential value in accordance with the formulas provided in Table D of this section. However, if the securitization documents do not require excess spread to be diverted to a spread or reserve account at a certain level, the excess spread differential is equal to 4.5 percentage points.

(C) (1) If the three-month average excess spread equals or exceeds the securitization's spread trapping point, then the credit conversion factor is equal to zero. If the three-month average excess spread is less than the spread trapping point, then the credit conversion factors (5 percent, 10 percent, 50 percent, and 100 percent) are then assigned to each of the four equal excess spread differential segments in descending order, beginning at the spread trapping point as the securitization approaches early amortization, in accordance with Table D of this section.

(2) If the securitization does not use the excess spread as an early amortization trigger, then a 10 percent credit conversion factor is applied to the current outstanding principal balance of the investors' interest.

Table D—Calculation of Credit Conversion Factors for Early Amortizations

Excess Spread Differential Segments	Excess Spread Ranges	Credit Conversion Factor
1	Excess spread equals or exceeds the spread trapping point	0%
2	Upper Bound < Spread Trapping Point Lower Bound = Spread Trapping Point – (1 x SESDV)	5%
3	Upper Bound < Spread Trapping Point – (1 x SESDV) Lower Bound = Spread Trapping Point – (2 x SESDV)	10%
4	Upper Bound < Spread Trapping Point – (2 x SESDV) Lower Bound = Spread Trapping Point – (3 x SESDV)	50%
5	Upper Bound < Spread Trapping Point – (3 x SESDV) Lower Bound = None	100%

Note: SESDV is the standard excess spread differential value.

(iii) Limitations on risk-based capital requirements. For a savings association subject to the early amortization requirements in paragraph (b)(9) of this section, the total risk-based capital requirement for all of the savings association's exposures to a securitization of revolving retail credits is limited to the greater of the risk-based capital requirement for residual interests or the risk-based capital requirement for the underlying securitized assets calculated as if the savings association continued to hold the assets on its balance sheet.

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[THIS SIGNATURE PAGE RELATES TO THE JOINT NOTICE OF PROPOSED RULEMAKING "RISK-BASED CAPITAL GUIDELINES; CAPITAL ADEQUACY GUIDELINES; CAPITAL MAINTENANCE; ASSET-BACKED COMMERCIAL PAPER PROGRAMS AND EARLY AMORTIZATION PROVISIONS"]

Dated September 9, 2003

BY THE OFFICE OF THRIFT SUPERVISION

James T. Gilleran (signed)
James T. Gilleran
Director