Office of the Comptroller of the Currency

Board of Governors of the Federal Reserve System

Interpretive Letter #1099
July 2008

May 11, 2007

Dear **[ ]**:

This letter responds to your letters of August 10 and August 16, 2006 regarding the risk-based capital treatment for certain asset-backed commercial paper (ABCP) liquidity facilities described in your letters (the "Liquidity Facilities") provided by **[*Bank*]**. (" ") to certain multi-seller ABCP conduits managed by **[*BHC*]** (the "**[ ]** Conduits"). The **[ ]** Conduits provide a limited number of credit facilities to investment funds that are typically secured by a diversified pool of exchange-traded equity securities ("margin loan facilities"). The margin loan facilities have no maturity and no external rating. Your letter describes the Liquidity Facilities and the margin loan facilities and requests permission to apply a 10 percent credit conversion factor ("CCF") to the unused portion of the Liquidity Facilities.

Based on the facts and circumstances stated in your letters, staffs of the OCC and Federal Reserve have determined that the Liquidity Facilities may be considered eligible ABCP liquidity facilities for purposes of the risk-based capital rules of the agencies. Accordingly, the unused portion of the Liquidity Facilities, which have an original maturity of one year or less, would be subject to a 10 percent CCF.

Background

In July 2004, the Federal Banking Agencies (the "Agencies") published a final rule on the consolidation of ABCP programs that included a new risk-based capital charge for ABCP liquidity facilities (the "ABCP Rule").[1] This ABCP Rule became fully effective on September 30, 2005. Just prior to the full implementation of the ABCP Rule, the Agencies issued additional guidance that responded to industry questions about the ABCP Rule (the "ABCP Guidance").[2] Under the ABCP Rule, the undrawn portion of an eligible ABCP liquidity facility has a 10 percent CCF, whereas an ineligible ABCP liquidity facility is treated as a recourse obligation or direct credit substitute. The OCC and Federal Reserve risk-based capital rules generally define an eligible ABCP liquidity facility as a liquidity facility to an ABCP

[1] 69 FR 44098 (July 28, 2004).
[2] "Interagency Guidance on the Eligibility of Asset-backed Commercial Paper Liquidity Facilities and the Resulting Risk-based Capital Treatment," OCC Bulletin 2005-26 and SR Letter 05-13 (FRB) (August 4, 2005).

program that is subject to an asset quality test at the time of draw that precludes funding against assets that are 90 days or more past due or in default. In addition, if the assets that an eligible ABCP 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.[3] The preamble to the ABCP Rule emphasizes the belief of the Agencies that the primary function of an eligible ABCP liquidity facility should be to provide liquidity. ABCP liquidity facilities that are permitted to fund assets that are 90 days or more past due or below investment grade are viewed as providing potential credit protection for commercial paper investors in the ABCP program. Accordingly, as noted, these liquidity facilities are treated as recourse exposures or direct credit substitutes.[4] Neither the ABCP Rule nor the ABCP Guidance, however, discusses how the asset quality test should be applied to ABCP program assets with no maturity and no external rating.

Discussion

As noted above, the **[ ]** Conduits have some assets that are margin loan facilities. The equity securities that serve as collateral for the margin loan facilities must meet a list of requirements that are intended to ensure that the pool of securities is readily marketable and reasonably diversified. In addition, the investment fund borrowers must be managed by a reputable manager that is a client of **[*Bank*]**. Moreover, all the margin loan facilities incorporate certain collateral requirements, fund leverage limits, and other provisions designed to provide protection to the **[ ]** Conduits and indirectly to **[*Bank*]**, as the Liquidity Facility provider to the **[ ]** Conduits. For example, advances by a **[ ]** Conduit to an investment fund borrower under a margin loan facility may not exceed 50 percent of the market value of the equity securities. This collateral requirement is consistent with the initial margin requirement of 50 percent in the Federal Reserve's Regulation T and higher than the New York Stock Exchange's ("NYSE") margin maintenance requirement of 25 percent in Rule 431. In addition, the total debt of the investment fund may not exceed 33 percent of the fund's total assets. To monitor these provisions, the investment fund is required to mark all of its assets to market daily. Compliance by the investment funds with these requirements is also monitored daily by the **[ ]** Conduits.

In the event of a default by an investment fund under a margin loan facility, the trustee of the **[ ]**Conduit may terminate the facility, declare all advances due and payable immediately, and take the collateral. Events of default include any breach of the 50 percent loan-to-collateral-value requirement that is not cured in three days, any action by the investment fund to incur any other debt, termination of the investment advisory agreement with the investment fund's manager, and other typical default events.

Your letter proposes that a Liquidity Facility should be considered an eligible ABCP liquidity facility for purposes of the risk-based capital rules of the OCC and Federal Reserve so long as the liquidity provider is only permitted to purchase margin loan facilities from the **[ ]** Conduit at par if the market value of the collateral exceeds the outstanding loan balance by 25 percent.

[3] 12 CFR Part 3, Appendix A Section 3(b)(6)(ii) (OCC); and 12 CFR part 225, appendix A, section III.B.3.a.iv (FRB).
[4] 69 FR 44098 (July 28, 2004).

Your letter asserts that a funding trigger based on the amount of overcollateralization is more conservative than a past-due-related trigger, because the margin loan facility could be current even though the value of the securities collateral had declined.

Conclusion

Based on all the facts of record, the staffs of the OCC and Federal Reserve have determined that the bank may consider the Liquidity Facilities to be eligible ABCP liquidity facilities under the risk-based capital rules of the Agencies. The risk-based capital treatment for the Liquidity Facilities would therefore be as follows: apply a 10 percent CCF to the unused amount of the commitment with an original maturity of one year or less and assign a 100 percent risk weight to the resulting credit equivalent assets based on the nature of the obligor and collateral.

This determination is based on the specific facts presented for the transactions cited above and may not be relied upon for determining the eligibility of any other ABCP liquidity facility. If you have questions or need additional information, please contact Roger Tufts of the OCC staff at (202) 874-4925 or Larry Rufrano at (202) 452-2808 of the Federal Reserve staff.

Sincerely,

Signed

Tommy Snow
Director
Capital Policy Division

Signed

Barbara Bouchard
Deputy Associate Director
Federal Reserve Board